## Financial System and Markets

A **financial system** (within the scope of finance) is a system that allows the exchange of funds between lenders, investors, and borrowers. Financial systems operate at national, global, and firm-specific levels. They consist of complex, closely related services, markets, and institutions intended to provide an efficient and regular linkage between investors and depositors.

Money, credit, and finance are used as media of exchange in financial systems. They serve as a medium of known value for which goods and services can be exchanged as an alternative to bartering. A modern financial system may include banks (operated by the government or private sector), financial markets, financial instruments, and financial services. Financial systems allow funds to be allocated, invested, or moved between economic sectors. They enable individuals and companies to share the associated risks.

The **components of a financial market** include:

- **Financial institutions** - Financial institutions provide financial services for members and clients.
- **Banks** - Banks are financial intermediaries that lend money to borrowers to generate revenue. They are typically regulated heavily, as they provide market stability and consumer protection. Banks include:
  - Public banks
  - Commercial banks
  - Non-bank financial institutions
- **Non-bank financial institutions** - Non-bank financial institutions facilitate financial services like investment, risk pooling, and market brokering. They generally do not have full banking licenses or are not supervised by a bank regulation agency. Non-bank financial institutions include:
  - Casinos and cardrooms
  - Finance and loan companies
  - Financial services
- **Financial markets** - Financial markets are markets in which securities, commodities, and fungible items are traded at prices representing supply and demand. The term "market" typically means the institution of aggregate exchanges of possible buyers and sellers of such items.
- **Primary markets** - The primary market (or initial market) generally refers to new issues of stocks, bonds, or other financial instruments.
- **Secondary markets** - The secondary market refers to transactions in financial instruments that were previously issued.
- **Cash instruments** - A cash instrument's value is determined directly by markets. They may include securities, loans, and deposits.
- **Derivative instruments** - A derivative instrument is a contract that derives its value from one or more underlying entities (including an asset, index, or interest rate).
- **Financial services** - Financial services are offered by a large number of businesses that encompass the finance industry. These include credit unions, banks, credit card companies, insurance companies, stock brokerages, and investment funds.

### What is a 'Financial System'?

A financial system is the system that covers financial transactions and the exchange of money between investors, lender and borrowers. A financial system can be defined at the global, regional or firm specific level. Financial systems are made of intricate and complex models that portray financial services, institutions and markets that link depositors with investors.

### BREAKING DOWN 'Financial System'

The firm's financial system is the set of implemented procedures that track the financial activities of the company. On a regional scale, the financial system is the system that enables lenders and borrowers to exchange funds. The global financial system is basically a broader regional system that encompasses all financial institutions, borrowers and lenders within the global economy.

There are multiple components making up the financial system of different levels: Within a firm, the financial system encompasses all aspects of financial systems. For example, it would include accounting measures, revenue and expense schedules, wages and balance sheet verification. Regional financial systems would include banks and other financial institutions, financial markets, financial services in a global view, financial systems would include the International Monetary Fund, central banks, World Bank and major banks that practice overseas lending.

### Financial Market Components

Financial systems are strictly regulated because they directly influence financial markets. The stability of the financial markets plays a crucial role in the monetary protection of consumers. These financial systems are mostly handled by financial institutions which include...
commercial banks, central banks, public banks and cooperative banks. Cooperative banks and development banks managed by states are also listed under financial institutions that have heavily regulated financial systems.

Financial systems are not only evident in bank financial institutions. Some institutions have market brokering, investment and risk pooling services. However, these institutions are non-bank financial institutions that are not regulated by a bank regulation firm or agency. Examples of non-bank financial institutions are companies that offer mutual funds, insurance, and financial loans. Companies with commodity traders are also considered to be non-bank financial institutions that have financial systems.

Another component of financial systems are financial markets that trade commodities, securities and other items that are traded according to primary supply and demand. Financial markets include the primary markets and secondary markets. Primary markets provide avenues for buyers and sellers to buy and sell stocks and bonds. Secondary markets provide a venue for investors and traders to purchase instruments that have been previously bought.

Aside from financial institutions and markets, financial systems are also evident in financial instruments. These financial instruments include cash instruments and derivative instruments. Cash instruments include loans, deposits and securities. Derivative instruments are financial instruments that are dependent on an underlying asset's performance.

People have virtually unlimited wants, but the economic resources to produce those wants are limited. Therefore, the greatest benefit of an economy is to provide the most desirable consumer goods and services in the most desirable amounts—what is known as the efficient. To produce these consumer goods and services requires capital in the form of labor, land, capital goods used to produce a desired product or service, and entrepreneurial ability to use these resources together to the greatest efficiency in producing what consumers want most. Real capital consists of the land, labor, tools and machinery, and entrepreneurial ability to produce consumer goods and services, and to acquire real capital costs money.

The financial system of an economy provides the means to collect money from the people who have it and distribute it to those who can use it best. Hence, the efficient allocation of economic resources is achieved by a financial system that allocates money to those people and for those purposes that will yield the greatest return.

The financial system is composed of the products and services provided by financial institutions, which includes banks, insurance companies, pension funds, organized exchanges, and the many other companies that serve to facilitate economic transactions. Virtually all economic transactions are effected by one or more of these financial institutions. They create financial instruments, such as stocks and bonds, pay interest on deposits, lend money to creditworthy borrowers, and create and maintain the payment systems of modern economies.

These financial products and services are based on the following fundamental objectives of any modern financial system:

- to provide a payment system,
- to offer products and services to reduce financial risk or to compensate risk-taking for desirable objectives,
- to collect and disperse information that allows the most efficient allocation of economic resources,
- to create and maintain financial markets that provide prices, which indicates how well investments are performing, which also determines the subsequent allocation of resources, and to maintain economic stability.

Payment System

While money as currency is a convenient means of payment between individuals, it is not so convenient for banks, businesses, and other organizations, such as governments, that require and pay out large amounts of money and to have records of their transactions for accounting and tax purposes. Hence, payment systems have evolved to increase the efficiency of money flow and recordkeeping. Checks were the 1st major financial innovation that simplified payments. The use of checks, which is not money but rather part of the payment system, is a legal document in which the payer of the check promises to pay the payee of the check. Checks greatly simplify payments by eliminating the need to have large amounts of coin and currency, which also makes them more secure. They also generate records of who was paid, how much, and on what date.

However, checks had disadvantages. They could be forged, the payee often had to wait several business days to know if the check was good, and it was expensive to process checks, since paper checks, as physical items, had to be transported, sometimes over great distances, to different banks for clearing and settlement, and the information on the checks had to be transferred to an accounting system. Since checks were just paper with information on them, there was really no need for the paper since only the information mattered.

Hence, various electronic networks have been developed that can quickly and securely transfer money information as electronic records—what is often referred to as electronic money.

Increasingly, financial transactions are being conducted electronically because it eliminates the need to transport physical checks, and greatly increases the speed in which money can be transferred for payment. And since most accounting systems are in computer databases, it is much easier to transfer the information in these electronic records to accounting systems automatically.

Hence, a primary objective of the financial system is to provide an efficient payment system that can quickly and securely transfer money and record the transactions.

Interest and Capital Gains

Some people have more money than their immediate needs require. Some people have needs or want to do things that require more money than they have. The economy can grow by having people in the 1st group lend money to the 2nd group. But lenders won't lend money for nothing; to entice people to lend the money, the borrowers pay the lenders' interest. This is what gives money time value.
However, it isn’t easy for lenders to find borrowers, or vice versa, nor could lenders easily determine who would pay the most interest at the least risk. Hence, another objective of a financial system is to facilitate the location and interaction of lenders and borrowers and to minimize the opportunity cost of both, where lenders can lend money at the highest possible rate for a given amount of risk and borrowers can borrow money at the lowest rate.

Another means of profiting from money is through capital gains—buying low and selling high. When investors pay money to a company in exchange for an ownership interest, usually represented by stock, the investors hope that the stock will increase in value so that they can sell it later for a higher price. Hence, a modern financial system provides various means of earning capital gains, by providing marketplaces for buying or selling financial instruments, such as stocks or bonds, or by providing a marketplace for buying and selling valuable assets, such as real estate.

**Financial Risk**

There is always financial risk whenever a person pays out money in the hope of gaining more back at some future date. This can occur when a lender lends to a borrower by buying a bond, when a person buys stock in a company in the hope that it will increase in value, or when a person saves money at a bank to earn interest. Hence, another goal of a financial system is to allow people to reduce risk by offering to act as an intermediary or to offer products that offset the potential risk. So banks take on much of the risk of lending out savers’ money by acting as the intermediary between lender and borrower, and financial markets offer many products that can offset risk, such as buying a put to protect against the decline of a stock, or entering into a futures contract that can protect both the buyer and the seller of a commodity from adverse price moves.

Risk requires compensation, so the greater the risk, the greater the potential compensation must be for lenders or investors to invest their money. For instance, since the bonds of a company are safer than its stock, investors will not buy the stock unless they think the potential profits are greater; otherwise, they would just buy the bonds for a safer return. So a financial system must provide accurate risk assessments to induce lenders or investors to invest their money.

There is also financial risk from accidents or other destructive events. Insurance companies help to protect against this risk by pooling the money of all of the insured to pay out the few claims that will arise in the pool. There are also financial instruments that can protect against calamities, such as weather derivatives that pay off if bad weather occurs.

**Financial Information**

Financial transactions not only entail risk, but investors will also want to know what the expected returns are, so that they can evaluate whether the expected returns justify the risk. Financial transactions also have set procedures and legal requirements that must be followed, which can be a barrier to investments.

Hence, a major objective of a financial system is to institutionalize and standardize many common financial transactions, such as the buying and selling of stocks, and to provide common financial instruments with similar characteristics, such as options and futures. Financial institutions also provide the necessary information about companies, contracts, and financial instruments so that investors can make an intelligent choice, and provide current market information so that investors can assess the performance of their investments.

For instance, credit rating agencies rate the credit of companies and other organizations that issue bonds. If a company has a poor credit rating, then it must pay a higher yield on its bonds in order to sell them. Banks assess the creditworthiness of borrowers to determine if they should lend them money and at what price, or interest rate. Organized exchanges provide current prices on stocks and other assets and financial news organizations publish news about companies, the economy, and anything else that can affect the financial markets.

**Financial Markets**

Financial markets consist of all products and services that are offered for sale in exchange for interest, potential capital gains, or for the protection of financial risk, which includes the products and services offered by banks, insurance companies, and other financial institutions, and by marketplaces, such as organized exchanges or the over-the-counter (OTC) market.

Financial markets provide pricing information, which determines how money, and therefore, economic resources, will be allocated. For instance, a company that produces a desirable product will grow faster than a company offering a less desirable product, since more people will buy the more desirable product. Hence, investors will invest money in the company producing the more desirable product, since it will probably grow faster. So the company with the more desirable product expands, creating more of the desirable product, and so its stock price climbs higher and faster than the one with the less desirable product, so it attracts more money.

Financial markets provide liquidity, which allows investors to quickly convert their financial assets to cash at relatively low cost.

Financial markets must also be fair; otherwise, people would be less willing to lend or invest. So the financial system must create fair markets and maintain their fairness through the enforcement of rules, regulations, and laws that help to level the playing field. In fact, the structure of all financial markets and the way they conduct business is largely determined by the financial regulatory agencies that enforce security and fairness. This is why there are laws against insider trading, for instance.

**Economic Stability**

Economies work best when they are stable. When the financial system falters, so does the economy. There is no better illustration of this than the current credit crisis brought on by excessive speculation and excessive risk-taking by banks, hedge funds, and other major financial institutions. Governments around the world were forced to inject trillions of dollars into their banking systems so that they would not collapse, and to get credit flowing again.

For without credit, businesses stop hiring and start laying off people. People stop spending to conserve money, which causes businesses to contract further, with more layoffs, and more consumer tightening, and so on. A contracting economy also reduces tax receipts for
The Role of the Financial System

A financial market or system is a market in which people and entities can trade financial securities, commodities, and other fungible items.

LEARNING OBJECTIVE - Explain the importance of the financial system

KEY POINTS

- An economy which relies primarily on interactions between buyers and sellers to allocate resources is known as a market economy.
- Markets work by placing many interested buyers and sellers, including households, firms, and government agencies, in one "place," thus making it easier for them to find each other.
- Healthy financial systems are associated with the accelerated development of an economy.

TERMS

- entrepreneurship - The art or science of innovation and risk-taking for profit in business.
- investment - A placement of capital in expectation of deriving income or profit from its use.
- saving - the act of storing for future use

FULL TEXT

Financial System - A financial market or system is a market in which people and entities can trade financial securities, commodities, and other fungible items. Securities include stocks and bonds, and commodities include precious metals or agricultural goods.

Equity Markets

Equity markets are the most closely followed of the financial markets. They provide transparent and active trading platforms that promote liquidity and access to funds on a global scale. There are both general markets (where many commodities are traded) and specialized markets (where only one commodity is traded). Markets work by placing many interested buyers and sellers, including households, firms, and government agencies, in one place, thus making it easier for them to find each other.

An economy that relies primarily on interactions between buyers and sellers to allocate resources is known as a market economy, in contrast either to a command economy or to a non-market economy such as a gift economy.

Role of the Financial System

Financial markets are associated with the accelerated growth of an economy. A financial market helps to achieve the following non-comprehensive list of goals:

- Saving mobilization: Obtaining funds from the savers or surplus units such as household individuals, business firms, public sector units, central government, state governments, etc. is an important role played by financial markets. Borrowers (e.g., bond issuers) are connected with lenders (e.g., bond buyers) in financial markets.
- Investment: Financial markets play a crucial role in arranging to invest funds. Both firms and individuals can invest in companies through financial markets (e.g., by buying stock).
- National Growth: An important role played by the financial market is that, they contribute to a nation's growth by ensuring unhindered flow of surplus funds to deficit units. In other words, financial markets help shift money from industry to industry or firm to firm based on the supply and demand for their products.
- Entrepreneurship growth: Financial markets allow entrepreneurs (and established firms) to access the funds needed to invest in projects or companies.

Financial Services

Definition of Financial Services

As per section 65(10) of the Finance Act, 1994, "banking and financial services" means the following services provided by a banking company or a financial institution including a non banking financial company, namely;

(i) financial leasing services including equipment leasing and hire-purchase by a body corporate;
(ii) credit card services;
(iii) merchant banking services;
(iv) securities and foreign exchange (forex) broking;
(v) asset management including portfolio management, all forms of fund management, pension fund management, custodial depository and trust services, but does not include cash management;


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<th>Characteristic and Feature of Financial Services</th>
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| 1. **Customer-Specific**  
Financial services are usually customer-focused. The firms providing these services, study the needs of their customers in detail before deciding their financial strategy, giving due regard to costs, liquidity and maturity considerations. Financial services firms continuously remain in touch with their customers, so that they can design products which can cater to the specific needs of their customers. The providers of financial services constantly carry out market surveys, so they can offer new products much ahead of need and impending legislation. Newer technologies are being used to introduce innovative, customer-friendly products and services which clearly indicate that the concentration of the providers of financial services is on generating firm/customer specific services. |
| 2. **Intangibility**  
In a highly competitive global environment brand image is very crucial. Unless the financial institutions providing financial products and services have good image, enjoying the confidence of their clients, they may not be successful. Thus institutions have to focus on the quality and innovativeness of their services to build up their credibility. |
| 3. **Concomitant**  
Production of financial services and supply of these services have to be concomitant. Both these functions i.e. production of new and innovative financial services and supplying of these services are to be performed simultaneously. |
| 4. **Tendency to Perish**  
Unlike any other service, financial services do tend to perish and hence cannot be stored. They have to be supplied as required by the customers. Hence financial institutions have to ensure a proper synchronization of demand and supply. |
| 5. **People Based Services**  
Marketing of financial services has to be people intensive and hence it’s subjected to variability of performance or quality of service. The personnel in financial services organisation need to be selected on the basis of their suitability and trained properly, so that they can perform their activities efficiently and effectively. |
| 6. **Market Dynamics**  
The market dynamics depends to a great extent, on socioeconomic changes such as disposable income, standard of living and educational changes related to the various classes of customers. Therefore financial services have to be constantly redefined and refined taking into consideration the market dynamics. The institutions providing financial services, while evolving new services could be proactive in visualizing in advance what the market wants, or being reactive to the needs and wants of their customers. |

**Scopes of Financial Services**

Financial services cover a wide range of activities. They can be broadly classified into two, namely:

1. **Traditional Activities** - Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads, viz.
   1. Fund based activities and 2. Non-fund based activities.

   **Fund based activities**: The traditional services which come under fund based activities are the following:
   - Underwriting or investment in shares, debentures, bonds, etc. of new issues (primary market activities).
   - Dealing in secondary market activities.
   - Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc.
   - Involving in equipment leasing, hire purchase, venture capital, seed capital etc.
   - Dealing in foreign exchange market activities. Non fund based activities

   **Non fund based activities**: Financial intermediaries provide services on the basis of non-fund activities also. This can be called ‘fee based’ activity. Today customers, whether individual or corporate, are not satisfied with mere provisions of finance. They expect more from financial services companies. Hence a wide variety of services, are being provided under this head. They include:
   - Managing the capital issue i.e. management of pre-issue and post-issue activities relating to the capital issue in accordance with the SEBI guidelines and thus enabling the promoters to market their issue.
   - Making arrangements for the placement of capital and debt instruments with investment institutions.
   - Arrangement of funds from financial institutions for the clients project cost or his working capital requirements.
   - Assisting in the process of getting all Government and other clearances.

2. **Modern Activities**
Beside the above traditional services, the financial intermediaries render innumerable services in recent times. Most of them are in the nature of non-fund based activity. In view of the importance, these activities have been in brief under the head 'New financial products and services'. However, some of the modern services provided by them are given in brief here under.

- Rendering project advisory services right from the preparation of the project report till the raising of funds for starting the project with necessary Government approvals.
- Planning for M&A and assisting for their smooth carry out.
- Acting as trustees to the debenture holders.
- Recommending suitable changes in the management structure and management style with a view to achieving better results.
- Structuring the financial collaborations/joint ventures by identifying suitable joint venture partners and preparing joint venture agreements.
- Rehabilitating and restructuring sick companies through appropriate scheme of reconstruction and facilitating the implementation of the scheme.
- Hedging of risks due to exchange rate risk, interest rate risk, economic risk, and political risk by using swaps and other derivative products.
- Managing in-portfolio of large Public Sector Corporations.
- Undertaking risk management services like insurance services, buy-back options etc.
- Advising the clients on the questions of selecting the best source of funds taking into consideration the quantum of funds required, their cost, lending period etc.
- Guiding the clients in the minimization of the cost of debt and in the determination of the optimum debt-equity mix.
- Promoting credit rating agencies for the purpose of rating companies which want to go public by the issue of debt instrument.
- Undertaking services relating to the capital market, such as 1)Clearing services, 2)Registration and transfers, 3)Safe custody of securities,

### Structure and Function of of Indian Financial System

**Structure and Function of Indian Financial System**

Financial System is a set of institutional arrangements through which financial surpluses in the economy are mobilised from surplus units and transferred to deficit spenders.

The institutional arrangements include all conditions and mechanisms governing the production, distribution, exchange and holding of financial assets or instruments of all kinds and the organisations as well as the manner of operations of financial markets and institutions of all descriptions.

Thus, there are three main constituents of financial system:

(a) Financial Assets
(b) Financial Markets, and
(c) Financial Institutions.

Financial assets are subdivided under two heads:

- Primary securities and secondary securities. The former are financial claims against real-sector units, for example, bills, bonds, equities etc. They are created by real-sector units as ultimate borrowers for raising funds to finance their deficit spending. The secondary securities are financial claims issued by financial institutions or intermediaries against themselves to raise funds from public. For examples, bank deposits, life insurance policies, UTI units, IDBI bonds etc.

#### Functions of Financial System:

The financial system helps production, capital accumulation, and growth by (i) encouraging savings, (ii) mobilising them, and (iii) allocating them among alternative uses and users. Each of these functions is important and the efficiency of a given financial system depends on how well it performs each of these functions.

(i) **Encourage Savings**: Financial system promotes savings by providing a wide array of financial assets as stores of value aided by the services of financial markets and intermediaries of various kinds. For wealth holders, all this offers ample choice of portfolios with attractive combinations of income, safety and yield. With financial progress and innovations in financial technology, the scope of portfolio choice has also improved. Therefore, it is widely held that the savings-income ratio is directly related to both financial assets and financial institutions. That is, financial progress generally insures larger savings out of the same level of real income.

(ii) **Mobilisation of Savings**: Financial system is a highly efficient mechanism for mobilising savings. In a fully-monetised economy this is done automatically when, in the first instance, the public holds its savings in the form of money. However, this is not the only way of instantaneous mobilisation of savings.

(iii) **Allocation of Funds**: Another important function of a financial system is to arrange smooth, efficient, and socially equitable allocation of credit. With modern financial development and new financial assets, institutions and markets have come to be organised, which are reaping an increasingly important role in the provision of credit.

In the allocative functions of financial institutions lies their main source of power. By granting easy and cheap credit to particular firms, they can shift outward the resource constraint of these firms and make them grow faster.

#### Structure of Indian Financial System:

Financial system operates through financial markets and institutions.

The Indian Financial system (financial markets) is broadly divided under two heads:

(i) Indian Money Market
(ii) Indian Capital Market

The Indian money market is the market in which short-term funds are borrowed and lent. The money market does not deal in cash, or money but in bills of exchange, grade bills and treasury bills and other instruments. The capital market in India on the other hand is the market for the medium term and long term funds.

### Regulatory Framework for Financial Service Providers Updated
### Criteria for Obtaining a Licence

- **In granting a licence, the inspector will consider the following:**
  - Whether the applicant is a fit and proper person;
  - Whether the applicant is qualified to carry out the business of a financial and corporate service provider;
  - The professional reputation and experience of the applicant;
  - Whether each officer, director or manager of the applicant is a fit and proper person to act as such;
  - In the case of an application by a partnership, whether each partner is a fit and proper person to act as such; and
  - Whether the applicant, if an individual, is resident in The Bahamas or, if a company, is registered under the Companies Act.

### Powers of the Inspector

- **With respect to the performance of his duties under the act, the inspector has the power to require a licensee to:**
  - produce for examination its books, records and other documents that it is required to maintain pursuant to the provisions of the Financial and Corporate Service Providers Act, and (ii) supply such information or explanation as the inspector may reasonably consider upon submission of an application for a licence.

### Duties of a Licensee

- **A licensee has the following duties under the act:**
  - to maintain a high standard of professional conduct in the performance of its duties and refrain from engaging itself or any of its employees in any illegal or improper conduct. This includes engaging in any activity, in or outside of The Bahamas, which may reflect negatively on other service providers or on the reputation of the country as an international financial centre;
  - to verify the identity of each client upon receipt of instructions; and
  - to maintain a record of each client for a period of at least six years from the date of termination of such relationship.

### Suspension or Revocation of Licences

- **Where the inspector is of the opinion that a licensee is in contravention of any provision under the Financial and Corporate Service Providers Act or any other law, he may require the licensee immediately to take such steps as may be necessary to rectify the contravention, and suspend the licensee’s licence for a maximum period of 30 days.** A suspension for a longer period requires a court order and in such instance may only be for a maximum period of 60 days.

### The inspector may revoke the licence of a licensee if:

- the inspector is of the opinion that the licensee is carrying on its business in a manner that is detrimental to the public interest, the interest of the companies managed by him or the reputation of The Bahamas;

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<td>- the registration or management and administration of international business companies incorporated or existing under the International Business Companies Act 2000;</td>
<td><strong>Authorized Persons</strong> - The following persons only are authorized to provide the regulated services: (i) banks and trust companies licensed under the Banks and Trust Companies Regulation Act 2000, and (ii) persons licensed as financial and corporate service providers under the Financial and Corporate Service Providers Act.</td>
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<td>- the provision of registered agent services and registered office services for Bahamian international business companies (IBCs);</td>
<td>Individuals or organizations conducting the business of financial and corporate services, including registered agent services, immediately prior to the commencement of the Financial and Corporate Service Providers Act are required to submit an application for a licence to the inspector within three months of the commencement date of the act (December 29 2000).</td>
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<td>- the provision of directors or officers for Bahamian IBCs;</td>
<td><strong>Register of Licensees</strong> - The inspector will maintain a register of licensees, which will be opened to the public. The name, address and location of the registered office of each licensee, and the date on which the licence was issued, will be stated therein.</td>
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<td>- the provision of nominee shareholders for Bahamian IBCs;</td>
<td><strong>Functions of the Inspector</strong> - The inspector’s role is to maintain a general review of financial and corporate services in The Bahamas. On an annual basis and when required by the minister of finance, the inspector also conducts on-site and off-site examinations of the licensee’s business, at the expense of the licensee, in order to ensure that the licensee is in compliance with the provisions of the Financial and Corporate Service Providers Act, the Financial Transaction Reporting Act 2000, the International Business Companies Act 2000 and any other laws. In such cases, where the inspector is unable to conduct such examination, he may appoint an auditor, at the expense of the licensee, to conduct such examination and to report thereon.</td>
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<td>- the provision of partners for partnerships registered and existing under the Exempted Limited Partnership Act 1995; and</td>
<td><strong>Powers of the Inspector</strong> - With respect to the performance of his duties under the act, the inspector has the power to require a licensee to (i) produce for examination its books, records and other documents that it is required to maintain pursuant to the provisions of the Financial and Corporate Service Providers Act, and (ii) supply such information or explanation as the inspector may reasonably require for the purpose of enabling him to perform his functions under the act.</td>
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| - the provision of registered agent services and registered office services for partnerships registered and existing under the Exempted Limited Partnership Act 1995. | **Duties of a Licensee** - A licensee has the following duties under the act:
  - to maintain a high standard of professional conduct in the performance of its duties and refrain from engaging itself or any of its employees in any illegal or improper conduct. This includes engaging in any activity, in or outside of The Bahamas, which may reflect negatively on other service providers or on the reputation of the country as an international financial centre;
  - to verify the identity of each client upon receipt of instructions; and
  - to maintain a record of each client for a period of at least six years from the date of termination of such relationship. |
| **Suspension or Revocation of Licences** - Where the inspector is of the opinion that a licensee is in contravention of any provision under the Financial and Corporate Service Providers Act or any other law, he may require the licensee immediately to take such steps as may be necessary to rectify the contravention, and suspend the licensee’s licence for a maximum period of 30 days. A suspension for a longer period requires a court order and in such instance may only be for a maximum period of 60 days. | **The inspector may revoke the licence of a licensee if:**
  - the inspector is of the opinion that the licensee is carrying on its business in a manner that is detrimental to the public interest, the interest of the companies managed by him or the reputation of The Bahamas; |
the licensee has ceased to carry on financial and corporate services; or
the licensee becomes bankrupt or goes into liquidation, or is wound up or otherwise dissolved.
A licensee may appeal to the court a decision by the inspector to suspend or revoke its licence.

Offences under the Act

The offences under the act are as follows:

• Any person who engages in or carries on the business of financial corporate services in or from within The Bahamas without a licence commits an offence and is liable upon summary conviction to a fine of $75,000. Where the offence continues subsequent to conviction that person is liable to a fine of $1,000 for each day that the offence continues.
• A person who, with intent to deceive, contravenes any provision or requirement of the act by any action or omission commits an offence and is liable upon summary conviction to a fine of $100,000.
• Any licensor who invites, either directly or indirectly by advertisement, other parties to commit breaches of the law of the country in which such advertisement appears, or to which such advertisement is directed, commits an offence and is liable upon summary conviction to a fine of $50,000. Such liability is imputed to every director and officer concerned with the management of a company convicted for this offence, unless such director or officer satisfies the court that the offence was committed without his knowledge or consent, or that he took all reasonable steps to prevent commission of the offence.
• Any person who, with intent to deceive, for any purposes of the act makes any representation that he knows to be false or does not believe to be true commits an offence and is liable upon summary conviction to a fine of $100,000.
• Any person who assaults or obstructs the inspector or his appointee in the performance of his functions, or contravenes any provision of the act for which no punishment is specially provided, commits an offence and is liable upon summary conviction to a fine of $50,000.
• Any licensee who fails to comply with the record-keeping requirement of the act commits an offence and is liable upon summary conviction to a fine of $50,000.

Financial regulation

Financial regulation is a form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system. This may be handled by either a government or non-government organization. Financial regulation has also influenced the structure of banking sectors, by decreasing borrowing costs and increasing the variety of financial products available.

Aims of regulation

The objectives of financial regulators are usually:

• market confidence – to maintain confidence in the financial system
• financial stability – contributing to the protection and enhancement of stability of the financial system
• Consumer protection – securing the appropriate degree of protection for consumers.
• Reduction of financial crime – reducing the extent to which it is possible for a regulated business to be used for a purpose connected with financial crime.
• Regulating foreign participation in the financial markets.

Structure of supervision

Acts empower organizations, government or non-government, to monitor activities and enforce actions. There are various setups and combinations in place for the financial regulatory structure around the global. Leaf parts are in any case:

Supervision of stock exchanges - Exchange acts ensure that trading on the exchanges is conducted in a proper manner. Most prominent the pricing process, execution and settlement of trades, direct and efficient trade monitoring.

Supervision of listed companies - Financial regulators ensure that listed companies and market participants comply with various regulations under the trading acts. The trading acts demands that listed companies publish regular financial reports, ad hoc notifications or directors' dealings. Whereas market participants are required to Publish major shareholder notifications. The objective of monitoring compliance by listed companies with their disclosure requirements is to ensure that investors have access to essential and adequate information for making an informed assessment of listed companies and their securities.

Supervision of investment management - Asset management supervision or investment acts ensures the frictionless operation of those vehicles.

Supervision of banks and financial services providers

Banking acts lay down rules for banks which they have to observe when they are being established and when they are carrying on their business. These rules are designed to prevent unwelcome developments that might disrupt the smooth functioning of the banking system. Thus ensuring a strong and efficient banking system.

Authority by country

Number of countries having a banking crisis in each year since 1800. This is based on This Time is Different: Eight Centuries of Financial Folly which covers only 70 countries. The general upward trend might be attributed to many factors. One of these is a gradual increase in the percent of people who receive money for their labor. The dramatic feature of this graph is the virtual absence of banking crises during
the period of the Bretton Woods agreement, 1945 to 1971. This analysis is similar to Figure 10.1 in Reinhart and Rogoff (2009). For more details see the help file for "bankingCrises" in the Ecdat package available from the Comprehensive R Archive Network (CRAN).

The following is a short listing of regulatory authorities in various jurisdictions, for a more complete listing, please see list of financial regulatory authorities by country.

- United States
  - U.S. Securities and Exchange Commission (SEC)
  - Financial Industry Regulatory Authority (FINRA)
  - Commodity Futures Trading Commission (CFTC)
  - Federal Reserve System ("Fed")
  - Federal Deposit Insurance Corporation (FDIC)
  - Office of the Comptroller of the Currency (OCC)
  - National Credit Union Administration (NCUA)
  - Office of Thrift Supervision (OTS) (dissolved in 2011)
  - Consumer Financial Protection Bureau (CFPB)
- United Kingdom
  - Bank of England (BoE)
- Australia
  - Australian Prudential Regulation Authority (APRA)
  - Financial Conduct Authority (FCA)
  - Prudential Regulation Authority (PRA)
  - Financial Services Agency (FSA), Japan
  - Financial Services Authority (FSA), Australia
  - Swiss Financial Market Supervisory Authority (FINMA), Switzerland
  - People’s Republic of China
  - China Banking Regulatory Commission (CBRC)
  - China Insurance Regulatory Commission (CIRC)
  - China Securities Regulatory Commission (CSRC)

**Unique jurisdictions**

In most cases, financial regulatory authorities regulate all financial activities. But in some cases, there are specific authorities to regulate each sector of the finance industry, mainly banking, securities, insurance and pensions markets, but in some cases also commodities, futures, forwards, etc. For example, in Australia, the Australian Prudential Regulation Authority (APRA) supervises banks and insurers, while the Australian Securities and Investments Commission (ASIC) is responsible for enforcing financial services and corporations laws.

Sometimes more than one institution regulates and supervises the banking market, normally because, apart from regulatory authorities, central banks also regulate the banking industry. For example, in the USA banking is regulated by a lot of regulators, such as the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the National Credit Union Administration, the Office of Thrift Supervision, as well as regulators at the state level.

In the European Union, the European System of Financial Supervision consists of the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) as well as the European Systemic Risk Board. The Eurozone countries are forming a Single Supervisory Mechanism under the European Central Bank as a prelude to Banking union.

In addition, there are also associations of financial regulatory authorities. At the international level, there is the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors, the Basel Committee on Banking Supervision, the Joint Forum, and the Financial Stability Board, where national authorities set standards through consensus-based decision-making processes.

The structure of financial regulation has changed significantly in the past two decades, as the legal and geographic boundaries between markets in banking, securities, and insurance have become increasingly “blurred” and globalized.

**Regulatory reliance on credit rating agencies**

Think-tanks such as the World Pensions Council (WPC) have argued that most European governments pushed dogmatically for the adoption of the Basel II recommendations, adopted in 2005, transposed in European Union law through the Capital Requirements Directive (CRD), effective since 2008. In essence, they forced European banks, and, more importantly, the European Central Bank itself e.g. when gauging the solvency of EU-based financial institutions, to rely more than ever on the standardized assessments of credit risk marketed by two private US agencies- Moody’s and S&P, thus using public policy and ultimately taxpayers’ money to strengthen an anti-competitive duopolistic industry.

**Financial Services & the New Regulatory Framework: A Comprehensive Update**

Introduction

This course draws together the significant changes in the legislative framework and regulatory institutions over recent years as a result of both UK and EU initiatives.

Financial services issue increasingly feature in decided cases, and the course will also address the most recent significant authorities and their practical implications. Find out:

- What new powers does the Financial Conduct Authority have compared to its predecessor (the Financial Services Authority) and how does it plan to use them?
- What changes will result from the implementation of the Markets in Financial Instruments Directive II (MiFID II)?
- Will the courts treat FCA Principles or conduct of business rules as terms of the contract between a firm and a customer or as informing the standard of care owed to the customer?

**What You Will Learn**

This course will cover the following:
Management of Risk in Financial Services

Financial risk management is the practice of economic value in a firm by using financial instruments to manage exposure to risk, particularly credit risk and market risk. Other types include foreign exchange risk, shape risk, volatility risk, sector risk, liquidity risk, inflation risk, etc. Similar to general risk management, financial risk management requires identifying its sources, measuring it, and plans to address them.

Financial risk management can be qualitative and quantitative. As a specialization of risk management, financial risk management focuses on when and how to hedge using financial instruments to manage costly exposures to risk.

In the banking sector worldwide, the Basel Accords are generally adopted by internationally active banks for tracking, reporting and exposing operational, credit and market risks.

When to use financial risk management

Finance theory (i.e., financial economics) prescribes that a firm should take on a project when it increases shareholder value. Finance theory also shows that firm managers cannot create value for shareholders, also called its investors, by taking on projects that shareholders could do for themselves at the same cost.

When applied to financial risk management, this implies that firm managers should not hedge risks that investors can hedge for themselves at the same cost. This notion was captured by the so-called "hedging irrelevance proposition": In a perfect market, the firm cannot create value by hedging a risk when the price of bearing that risk within the firm is the same as the price of bearing it outside of the firm.

In practice, financial markets are not likely to be perfect markets. This suggests that firm managers likely have many opportunities to create value for shareholders using financial risk management, where in they have to determine which risks are cheaper for the firm to manage than the shareholders. Market risks that result in unique risks for the firm are commonly the best candidates for financial risk management.
The concepts of financial risk management change dramatically in the international realm. Multinational Corporations are faced with many different obstacles in overcoming these challenges. There has been some research on the risks firms must consider when operating in many countries, such as the three kinds of foreign exchange exposure for various future time horizons: transactions exposure, accounting exposure, and economic exposure.

Risk Management in the Financial Services industry
What is Risk?
Risk is exposure to uncertainty. Thus, risk has two components: Uncertainty and Exposure to that uncertainty. For example, if a man jumps out of an airplane with a parachute on his back, he may be uncertain as to whether or not the chute will open. He is taking a risk because he is exposed to that uncertainty. If the chute fails to open, he will suffer personally.

In this example, a typical spectator on the ground would not be taking risk. They may be equally uncertain as to whether the chute will open, but they have no personal exposure to that uncertainty. Exceptions might include:

- A spectator to whom the man jumping from the plane owes money
- A spectator who is a member of the man’s family

Such spectators do face risk because they may suffer financially and/or emotionally should the man’s chute fail to open they are exposed to the uncertainty. The financial services industry is primarily concerned with financial risk which is financial exposure to uncertainty.

Types Of Risks
Some of the most significant risks which organizations face are highly subjective. These include:

Credit Risk: Credit risk is risk resulting from uncertainty in a counterparty’s ability or willingness to meet its contractual obligations. Examples include:

- A broker executes a trade on the behalf of an investor. If the investor is a margin client, it is possible that he might fail to make the payment on the settlement day. Thus the broker faces credit risk.

A housing finance company extends a housing loan to a client. Because the client could fail to make timely principal or interest payments, the housing finance company faces a credit risk.

Operational Risk: During the 1990s, financial institutions started to focus attention on the risks associated with their back office operations—what came to be called operational risks. Having already focused on managing market and credit risks, a number of institutions broadly defined operational risk as all risks other than market or credit risks. Others have defined operational risk more narrowly as risk associated with human or technology failure. Under either definition, some examples of operational failures are:

1. A broker’s back office fails to catch a discrepancy between a reported trade and a confirmation from the counterparty. Ultimately, the trade could be disputed, causing a loss.
2. A trading floor burns down. (This happened to Crédit Lyonnais in 1996.)
3. Before the compulsory dematerialization, a broker could suffer losses due to bad delivery resulting from the signature difference and/or fake certificates.

Market Risk: Market risk is the financial risk of uncertainty in the future market value of a portfolio of assets and/or liabilities. Institutions can actually reduce these risks simply by researching them. A brokerage firm can reduce market risk by being knowledgeable about the markets it operates in. One of the fundamental challenges of enterprise risk management is the fact that individuals who take risks on behalf of an organization are not always the same people who suffer the ultimate consequences of those risks.

Components of Enterprise risk management
Corporate Governance: It is the responsibility of the top management to ensure that an effective risk management program is in place. This includes:

- Defining organization’s risk appetite in terms of loss tolerance, risk-to-capital leverage and target debt rating.
- Ensuring that the organization has required risk management skills and risk absorption capability to support its business strategy.
- Establishing an organisation structure and defining the roles and responsibilities for risk management.
- Implementing an integrated risk measurement and management framework for credit, market and operational risk.
- Establishing a risk assessment and audit processes as well as benchmarking company practices industry best practices Line Management: In the pursuit of new business and growth opportunities, line management must align its business strategy with the corporate risk policy. In executing that business strategy, the risks of business transactions should be fully assessed and incorporated into pricing and profitability targets.

Risk Transfer: To support portfolio management objectives, risk transfer strategies should be executed to lower the cost of hedging undesirable risks. To reduce undesirable risks, management should evaluate Risk Management in Financial Services Industry: derivatives, insurance and hybrid products on a consistent basis and select the most cost effective alternative. For example, corporations such as Honeywell and Mead have executed alternative risk transfer (ART) products that combine the traditional insurance protection with financial risk protection. By bundling various risks, risk managers have estimated 20-30% savings in the cost of risk transfer.

Risk Analytics: The development of advanced risk analytics has supported the quantification and management of credit, market and operational risks on a more consistent basis. In addition to the quantification of risk exposures and risk-adjusted profitability, the same
reduce its risk exposure, say from a value-at-risk (VaR) of Rs.100 crore to a VaR of Rs. 50 crore, risk analytics can be used to determine the most cost effective structure to accomplish that risk objective.

Data and Technology resources: One of the greatest challenges for the enterprise risk management is the aggregation of the underlying portfolio and market data. Portfolio data include risk positions that are captured in different front and back office systems. Market data include prices, volatilities and correlations. In addition to data aggregation, standards and processes must be established to improve the quality of data that are fed into the risk system. With respect to risk technology there is no product that provides a total solution to enterprise risk management. Organisations are required to build or buy-and-build the required functionality.

**Risk Management Framework**

Measuring and monitoring risk at a firm wide level has increased the focus on quantification and the need for a consistent firmwide approach. Apart from the quantitative components required for effective risk management, policies, guidelines, limits, checks and balances are vital components of effective risk management.

**Quantitative Side**

VaR was pioneered by major U.S. banks in the ’80s, as the derivative markets developed. The birth of derivatives represented a new challenge for risk management because traditional measures of exposure were clearly inadequate. For example, two derivative contracts with the same notional value could have very different risks. With VaR, banks had developed a general measure of economic loss that could equate risk across products and aggregate risk on a port-folio basis.

Another important stimulus to the development of VaR was the move toward mark-to-market, both for cash instruments and derivatives. Prior to that, the emphasis was on net interest income, where the common risk measure was repricing gap. As trading increased, duration analysis took over, but duration’s inadequacies led to the adoption of VaR. Definition of VaR VaR is defined as the predicted worst-case loss at a specific confidence level (e.g., 95%) over a certain period of time (e.g., 1 day). For example, every afternoon, J.P. Morgan takes a snapshot of its global trading positions to estimate its Daily-Earnings-at-Risk (DEaR), which is a VaR measure that Morgan defines as the 95% confidence worst-case loss over the next 24 hours due to adverse market movements.

The elegance of the VaR solution is that it works on multiple levels, from the position-specific micro level to the portfolio-based macro level. VaR has become a common language for communicating about aggregate risk taking, both within an organization and outside (e.g., with analysts, regulators, rating agencies, and shareholders). Virtually all major financial institutions have adopted VaR as a cornerstone of day-to-day risk measurement.

**Limitations of VaR**

Var is not a panacea for all risk management and measurement issues. Many of the financial losses were caused by failures that a VaR measurement system would not have prevented. Numbers do not tell the whole story. Time series does not include all the market information, because market efficiency is not perfect. For example, in 1993, the US fed fund rates were flat, at 3% for the whole year. If one uses only historical price data of US short term debt securities, VaR will tell that there is very little risk in US interest rate market, since the historical standard deviation of the price series had been heading lower and lower as the Federal Reserve held the short term interest rates fixed. In February 1994, fixed income markets blew up! If in addition to historical price data, the analysis had included factors like inflation, employment, growth and other macroeconomic factors, one would have heard a lot of noise coming and known that there was a potential storm brewing.

**Qualitative Side**

A calculation like VaR is necessary but not sufficient to assess the risk of complex instruments or complex arbitrage strategies. Qualitative input is just as important. In fact, the two must be used in tandem for best results. Appropriate policies, procedures, limits, controls as well as checks are essential. A critical focal point of effective risk management practice is the proper allocation of responsibilities among front, mid and back office as well as high-level risk oversight functions. The aim of a risk manager is not to nullify risk but rather to increase adequate risk-adjusted returns and to reduce as much as possible what he or she cannot control and is beyond risk management. To compensate for the limitations of VaR, firms must design and implement risk management add-ons to address the inherent weaknesses. Most users combine VaR with stress testing to address questions such as “How much do I expect to lose the other 1% of the time?” As no risk measurement model is without limitations or implied assumptions, it is helpful to understand what will happen should some of the underlying assumptions break down. Stress testing is the catchall term for doing a series of scenario or what if analyses to investigate the effect of violating some of the basic assumptions underlying the risk model. As with VaR, the quality of the answer depends on the inputs, including the financial engineer’s ability to select appropriate scenarios. Events such as the European currency crisis, the Gulf War and September 11 demonstrated that predicting factors such as maximum volatility is difficult and that correlation can change substantially during extreme market moves.

**Performance evaluation**

To date, trading and position taking talent have been rewarded to a significant extent on the basis of total returns. Given the high rewards bestowed on outstanding trading talent this may bias the trading professionals towards taking excessive risks. The interest of the firm or capital provider may be getting out of line with the interest of the risk taking individual unless the risks are properly measured and returns are adjusted for the amount of risk effectively taken.

To do this correctly one needs a standard measure of risks. Ideally risk taking should be evaluated on the basis of three interlinked measures: revenues, volatility of revenues, and risks. The firm or the capital provider has to do a trade off between the risk, expected...
revenues and the volatility of the revenues. Thus, instead of measuring the performance based only on revenues, the performance should be measured based on the targeted risk ratio, efficiency ratio and sharpe ratio.

**Stock Exchange Operations**

**Stock exchange**
The New York Stock Exchange on Wall Street in New York City, the world’s largest stock exchange per total market capitalization of its listed companies

A stock exchange or bourse is an exchange where stock brokers and traders can buy and/or sell stocks (also called shares), bonds, and other securities. Stock exchanges may also provide facilities for issue and redemption of securities and other financial instruments, and capital events including the payment of income and dividends. Securities traded on a stock exchange include stock issued by listed companies, unit trusts, derivatives, pooled investment products and bonds. Stock exchanges often function as “continuous auction” markets, with buyers and sellers consummating transactions at a central location, such as the floor of the exchange.

To be able to trade a security on a certain stock exchange, it must be listed there. Usually, there is a central location at least for record keeping, but trade is increasingly less linked to such a physical place, as modern markets use electronic networks, which gives them advantages of increased speed and reduced cost of transactions. Trade on an exchange is restricted to brokers who are members of the exchange. In recent years, various other trading venues, such as electronic communication networks, alternative trading systems and “dark pools” have taken much of the trading activity away from traditional stock exchanges.

The initial public offering of stocks and bonds to investors is by definition done in the primary market and subsequent trading is done in the secondary market. A stock exchange is often the most important component of a stock market. Supply and demand in stock markets are driven by various factors that, as in all free markets, affect the price of stocks (see stock valuation).

There is usually no obligation for stock to be issued via the stock exchange itself, nor must stock be subsequently traded on the exchange. Such trading may be off exchange or over-the-counter. This is the usual way that derivatives and bonds are traded. Increasingly, stock exchanges are part of a global securities market.

**Role of stock exchanges**

**Raising capital for businesses** - A stock exchange provides companies with the facility to raise capital for expansion through selling shares to the investing public.

**Common forms of capital raising** - Besides the borrowing capacity provided to an individual or firm by the banking system, in the form of credit or a loan, there are four common forms of capital raised used by companies and entrepreneurs. Most of these available options might be achieved, directly or indirectly, through a stock exchange.

**Going public** - Capital intensive companies, particularly high tech companies, always need to raise high volumes of capital in their early stages. For this reason, the public market provided by the stock exchanges has been one of the most important funding sources for many capital intensive startups. After the 1990s and early-2000s hi-tech listed companies’ boom and bust in the world’s major stock exchanges, it has been much more demanding for the high-tech entrepreneur to take his/her company public, unless either the company already has products in the market and is generating sales and earnings, or the company has completed advanced promising clinical trials, earned potentially profitable patents or conducted market research which demonstrated very positive outcomes. This is quite different from the situation of the 1990s to early-2000s period, when a number of companies (particularly Internet boom and biotechnology companies) went public in the most prominent stock exchanges around the world, in the total absence of sales, earnings and any well-documented promising outcome. Anyway, every year a number of companies, including unknown highly speculative and financially unpredictable hi-tech startups, are listed for the first time in all the major stock exchanges – there are even specialized entry markets for these kind of companies or stock indexes tracking their performance (examples include the Alternext, CAC Small, SDAX, TecDAX, or most of the third market good companies).

**Limited partnerships**

A number of companies have also raised significant amounts of capital through R&D limited partnerships. Tax law changes that were enacted in 1987 in the United States changed the tax deductibility of investments in R&D limited partnerships. In order for a partnership to be of interest to investors today, the cash on cash return must be high enough to entice investors.

**Venture capital** - A third usual source of capital for startup companies has been venture capital. This source remains largely available today, but the maximum statistical amount that the venture company firms in aggregate will invest in any one company is not limitless (it was approximately $15 million in 2001 for a biotechnology company).

**Corporate partners** - A fourth alternative source of cash for a private company is a corporate partner, usually an established multinational company, which provides capital for the smaller company in return for marketing rights, patent rights, or equity. Corporate partnerships have been used successfully in a large number of cases.

**Mobilizing savings for investment**

When people draw their savings and invest in shares (through an IPO or the issuance of new company shares of an already listed company), it usually leads to rational allocation of resources because funds, which could have been consumed, or kept in idle deposits with banks, are mobilized and redirected to help companies’ management boards finance their organizations. This may promote business activity with benefits for several economic sectors such as agriculture, commerce and industry, resulting in stronger economic growth and higher productivity levels of firms.
**Facilitating company growth**

Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase their market share, or acquire other necessary business assets. A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways for a company to grow by acquisition or fusion.

**Profit sharing** - Both casual and professional stock investors, as large as institutional investors or as small as an ordinary middle-class family, through dividends and stock price increases that may result in capital gains, share in the wealth of profitable businesses. Unprofitable and troubled businesses may result in capital losses for shareholders.

**Corporate governance** - By having a wide and varied scope of owners, companies generally tend to improve management standards and efficiency to satisfy the demands of these shareholders, and the more stringent rules for public corporations imposed by public stock exchanges and the government. Consequently, it is alleged that public companies (companies that are owned by shareholders who are members of the general public and trade shares on public exchanges) tend to have better management records than privately held companies (those companies where shares are not publicly traded, often owned by the company founders and/or their families and heirs, or otherwise by a small group of investors).

Despite this claim, some well-documented cases are known where it is alleged that there has been considerable slippage in corporate governance on the part of some public companies. The dot com bubble in the late 1990s, and the subprime mortgage crisis in 2007–08, are classical examples of corporate mismanagement. Companies like Pets.com (2000), Enron (2001), One.Tel (2001), Sunbeam (2001), Webvan (2001), Adelphia (2002), MCI WorldCom (2002), Parmalat (2003), American International Group (2008), Bear Stearns (2008), Lehman Brothers (2008), General Motors (2009) and Satyam Computer Services (2009) were among the most widely scrutinized by the media.

To assist in corporate governance many banks and companies worldwide utilize securities identification numbers (ISIN) to identify, uniquely, their stocks, bonds and other securities. Adding an ISIN code helps to distinctly identify securities and the ISIN system is used worldwide by funds, companies, and governments.

However, when poor financial, ethical or managerial records are known by the stock investors, the stock and the company tend to lose value. In the stock exchanges, shareholders of underperforming firms are often penalized by significant share price decline, and they tend as well to dismiss incompetent management teams.

**Creating investment opportunities for small investors**

As opposed to other businesses that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares they can afford. Therefore, the Stock Exchange provides the opportunity for small investors to own shares of the same companies as large investors.

**Government capital-raising for development projects**

Governments at various levels may decide to borrow money to finance infrastructure projects such as sewerage and water treatment works or housing estates by selling another category of securities known as bonds. These bonds can be raised through the stock exchange whereby members of the public buy them, thus loaning money to the government. The issuance of such bonds can obviate, in the short term, direct taxation of citizens to finance development—though by securing such bonds with the full faith and credit of the government instead of with collateral, the government must eventually tax citizens or otherwise raise additional funds to make any regular coupon payments and refund the principal when the bonds mature.

**Barometer of the economy** - At the stock exchange, share prices rise and fall depending, largely, on economic forces. Share prices tend to rise or remain stable when companies and the economy in general show signs of stability and growth. An economic recession, depression, or financial crisis could eventually lead to a stock market crash. Therefore, the movement of share prices and in general of the stock indexes can be an indicator of the general trend in the economy.

**Major stock exchanges**

**Major stock exchanges (top 20 by market capitalization) of issued shares of domestic companies, as of 31 January 2015** ([Monthly reports, World Federation of Exchanges](https://www.worldfedexchanges.org))

**Listing requirements** - Listing requirements are the set of conditions imposed by a given stock exchange upon companies that want to be listed on that exchange. Such conditions sometimes include minimum number of shares outstanding, minimum market capitalization, and minimum annual income.

**Requirements by stock exchange** - Companies must meet an exchange’s requirements to have their stocks and shares listed and traded there, but requirements vary by stock exchange:

- **New York Stock Exchange**: To be listed on the New York Stock Exchange (NYSE), a company must have issued at least a million shares of stock worth $100 million and must have earned more than $10 million over the last three years.

- **NASDAQ Stock Exchange**: To be listed on the NASDAQ a company must have issued at least 1.25 million shares of stock worth at least $70 million and must have earned more than $11 million over the last three years.

- **London Stock Exchange**: The main market of the London Stock Exchange has requirements for a minimum market capitalization (£700,000), three years of audited financial statements, minimum public float (25 per cent) and sufficient working capital for at least 12 months from the date of listing.

- **Bombay Stock Exchange**: Bombay Stock Exchange (BSE) has requirements for a minimum market capitalization of ₹250 million (US$3.7 million) and minimum public float equivalent to ₹100 million (US$1.5 million).
Ownership
Stock exchanges originated as mutual organizations, owned by its member stock brokers. There has been a recent trend for stock exchanges to demutualize, where the members sell their shares in an initial public offering. In this way the mutual organization becomes a corporation, with shares that are listed on a stock exchange. Examples are Australian Securities Exchange (1998), Euronext (merged with New York Stock Exchange), NASDAQ (2002), Bursa Malaysia (2004), the New York Stock Exchange (2005), Bolsas y Mercados Españoles, and the São Paulo Stock Exchange (2007). The Shenzhen and Shanghai stock exchanges can be characterized as quasi-state institutions insofar as they were created by government bodies in China and their leading personnel are directly appointed by the China Securities Regulatory Commission. Another example is Tashkent republic stock exchange (Uzbekistan) established in 1994, three years after collapse of Soviet Union, mainly state-owned but has a form of a public corporation (joint stock company). According to an Uzbek government decision (March 2012) 25 percent minus one share of Tashkent stock exchange was expected to be sold to Korea Exchange(KRX) in 2014.

Other types of exchanges
In the 19th century, exchanges were opened to trade forward contracts on commodities. Exchange traded forward contracts are called futures contracts. These commodity exchanges later started offering future contracts on other products, such as interest rates and shares, as well as options contracts. They are now generally known as futures exchanges.

Stock exchange operations
XV Finance is listing sponsor on NYSE Alternext and thus advises companies on their IPOs on this market.
Throughout the IPO process, XV Finance coordinates all the work and parties involved: stock exchange authorities, NYSE Euronext, the communication agency, the financial institution, lawyers and auditors.
XV Finance assists the issuer before, during and after the listing on Alternext.
Beyond its role, XV Finance assists issuers to list or to be listed companies on the following operations:
- initial public offerings
- issue of securities, simple or composite (common shares, shares with purchase warrant, bonds, convertible bonds...)
- secondary offerings (common shares, securities giving access to shares) public or private,
- capital restructuring, equity block trading
- public offers, delisting.
While they remain listed, XV Finance advises companies on stock exchange requirements, interaction with market authorities and permanent regulatory watch. XV Finance assists listed companies in their communication and interaction with the market and helps them to plan and organize public meetings, road shows and one-to-one meeting thereby contributing to after market value creation. XV Finance offers to issuers a follow-up by reputable industry analysts and capitalizes on the capabilities of independent research bureaus. The credibility of analysis is thus reinforced in the eyes of investors and the issuer benefits from a regular follow-up of its stock. Finally, XV Finance has agreements in place with investors to facilitate the offering of securities in and outside of France.

4 Main Features of Stock Exchange
(1) Organised Market: - Stock exchange is an organised market. Every stock exchange has a management committee, which has all the rights related to management and control of exchange. All the transactions taking place in the stock exchange are done as per the prescribed procedure under the guidance of the management committee.
(2) Dealings in Securities Issued by Various Concerns: - Only those securities are traded in the stock exchange which is listed there. After fulfilling certain terms and conditions, security gets listed on the stock exchange.
(3) Dealings only through Authorised Members: - Investors can sell and purchase securities in stock exchange only through the authorised members. Stock exchange is a specified market place where only the authorised members can go. Investor has to take their help to sell and purchase.
(4) Necessary to Obey the Rules and Bye-laws: - While transacting in Stock Exchange, it is necessary to obey the rules and bye-laws determined by the Stock Exchange.

Mutual Funds
Mutual Funds -- Investors have a basic choice: they can invest directly in individual securities, or they can invest indirectly through a financial intermediary. Financial intermediaries gather savings from investors and invest these monies in a portfolio of financial assets. A mutual fund is a type of financial intermediary that pools the funds of investors who seek the same general investment objective and invests there in a number of different types of financial claims (e.g., equity shares, bonds, money market instruments).

These pooled funds provide thousands of investors with proportional ownership of diversified portfolios managed by professional investment managers. The term ‘mutual’ is used in the sense that all its returns, minus its expenses, are shared by the fund’s unit holders.

Mutual fund investing vs. investing through banks:
Mutual funds are only one kind of financial intermediary. Bank is the largest intermediary in the financial system. Thousands of depositors pool their savings in a bank. However, investments in banks entitle the depositors to different financial claims than the one generated by the mutual funds.

Pass-Through Structure:
In a sense, mutual fund is the purest form of financial intermediary because there is almost perfect pass through of money between unit holders (savers) and the securities in which the fund invests.
Unit holders are indicated a-priori in what type of securities their funds will be invested. Value of the securities held in the fund portfolio is translated on the daily basis directly to the value of the fund units held by the unit holders.

By contrast, a commercial bank is not a pass through type of financial intermediary. Banks collect deposits from depositors (savers). The depositors have no specific knowledge of how their funds will be used.

Bank invests the monies of the depositors in loans & advances which the bank officers feel appropriate at the time. On the deposits collected banks usually give a specified rate of return (interest) that is not linked to the performance of its loans & advances portfolio.

How Risky is a Mutual Fund Investors May Lose Money in a Mutual Fund:

It is important to understand that a mutual fund is as risky as the underlying assets in which it invests. Though regulations ensure disciplined investments and ceilings on expenses that are charged to the unit holders, unit holders assume investment or market risk, including the possible loss of principal, because mutual funds invest in securities whose value may rise and fall.

Unlike bank deposits, mutual funds are not insured under Deposit Insurance and Credit Guarantee Corporation Act, 1961. Of course there is also an upside to investment or market risk. Generally speaking, if you aspire for higher returns then you have to take greater risk. One has to evaluate the riskiness of a mutual fund from the assets it invests.

**Mutual Funds**

Mutual fund schemes are repositories of trust and of investors’ hard earned money. The task of providing protection to them is a difficult one. Mutual funds are unique in a way as they are organized and operated by people whose primary loyalty and pecuniary interest lies outside the enterprise. Consequently the very structure of mutual funds has inherent conflicts of interest, creating great potential for abuse.

The existing SEBI (Mutual Fund) Regulations have tried to address the issue, through separation of various entities which constitute a mutual fund – sponsor, trustees, asset management companies and custodian, and also requiring that 2/3rd of the trustees and half of the board of directors of AMC must be independent of sponsor or its affiliates.

The beneficial owners of the trust, i.e. the unit holders have also been given a role, as their approval is required by the fund/AMC to enable it to bring about certain changes in the fund or to wind up a scheme.

The SEBI regulations have made it mandatory that the trustees shall obtain the consent of the unit holders in important matters.

The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders, shall be carried out unless it is made known to the unit holders and the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load.

The unit holders have a right to terminate the asset management company. The appointment of an asset management company can be terminated by majority of the trustees or by seventy five per cent of the unit holders of the scheme. Any change in the appointment of the asset management company shall be subject to prior approval of SEBI and the unit holders.

**Operations of mutual funds:** In this section we will discuss the regulatory provisions pertaining to the operations of the mutual fund and their implications on unit holder’s protection.

**Chinese wall between Various Activities:**

Business of the Asset Management Company:

Regulation 23 of the SEBI (Mutual Fund) Regulations provides that AMC shall not undertake any business activity other than the management of the mutual funds and such other activities as financial services consultancy, exchange of research and analysis on commercial basis as long as these are not in conflict with the fund management activity itself, without prior approval of the trustees and SEBI.

**Disclosure Requirements:**

Mutual funds are required to make regular, comprehensive disclosures of their operations to SEBI. In addition, each fund must provide unit holders with annual report along with a statement on portfolio holdings, and it must furnish unit holders and prospective investors with an up-to-date prospectus.

The prospectus contains full disclosures on the fund’s management, investment objectives, purchase redemption procedures and other business practices, including load charges, if any.

It is often criticized that big investors trade to the disadvantage of small investors. Mutual funds shall disclose large unit holdings in the scheme, which are over 25% of the NAV.

The scheme information document discloses, the constitution of the mutual fund including the details regarding the sponsor, the trustees, the AMC, the custodian and the responsibilities and functions of each constituent of the mutual fund; the detailed investment objective of the scheme and the investment pattern likely to be followed by the AMC, the risk proofed of the investments; and risk factors.

The offer document also contains other information pertaining to the redemption of units, the tax benefits available to unit holders, the principles of valuation of investments, the method of calculation of NAV, the frequency and mode of distribution of income, the duration of the scheme, the detailed breakup of the expenses that will be incurred for the management of the scheme and the extent to which expenses are loaded on the scheme, the rights of the unit holders and all such information that is necessary to enable the prospective investor to take an informed decision to invest in the scheme.

Mutual funds are required to disclose full portfolio of their schemes every half year, either by sending a complete statement of scheme portfolio or by publishing it by way of an advertisement in one English daily circulating in the whole of India and in a newspaper published in the language of the region where the head office of the mutual fund is situated.
Mutual funds must adhere to specific rules regarding the sale, distribution and advertising of mutual funds. Advertisements or sales literature must be carefully worded and explained. The advertisement for each scheme shall disclose investment objective for each scheme. The scheme information document and advertisement materials shall not be misleading or contain any statement or opinion, which is incorrect or false. These steps ensure that potential investors are aware of the benefits as well as the potential risks involved in mutual fund investing.

With a view to ensure that an asset management company may not in promoting its schemes use untrue and misleading information or withhold important facts from investors SEBI has prescribed an advertisement code. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code.

**Only AMFI Certified Agents Can Sell Mutual Fund Units:**

Mutual funds are advised to ensure that their agents/distributors do not indulge in any kind of malpractice or unethical practice while selling/marketing mutual fund units. SEBI has prescribed a detailed code of conduct for the mutual fund intermediaries i.e. agent and distributors.

With a view to implement this code of conduct effectively the AMFI certification examination was made mandatory for all distributors and agents of mutual funds.

All promotional material must contain an express warning note to the fact that risk is connected with the investment and returns to date are not a guarantee of future return. An illustration is given in the box below:

**BIRLA MNC FUND Risk factors:**

Mutual funds and securities investments are subject to usual risks associated with capital and money market instruments. There can be no assurance that the fund’s objectives will be achieved. As with any investment in securities, the NAV of the units issued under the schemes can go up or down depending on the factors and forces affecting the securities markets.

Past performance of BMF does not guarantee the future performance of the schemes of BMF and does not form a basis of comparison with other investments.

The name of the scheme does not in any manner indicate either the quality of the scheme, its future prospects or returns. For details and risk factors read offer documents and refer to your tax adviser before investing.

Mutual funds cannot provide guaranteed return, unless such returns are fully guaranteed by the sponsor or the asset management company. When guaranteed by the sponsor or the AMC a statement indicating the name of the person who will guarantee the return, is made in the scheme information document; or the manner in which the guarantee to be met has been stated in the scheme information document.

**Investment Restrictions:**

Investments by mutual funds are subject to investment restrictions. These restrictions are essentially prudential investment norms, most of which are universally followed by mutual funds to ensure portfolio risk diversification. For example, investment in equity related instruments of a single company are restricted to 10% of the NAV of a scheme.

**Daily Pricing:**

In open-ended schemes unit holders are always free to “vote with their rupees” by not buying a product if the fees are too high or “vote with their feet” by redeeming the units if they are unhappy over the performance of schemes.

Mutual funds are required to update the NAV of the scheme and the sale/repurchase prices of their schemes on the AMFI website on a daily basis in case of open-ended schemes. Price determination of units is not an arbitrary process.

SEBI has prescribed the accounting and valuation norms. While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the Net Asset Value and the sale price is not higher than 107% of the Net Asset Value. Provided that the difference between the repurchase price and the sale price of the unit shall not exceed 7% calculated on the sale price.

**Mutual Funds Cannot Borrow Except as a Measure of Last Resort:**

**Borrowings by Mutual Funds:**

Since leveraging has risks attached to it, mutual funds can borrow only to meet the temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders.

Provided that the mutual fund shall not borrow more than 20% of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months.

The trustees are required to ensure that borrowing is used as a measure of last resort and determine whether the mutual fund could borrow should be disclosed in the schemes information document.

**Reporting Requirement:**

Every mutual fund has to appoint compliance officer. The compliance officer ensures the compliance of the mutual fund schemes with SEBI regulations. It receives circulars notifications from SEBI and puts the same to the respective department for necessary action.

The officer receives relevant information from various departments/officers of the trust, compiles the same into standard formats and submits to SEBI/AMFI etc. He vets the offer document to ensure the offer document discloses all the information as required by SEBI. This helps SEBI to do continuous offsite inspection.

**Risk Management System in Mutual Funds:**

Recognizing the need to establish a minimum level of risk management system conforming to international standards, AMFI formed a committee for studying the present system of risk management and proposing ways and means of strengthening the same.

They have made certain recommendations to ensure a minimum standard of due diligence or risk management system for all the mutual funds in various areas of their operations like fund management, operations, customer service, marketing and distribution, disaster recovery and business contingency, etc.
Although it could be a high growth opportunity for investors, it is still considered a risky investment avenue which is ideal for investors seeing a high return opportunity within the equity space. In a debt/income scheme, a major part of the investable fund are channelized towards debentures, government securities, and other debt instruments. Although capital appreciation is low (compared to the equity mutual funds), this is a relatively low risk-low return investment avenue which is ideal for investors seeking a steady income.

2. Money Market/ Liquid - This is ideal for investors looking to utilize their surplus funds in short term instruments while awaiting better opportunities. These schemes invest in short-term debt instruments and seek to provide reasonable returns for the investors.

3. Equity/Growth - Equities are a popular mutual fund category amongst retail investors. Although it could be a high-risk investment in the short term, investors can expect capital appreciation in the long run. If you are at your prime earning stage and looking for long-term benefits, growth schemes could be an ideal investment.

3.1. Index Scheme - Index schemes is a widely popular concept in the west. These follow a passive investment strategy where your investments replicate the movements of benchmark indices like Nifty, Sensex, etc.

3.2. Sectoral Scheme - Sectoral funds are invested in a specific sector like infrastructure, IT, pharmaceuticals, etc. or segments of the capital market like large caps, mid-caps, etc. This scheme provides a relatively high risk-high return opportunity within the equity space.

3.3. Tax Saving - As the name suggests, this scheme offers tax benefits to its investors. The funds are invested in equities thereby offering long-term growth opportunities. Tax saving mutual funds (called Equity Linked Savings Schemes) has a 3-year lock-in period.

4. Balanced - This scheme allows investors to enjoy growth and income at regular intervals. Funds are invested in both equities and fixed income securities; the proportion is pre-determined and disclosed in the scheme related offer document. These are ideal for the cautiously aggressive investors.

II. Closed-Ended - In India, this type of scheme has a stipulated maturity period and investors can invest only during the initial launch period known as the NFO (New Fund Offer) period.

Let us have a look at some important mutual fund schemes under the following three categories based on maturity period of investment:

I. Open-Ended - This scheme allows investors to buy or sell units at any point in time. This does not have a fixed maturity date.

1. Debt/ Income - In a debt/income scheme, a major part of the investable fund are channelized towards debentures, government securities, and other debt instruments. Although capital appreciation is low (compared to the equity mutual funds), this is a relatively low risk-low return investment avenue which is ideal for investors seeking a steady income.

2. Money Market/ Liquid - This is ideal for investors looking to utilize their surplus funds in short term instruments while awaiting better options. These schemes invest in short-term debt instruments and seek to provide reasonable returns for the investors.

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II. Closed-Ended - In India, this type of scheme has a stipulated maturity period and investors can invest only during the initial launch period known as the NFO (New Fund Offer) period.
### 1. Capital Protection - The primary objective of this scheme is to safeguard the principal amount while trying to deliver reasonable returns. These invest in high-quality fixed income securities with marginal exposure to equities and mature along with the maturity period of the scheme.

### 2. Fixed Maturity Plans (FMPs) - FMPs, as the name suggests, are mutual fund schemes with a defined maturity period. These schemes normally comprise of debt instruments which mature in line with the maturity of the scheme, thereby earning through the interest component (also called coupons) of the securities in the portfolio. FMPs are normally passively managed, i.e. there is no active trading of debt instruments in the portfolio. The expenses which are charged to the scheme, are hence, generally lower than actively managed schemes.

### III. Interval - Operating as a combination of open and closed ended schemes, it allows investors to trade units at pre-defined intervals.

#### Which scheme should I invest in?

When it comes to selecting a scheme to invest in, one should look for customized advice. Your best bet are the schemes that provide the right combination of growth, stability and income, keeping your risk appetite in mind.

### 8 Important Advantages of Mutual Funds to Investors over Direct Investing

| a. Professional investment management. | f. Lower transaction and other costs. |
| b. Risk reduction through diversification. | g. Regulatory protection. |
| c. Convenience. | h. Relatively higher returns than other financial instruments vis-a-vis their risks. |
| d. Availability of alternative portfolio objectives and products. | e. Unit holders account administration and services ensuring liquidity of investment. |

#### a. Professional Investment Management:

The money pooled in the mutual fund is managed by professionals who decide investment strategy on behalf of the unit holders. Because of the relatively large pool of investable funds, mutual funds have the resources to hire very qualified, full time investment managers. These professionals choose investments that best match the investment objective of the scheme as described in the scheme’s prospectus. Their investment decisions are based on extensive research of the market conditions, and financial performance of the individual companies and specific securities. As the market conditions and/or the expectation about the securities performance change these professionals churn over their portfolios accordingly with a view to provide higher returns to the unit holders.

#### b. Risk Reduction through Diversification:

The old axiom that ‘it is not wise to put all eggs into one basket’ was probably in the minds of those who formed the first mutual fund. The one important thing one should keep in mind regarding diversification is that one is interested in risk as well as returns. Diversification is an admission of not knowing what to do, and our effort will be to strike the average. The function of mutual fund is not to insure its unit holders against losses by investments, but to afford them the opportunity of investing small amounts in a large number of securities.

A single event defies prediction, but the mass remains always practically the same or varies in ways that can be predicted. Elimination of risk by combination is the application of the so-called law of large numbers.

#### Market Risk and Unique Risk:

The total risk of the portfolio comprises of systematic (market) risk and unsystematic (unique) risk. The risk that can be effectively diversified by investing in adequate number of securities is the unique risk of each security and the industry risk. The other type of risk that cannot be diversified away is the market related risk (systematic risk).

One of the major tasks performed by the fund manager is the risk reduction of portfolio by providing adequate diversification. Mutual funds provide diversification benefits in a manageable, compact way because each unit represents a pro rata share of the entire portfolio. Diversification may take several forms. It may involve investing in different types of financial claims e.g., equity shares, bonds etc., or investment in securities offered by different issuers, e.g., investment in bonds issued by different companies.

Portfolio diversification is the major advantage stressed by mutual funds, especially for retail investors. Retail investors with limited money to invest are likely to incur huge transaction costs, should they desire to hold a well-diversified portfolio, due to small quantity purchase of each security. By purchasing units of mutual funds, investor holds a proportional claim on a portfolio comprising a large number of securities in adequate quantity.

#### c. Availability of Varied Portfolio Objectives:

There are more than 400 mutual fund schemes with wide variety of investment objectives and options available to investors in India. AMFI has classified mutual fund schemes into following 7 broad categories according to their basic investment objectives:

1. Growth
2. Income
3. Balanced
4. Liquid & Money Market
5. Gilt
6. Equity Linked Saving Schemes (ELSS)
7. Fund of Funds.

Each of these categories can further be classified into more categories. These wide ranges of schemes have been developed over the years to meet the requirements of the investors with different financial objectives.

#### d. Convenience:

- Operating as a combination of open and closed ended schemes, it allows investors to trade units at pre-defined intervals.
- The primary objective of this scheme is to safeguard the principal amount while trying to deliver reasonable returns. These invest in high-quality fixed income securities with marginal exposure to equities and mature along with the maturity period of the scheme.
- Mutual fund schemes with a defined maturity period. These schemes normally comprise of debt instruments which mature in line with the maturity of the scheme, thereby earning through the interest component (also called coupons) of the securities in the portfolio.
- Operating as a combination of open and closed ended schemes, it allows investors to trade units at pre-defined intervals.
- The money pooled in the mutual fund is managed by professionals who decide investment strategy on behalf of the unit holders. Because of the relatively large pool of investable funds, mutual funds have the resources to hire very qualified, full time investment managers. These professionals choose investments that best match the investment objective of the scheme as described in the scheme’s prospectus. Their investment decisions are based on extensive research of the market conditions, and financial performance of the individual companies and specific securities. As the market conditions and/or the expectation about the securities performance change these professionals churn over their portfolios accordingly with a view to provide higher returns to the unit holders.
- The old axiom that ‘it is not wise to put all eggs into one basket’ was probably in the minds of those who formed the first mutual fund. The one important thing one should keep in mind regarding diversification is that one is interested in risk as well as returns. Diversification is an admission of not knowing what to do, and our effort will be to strike the average. The function of mutual fund is not to insure its unit holders against losses by investments, but to afford them the opportunity of investing small amounts in a large number of securities.
- A single event defies prediction, but the mass remains always practically the same or varies in ways that can be predicted. Elimination of risk by combination is the application of the so-called law of large numbers.
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Mutual funds provide investors with a variety of products and increasingly a broad array of customer services. The increasing breadth of mutual fund products and services offer investors a great deal of choice in picking up the scheme that is consistent with his risk-return-liquidity requirements.

Mutual fund units are easy to buy and sell. Investors may purchase units either from agent or distributor or directly from the fund through its sales persons. They can also buy and sell over Internet, telephone and ATMs.

e. Unit Holders Account Administration and Services:
A major service offered by the mutual funds is liquidity. Liquidity refers to the speed with which an asset can be converted into cash without much loss of its economic value. SEBI requires the open-ended fund to stand ready to redeem the units on a daily basis at its NAV based price. NAV of the scheme is to be calculated and reported daily.

Apart from ensuring continuous liquidity, mutual funds provide many other services. These services include providing a variety of flexible and convenient plans to the investors.

A mutual fund product with Systematic Investment Plan (SIP) refers to the practice of investing a constant amount every month. This translates into holding lesser number of units in rising market and more number of units in falling market.

Systematic Withdrawal Plan (SWP) is a mirror image of SIP. Flexi Withdrawal Plan (FWP) enables withdrawal of different amounts of money for different months. A mutual fund product with Systematic Transfer Plan (STP) allows the investor to maintain a target mix of debt and equity in one’s portfolio.

Unit holders are updated on their investment status. They receive periodical statements of their accounts. Their fund portfolio is disclosed regularly. Half yearly and annual reports are also published.

f. Reduction in Cost of Investment:
Average cost of managing a rupee will be much lower for a mutual fund then for an investor managing a diversified portfolio all on his own. The low costs are due to standardization, and high economies of scale (arising on account of the collective investment character). Further, SEBI has set ceiling with regard to expenses, which can be charged to the investors. Expenses above the set limits cannot be charged to the unit holders.

Apart from the regulatory ceilings, competition plays its own role in determining the cost of mutual fund investing. The recent past has witnessed a trend in reduction/elimination of sale charges and redemption fees.

g. Regulatory Protection:
Mutual funds are subject to strict regulation and oversight by SEBI. As part of this regulation all mutual funds provide full and complete disclosures about the funds in a written offer document.

This offer document describes, among other things scheme’s investment objectives, its investment policies, its investment methods, and information about how to purchase and redeem units and information about risk the portfolio of the scheme is exposed to.

SEBI requires the placement of a fee table at the beginning of every offer document. All mutual funds are required to provide their unit holders with annual and semi-annual reports that contain recent information about the fund’s portfolio, performance and investment goals and policies.

h. Mutual Funds as Components of One are Financial Planning:
Mutual funds invest in securities—both equities, bonds and other assets depending upon the investment objective of the fund. While bank deposits offer fixed returns, and similar risks for all their deposits, mutual funds have a variety of products with varied risk and potential for varying returns. One can build one’s portfolio by investing across equity, hybrid and debt funds and thus aspire to meet one’s financial goals.

Merchant Banking Services

Merchant Banking Services - Merchant Banking Resources is a recognized Top 20 company for merchant cash advances, accounts receivable financing, and other similar instruments for small and medium size businesses. Merchant Banking Resources has been helping small and medium size businesses accelerate their marketplace offerings; providing them with the financial resources that are essential for success in their immediate industry.

Most importantly, Merchant Banking Resources further aids their clients by exclusively employing non-recourse financing tools which to date, have helped a plethora of business owners expand their operations, meet payroll demands, accelerate their hiring practices, and solidify their infrastructures. The value inherent in using Merchant Banking Resources as your financial partner is substantial, to-wit:

- Non-Recourse Business Lending in the form of Merchant Cash Advances;
- The Proprietor Retains 100% of Owned Equity;
- No Usage Restrictions on Any Merchant Cash Advance.

Merchant Banking Resources has been growing rapidly, in parallel with their clients, since its founding in 1995, to a current book of business which is in the millions of dollars advanced, per month range. Further, Merchant Banking Resources understands that its successes, and failures, are predicated on the ability to help clients grow their enterprises, which have been in business for a minimum of one year, to new heights of success.

This approach ensures that MerchantBankingResources.com will recover its business cash advance, and, additionally, that the borrowing merchant is able to expand their business advance request, should they decide to renew. Merchant Banking Resources has helped thou-
sands of business owners retain their valuable equity, expand their operations, and do so without having to expose themselves to personal financial recourse.

**Merchant Banking Resources** is able to fulfill requests by business owners for merchant cash advances, ranging from, but not limited to:

- $5,000 to $3,000,000 plus!

**Merchant Banking Resources** is able to move quickly for any and all business cash advance and credit card processing requests, with approvals or denials being returned within a 72-hour window. Moreover, **Merchant Banking Resources** has a well-established, stable network of tiered lenders that are willing and eager to work with business owners operating under unique circumstances at the time of a merchant cash advance loan request.

Consequently, **Merchant Banking Resources** has relationships with lenders that perform wireless credit card processing for payment gateways, are able to establish and process gift card processing systems, and entertain commercial real estate and hard money loan requests, along with any other high ticket payment processing platform. **Merchant Banking Resources** proudly serves the United States, Canada, and the United Kingdom for merchant cash advance financing, whereas, the proceeds can be used for equipment purchasing, buying inventory, opening additional business locations and similar uses.

To learn more about **Merchant Banking Resources** and our business cash advance program, please contact us at your convenience; get qualified today! We take pride in our ability to always work faster than our clients.

**Merchant bank**

A merchant bank is a financial institution providing capital to companies in the form of share ownership instead of loans. A merchant bank also provides advisory on corporate matters to the firms in which they invest. In the United Kingdom, the historical term "merchant bank" refers to an investment bank.

Today, according to the U.S. Federal Deposit Insurance Corporation (FDIC), "the term merchant banking is generally understood to mean negotiated private equity investment by financial institutions in the unregistered securities of either privately or publicly held companies." Both commercial banks and investment banks may engage in merchant banking activities. Historically, merchant banks' original purpose was to facilitate and/or finance production and trade of commodities, hence the name "merchant." Few banks today restrict their activities to such a narrow scope.

**Here is a list of merchant banks of the past and present:**

- Barings Bank
- Berenberg Bank
- Borthmann Bank
- BDT Capital Partners
- N. M. Rothschild & Sons
- George Peabody & Co.
- Kleinwort Benson
- Kempen & Co
- Guinness Mahon
- Schroders
- J. S. Morgan & Co.
- Hope & Co.
- Defoe Fournier & Cie.
- Close Brothers
- Morgan Grenfell & Co.
- Greenhill & Co.
- Robert Fleming & Co.
- Kuhn, Loeb & Co.
- Hambros Bank
- Hill Samuel
- Brown, Shipley & Co.
- Brown Brothers Harriman & Co.
- Samuel Montagu & Co.
- H. J. Merck & Co.

**Modern practices**

Known as "accepting and issuing houses" in the UK and "investment banks" in the U.S., modern merchant banks offer a wide range of activities, including issue management, portfolio management, credit syndication, acceptance credit, counsel on mergers and acquisitions, insurance, etc.

Of these two classes of merchant banks, the U.S. variant initiates loans and then sells them to investors. These investors can be private investment firms such as Mid Ocean Partners. Even though some of these companies call themselves "merchant banks," they have few, if any, of the characteristics of former merchant banks.

**Merchant Services**

At Commerce Bank, we distinguish ourselves by providing payment processing knowledge and tailoring solutions that assist our clients in achieving key business objectives. With more than 45 years of experience, the goals of Commerce Bank Merchant Services remain the same: to provide you with the most efficient payment processing while helping you reduce operating costs, improve cash flow and minimize exposure to fraud and risk.

**What are Merchant Services?**

Merchant Services or better known as credit card processing is the handling of electronic payment transactions for merchants. Merchant processing activities involve obtaining sales information from the merchant, receiving authorization for the transaction, collecting funds from the bank which issued the credit card, and sending payment to the merchant.

**Managing of issue shares and bonds**

**Bond (finance)**

In finance, a bond is an instrument of indebtedness of the bond issuer to the holders. The most common types of bonds include municipal bonds and corporate bonds. It is a debt security, under which the issuer owes the holders a debt and, depending on the
The yield is the rate of return received from investing in the bond. It usually refers to one of two types: the current yield or the yield to maturity.

**Current Yield** - The current yield is the annual interest payment divided by the current market price of the bond, often referred to as the clean price:
\[
\text{Current yield} = \frac{\text{Annual interest} \times \text{Face amount}}{\text{Current market price}}
\]

**Yield to Maturity** - The yield to maturity is the internal rate of return that would be earned by an investor who buys the bond at the current market price and holds it until maturity. It takes into account the current market price, the amount and timing of all remaining coupon payments, and the repayment due on maturity. It is equivalent to the internal rate of return of a bond.

**Credit Quality** - The quality of the issue refers to the probability that the bondholders will receive the amounts promised at the due dates. This will depend on a wide range of factors. High-yield bonds are bonds that are rated below investment grade by the credit rating agencies.
Market price - The market price of a tradable bond will be influenced, amongst other factors, by the amounts, currency and timing of the interest payments and capital repayment due, the quality of the bond, and the available redemption yield of other comparable bonds which can be traded in the markets.

The price can be quoted as clean or dirty. "Dirty" includes the present value of all future cash flows, including accrued interest, and is most often used in Europe. "Clean" does not include accrued interest, and is most often used in the U.S.[1]

The issue price at which investors buy the bonds when they are first issued will typically be approximately equal to the nominal amount. The net proceeds that the issuer receives are thus the issue price, less issuance fees. The market price of the bond will vary over its life: it may trade at a premium (above par, usually because market interest rates have fallen since issue), or at a discount (price below par, if market rates have risen or there is a high probability of default on the bond).

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| 1. **Indentures and Covenants** — An indenture is a formal debt agreement that establishes the terms of a bond issue, while covenants are the clauses of such an agreement. Covenants specify the rights of bondholders and the duties of issuers, such as actions that the issuer is obligated to perform or is prohibited from performing. In the U.S., federal and state securities and commercial laws apply to the enforcement of these agreements, which are construed by courts as contracts between issuers and bondholders. The terms may be changed only with great difficulty while the bonds are outstanding, with amendments to the governing document generally requiring approval by a majority (or super-majority) vote of the bondholders.
| 2. **Optionality**: Occasionally a bond may contain an **embedded option**: that is, it grants option-like features to the holder or the issuer:
| 1. **Callability** — Some bonds give the issuer the right to repay the bond before the maturity date on the call dates; see call option. These bonds are referred to as **callable bonds**. Most callable bonds allow the issuer to repay the bond at par. With some bonds, the issuer has to pay a premium, the so-called call premium. This is mainly the case for high-yield bonds. These have very strict covenants, restricting the issuer in its operations. To be free from these covenants, the issuer can repay the bonds early, but only at a high cost.
| 2. **Putability** — Some bonds give the holder the right to force the issuer to repay the bond before the maturity date on the put dates; see put option. These are referred to as **putable bonds**.
| 3. **Call dates and put dates** — The **dates** on which callable and putable bonds can be redeemed early. There are four main categories:
| 1. A Bermudan callable has several call dates, usually coinciding with coupon dates.
| 2. A European callable has only one call date. This is a special case of a Bermudan callable.
| 3. An American callable can be called at any time until the maturity date.
| 4. A death put is an optional redemption feature on a debt instrument allowing the beneficiary of the estate of a deceased bondholder to put (sell) the bond back to the issuer at face value in the event of the bondholder’s death or legal incapacitation. This is also known as a "survivor’s option".
| 4. **Sinking fund** provision of the corporate bond indenture requires a certain portion of the issue to be retired periodically. The entire bond issue can be liquidated by the maturity date; if not, the remainder is called balloon maturity. Issuers may either pay to trustees, which in turn call randomly selected bonds in the issue, or, alternatively, purchase bonds in open market, then return them to trustees.
| 1. Bonds are often identified by its international securities identification number, or **ISIN**, which is a 12 digit alphanumeric code that uniquely identifies debt securities.
| 2. **A smart bond** is an automated programmable bond contract that uses the capabilities of a blockchain database to operate as a cryptographically-secure yet open and transparent general bond ledger.[2] It is one of a class of financial instruments known as a **smart contract** — a computerized transaction protocol that executes the terms of a contract. Smart bond technology may lower operational costs by the elimination of the "middle or back office", as well as the bond registry, substantially reducing the cost of bond servicing. Another potential benefit is the potential for instantaneous settlement, rather than the days, as well as lower operational risk. In 2015, UBS was experimenting with smart bonds that use the bitcoin blockchain.

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<th>Types</th>
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| 1. **Fixed rate bonds** have a coupon that remains constant throughout the life of the bond. A variation are stepped-coupon bonds, whose coupon increases during the life of the bond.
| 2. **Floating rate notes** (FRNs, floaters) have a variable coupon that is linked to a reference rate of interest, such as LIBOR or Euribor. For example, the coupon may be defined as three-month USD LIBOR + 0.20%. The coupon rate is recalculated periodically, typically every one or three months.
| 3. **Zero-coupon bonds** (zeros) pay no regular interest. They are issued at a substantial discount to par value, so that the interest is effectively rolled up to maturity (and usually taxed as such). The bondholder receives the full principal amount on the redemption date. An example of zero coupon bonds is Series E savings bonds issued by the U.S. government. **Zero-coupon bonds** may be created from fixed...
rate bonds by a financial institution separating ("striping off") the coupons from the principal. In other words, the separated coupons and the final principal payment of the bond may be traded separately. See IO (Interest Only) and PO (Principal Only).

4. High-yield bonds (junk bonds) are bonds that are rated below investment grade by the credit rating agencies. As these bonds are riskier than investment grade bonds, investors expect to earn a higher yield.

5. Convertible bonds let a bondholder exchange a bond to a number of shares of the issuer’s common stock. These are known as hybrid securities, because they combine equity and debt features.

6. Exchangeable bonds allows for exchange to shares of a corporation other than the issuer.

7. Inflation-indexed bonds (linkers) (US) or Index-linked bond (UK), in which the principal amount and the interest payments are indexed to inflation. The interest rate is normally lower than for fixed rate bonds with a comparable maturity (this position briefly reversed itself for short-term UK bonds in December 2008). However, as the principal amount grows, the payments increase with inflation.

The United Kingdom was the first sovereign issuer to issue inflation linked gilts in the 1980s. Treasury Inflation-Protected Securities (TIPS) and Indexed bonds are examples of inflation linked bonds issued by the U.S. government.

8. Other indexed bonds, for example equity-linked notes and bonds indexed on a business indicator (income, added value) or on a country’s GDP.

2. Asset-backed securities are bonds whose interest and principal payments are backed by underlying cash flows from other assets.

Examples of asset-backed securities are mortgage-backed securities (MBSs), collateralized mortgage obligations (CMOs) and collateralized debt obligations (CDOs).

3. Subordinated bonds are those that have a lower priority than other bonds of the issuer in case of liquidation. In case of bankruptcy, there is a hierarchy of creditors. First the liquidator is paid, then government taxes, etc. The first bond holders in line to be paid are those holding what is called senior bonds. After they have been paid, the subordinated bond holders are paid. As a result, the risk is higher. Therefore, subordinated bonds usually have a lower credit rating than senior bonds. The main examples of subordinated bonds can be found in bonds issued by banks, and asset-backed securities. The latter are often issued in tranches. The senior tranches get paid back first, the subordinated tranches later.

4. Covered bonds are backed by cash flows from mortgages or public sector assets. Contrary to asset-backed securities the assets for such bonds remain on the issuers balance sheet.

5. Perpetual bonds are also often called perpetuities or ‘Perps’. They have no maturity date. The most famous of these are the UK Consols, which are also known as Treasury Annuities or Undated Treasuries. Some of these were issued back in 1888 and still trade today, although the amounts are now insignificant. Some ultra-long-term bonds (sometimes a bond can last centuries: West Shore Railroad issued a bond which matures in 2361 (i.e. 24th century) are virtually perpetuities from a financial point of view, with the current value of principal near zero.

6. Bearer bond is an official certificate issued without a named holder. In other words, the person who has the paper certificate can claim the value of the bond. Often they are registered by a number to prevent counterfeiting, but may be traded like cash. Bearer bonds are very risky because they can be lost or stolen. Especially after federal income tax began in the United States, bearer bonds were seen as an opportunity to conceal income or assets. U.S. corporations stopped issuing bearer bonds in the 1960s, the U.S. Treasury stopped in 1982, and state and local tax-exempt bearer bonds were prohibited in 1983.

7. Registered bond is a bond whose ownership (and any subsequent purchaser) is recorded by the issuer, or by a transfer agent. It is the alternative to a Bearer bond. Interest payments, and the principal upon maturity are sent to the registered owner.

8. A government bond, also called Treasury bond, is issued by a national government and is not exposed to default risk. It is characterized as the safest bond, with the lowest interest rate. A treasury bond is backed by the “full faith and credit” of the relevant government. For that reason, for the major OECD countries this type of bond is often referred to as risk-free.

Municipal bond is a bond issued by a state, U.S. Territory, city, local government, or their agencies. Interest income received by holders of municipal bonds is often exempt from the federal income tax and from the income tax of the state in which they are issued, although municipal bonds issued for certain purposes may not be tax exempt.

9. Build America Bonds (BABs) are a form of municipal bond authorized by the American Recovery and Reinvestment Act of 2009. Unlike traditional US municipal bonds, which are usually tax exempt, interest received on BABs is subject to federal taxation. However, as with municipal bonds, the bond is tax-exempt within the US state where it is issued. Generally, BABs offer significantly higher yields (over 7 percent) than standard municipal bonds.

10. Book-entry bond is a bond that does not have a paper certificate. As physically processing paper bonds and interest coupons became more expensive, issuers (and banks that used to collect coupon interest for depositors) have tried to discourage their use. Some book-entry bond issues do not offer the option of a paper certificate, even to investors who prefer them.

11. Lottery bonds are issued by European and other states. Interest is paid as on a traditional fixed rate bond, but the issuer will redeem randomly selected individual bonds within the issue according to a schedule. Some of these redemptions will be for a higher value than the face value of the bond.

12. War bond is a bond issued by a government to fund military operations during wartime. This type of bond has low return rate.

13. Serial bond is a bond that matures in instalments over a period of time. In effect, a $100,000, 5-year serial bond would mature in a $20,000 annuity over a 5-year interval.
Revenue bond is a special type of municipal bond distinguished by its guarantee of repayment solely from revenues generated by a specified revenue-generating entity associated with the purpose of the bonds. Revenue bonds are typically "non-recourse", meaning that in the event of default, the bond holder has no recourse to other governmental assets or revenues.

Climate bond is a bond issued by a government or corporate entity in order to raise finance for climate change mitigation- or adaptation-related projects or programmes.

Dual currency bonds

Retail bonds are a type of corporate bond mostly designed for ordinary investors. They have become particularly attractive since the London Stock Exchange (LSE) launched an order book for retail bonds.

Social impact bonds are an agreement for public sector entities to pay back private investors after meeting verified improved social outcome goals that result in public sector savings from innovative social program pilot projects.

Foreign currencies - Some companies, banks, governments, and other sovereign entities may decide to issue bonds in foreign currencies as it may appear to be more stable and predictable than their domestic currency. Issuing bonds denominated in foreign currencies also gives issuers the ability to access investment capital available in foreign markets. The proceeds from the issuance of these bonds can be used by companies to break into foreign markets, or can be converted into the issuing company's local currency to be used on existing operations through the use of foreign exchange swap hedges. Foreign issuer bonds can also be used to hedge foreign exchange rate risk. Some foreign issuer bonds are called by their nicknames, such as the "samurai bond". These can be issued by foreign issuers looking to diversify their investor base away from domestic markets. These bond issues are generally governed by the law of the market of issuance, e.g., a samurai bond, issued by an investor based in Europe, will be governed by Japanese law. Not all of the following bonds are restricted for purchase by investors in the market of issuance.

1. Eurodollar bond, a U.S. dollar-denominated bond issued by a non-U.S. entity outside the U.S
2. Baklava bond, a bond denominated in Turkish Lira and issued by a domestic or foreign entity in the Turkish market
4. Kangaroo bond, an Australian dollar-denominated bond issued by a non-Australian entity in the Australian market
5. Maple bond, a Canadian dollar-denominated bond issued by a non-Canadian entity in the Canadian market
8. Shibosai Bond, a private placement bond in the Japanese market with distribution limited to institutions and banks.
9. Shogun bond, a non-yen-denominated bond issued in Japan by a non-Japanese institution or government
10. Bulldog bond, a pound sterling-denominated bond issued in London by a foreign institution or government.
11. Matryoshka bond, a Russian rouble-denominated bond issued in the Russian Federation by non-Russian entities. The name derives from the famous Russian wooden dolls, Matryoshka, popular among foreign visitors to Russia.
12. Arirang bond, a Korean won-denominated bond issued by a non-Korean entity in the Korean market
13. Kimchi bond, a non-Korean won-denominated bond issued by a non-Korean entity in the Korean market
14. Formosa bond, a non-New Taiwan Dollar-denominated bond issued by a non-Taiwan entity in the Taiwanese market
15. Panda bond, a Chinese renminbi-denominated bond issued by a non-China entity in the People's Republic of China market
16. Dim sum bond, a Chinese renminbi-denominated bond issued by a Chinese entity in Hong Kong. Enables foreign investors forbidden from investing in Chinese corporate debt in mainland China to invest in and be exposed to Chinese currency in Hong Kong.
17. Huaso bond, a Chilean peso-denominated bond issued by a non-Chilean entity in the Chilean market.
18. Masala bond, an Indian rupee denominated bond issued outside India.
19. Lion City bond foreign currency denominated bond issued by foreign company in Singapore

Mobilising of Fixed Deposits

Deposit Mobilisation

A lending institution solely dependent on borrowed funds for advancing loans can’t remain viable in the long run of its business. In the present conditions, ARDBs need to mobilise own resources to introduce new lending programmes depending on the needs of their members. While there is huge potential for ARDB to mobilise rural savings which was neglected all along as they restricted their advances to long term loans which require long term funds. At present some ARDBs are advancing short term loans for various purposes, for which they need to raise short term funds by way of deposits from members.

The Zonal Seminars on ‘Preparedness of ARDBs for Revival’ deliberated in detail about the need and scope of deposit mobilization by ARDBs on the background of provisions in the Act, Byelaws and guidelines of NABARD and viewed experts in the subject. Following observations/recommendations were made in Zonal Seminars;

1. Mobilisation of members’ savings is an essential function of credit cooperative and an important tool for financial inclusion. ARDBs have huge potential to mobilize rural savings due to statewide jurisdiction and large member base. They can mobilize deposits from their members as per deposit schemes approved by the Board of Management of respective banks.
2. SCARDBs are also allowed to mobilize deposits from public who are not members of the Bank as per the guidelines issued by NABARD in 1997 subject to certain conditions such as i) Total deposits outstanding at any point of time should not exceed the net worth of
the SCARDB. ii) The tenure of deposits should be more than one year and less than three years. iii) PCARDBs can collect deposits only as agents of SCARDB. iv) SCARDBs to maintain adequate ‘fluid resources’ which should not be less than 15% of deposits outstanding for meeting withdrawal demands.

3. The above scheme, though facilitates deposit taking even from individuals and institutions who are not members/not eligible to become members of the bank, failed to mobilize substantial deposits in any State due to restrictive provisions as mentioned above. ARDBs, should devise its own schemes for mobilizing deposits from its members as the restrictions in the deposit mobilization scheme of 1997 issued by NABARD do not apply when deposits are collected only from members.

Based on the above observations/recommendations of the Zonal Seminars, the Board of Management of the Federation had approved the deposit schemes as well as general guidelines prepared by the Standing Committee of CEOs of SCARDBs. Detailed guidelines regarding deposit mobilization by ARDBs are as follows;

(i) DEPOSIT SCHEMES FOR ARDBs

1. Thrift Deposits from members
   - Thrift deposits are suitable and advantageous for ARDBs in terms of cost of funds and retention of available balance for longer periods compared to other kinds of deposits.
   - SCARDBs should make opening of thrift deposit account compulsory for all members with an initial deposit of Rs.500 through appropriate board decisions/provisions in the byelaws.
   - Member can make deposits in the account whenever he wants and withdraw any amount over and above the minimum balance of Rs.500 using a withdrawal slip, any time he needs money, without restrictions.
   - The collection points of deposits shall be PCARDBs or its branches as well as branches of SCARDBs.
   - Rate of interest shall be 4% p.a. on monthly average balance as applicable to savings bank accounts with banks. The interest should be worked out and credited to the account on 31st March and 30th September every year.
   - SCARDBs to introduce quarterly ‘ Lucky Draw Scheme’ for thrift deposits having balance above Rs.5000 in the account throughout the quarter with the following features:- (i) There shall be four quarterly draws every year.
   - Total value of prizes given away during the year shall not exceed 1% of total deposits outstanding in accounts eligible for participating in the draw.
   - For each draw, there shall be a bumper prize such as motorcar/motorcycle/power tiller etc depending upon the amount that can be set apart for giving the prizes.
   - There shall also be a number of other prizes in each draw such as ceiling fans, mobile phones, cash prizes etc depending on the number of eligible accounts as well as the amount available for giving the prizes.
   - The bumper prizes for each draw should be arranged in advance and its image should be exhibited in all deposit collection points along with other details of prizes.

2. Recurring Deposits
   Members can open recurring deposits for depositing a fixed amount on a monthly basis. The maturity value of recurring deposits with interest accrued is withdrawable on completing the period of recurring deposit account which can be 12 months, 24 months, 36 months etc.

3. Fixed Deposits
   Fixed deposits are taken for a fixed period, the minimum of which may be 3 months in the case of ARDBs at a specific interest rate with options of interest payable on quarterly basis or capitalized quarterly and payable on maturity.

4. Cash Certificates
   Cash certificates of Rs.5000 or Rs.10000 can be issued for three years or five years at a discounted prize depending on the rate offered and the period of deposit. Cash certificate scheme suits certain class of depositors and will also be convenient for the bank from the pur-view of accounting and servicing of deposits.

5. Share Capital Converted Deposits
   Instead of repaying shares on closure of loan, the bank may convert the shares into fixed deposits or cash certificates with assured returns to the member.

(ii) WORKING INSTRUCTIONS

1. Banks to ensure that all depositors are enrolled as members.
2. In federal structure, member deposits can be collected only by primaries which needs to be transferred to SCARDBs for proper management and deployment of funds.
3. It should be ensured that deposits outstanding at the primary level at the end of every month should be equivalent to their deposits outstanding with the SCARDB.
4. SCARDB and PCARDBs should use on-line real time fund transfer facilities (through NEFT/RTGS) offered by banks for transfer of funds to avoid transit delays and minimize bank charges.
5. SCARDBs to pay interest on deposits by primaries at 1% more than the average cost of deposits for primaries to defray the cost of collection, accounting and servicing.
6. All deposit taking primaries need to avail overdraft limit from a bank close to it, in order to ensure timely liquidity to pay interest and meeting withdrawal demand.
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<tr>
<td>7.</td>
<td>The interest on overdraft availed by the PCARDB for timely servicing of deposits should be met by the SCARDB which is the ultimate custodian of deposits collected by the PCARDB.</td>
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<td>8.</td>
<td>Deposit resources should be used mainly for issuing non-agricultural short term loans, the interest rate of which may be linked to the actual cost of funds for the SCARDB including interest on overdraft drawings reimbursed to the primaries (for servicing the deposits) with a margin of 5% per annum for the structure as a whole to cover transaction and risk costs.</td>
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<td>9.</td>
<td>The rate of interest on deposits may be fixed at 1% above the prevailing rate of banks to encourage savings by members.</td>
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<td>10.</td>
<td>Banks to ensure auto renewal of deposits for the same tenure as original deposit at the prevailing interest rate when the depositor does not approach for closure of deposit account on maturity.</td>
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<td>11.</td>
<td>Banks should obtain nomination from all depositors along with deposit application.</td>
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<td>12.</td>
<td>Passbook should be issued for thrift deposit accounts and recurring deposit accounts.</td>
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<td>13.</td>
<td>The terms and conditions of deposits should be mentioned in the deposit application form which should also include a clause for giving one day’s notice by the depositor for withdrawal of the amount of deposit on maturity especially in respect of high value deposits.</td>
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<td>14.</td>
<td>There is no need for TDS deduction from interest earned by member on deposits since such incomes of the member received from a cooperative is exempted from income tax under the principle of mutuality.</td>
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<td>15.</td>
<td>The interest rates on various types of deposits and lending rates on short term loans being issued out of deposit funds are to be fixed by a Committee at the SCARDB level consisting of Chairman, CEO, CGM and GMs in-charge of Finance and Advances, periodically, based on general interest rate scenario.</td>
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<td>16.</td>
<td>SCARDBs to invest not less than 50% of total deposits in securities and bank deposits for maintaining liquidity and ensuring safety of funds. Balance amount should be deployed in short term credit products.</td>
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<td>17.</td>
<td>Following short term credit products should be implemented through PCADB for this purpose. (i) Jewel loans, (ii) General Cash Credit Scheme to prompt repayers of long term loans (ii) Consumer durable loans, (iv) Traders loans.</td>
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<td>18.</td>
<td>All deposit schemes should be given good publicity through advertisements and other means.</td>
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<td>19.</td>
<td>A separate budget for advertisement not exceeding 3% of the average level of outstanding deposits during the year should be allocated.</td>
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<td>20.</td>
<td>Deposit mobilization may be started in centres where building and other infrastructure are good.</td>
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<td>21.</td>
<td>Banks may also modernize buildings and other infrastructure in the branches for launching deposit schemes.</td>
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<td>22.</td>
<td>Concerned staff in such centers should be given necessary training.</td>
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<td>23.</td>
<td>Appropriate incentives to staff should be considered for encouraging deposit mobilization and enrolling new membership with deposit account who can subsequently become borrowing members also.</td>
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<tr>
<td>24.</td>
<td>SCARDBs should fix branch-wise/PCARDB-wise monthly targets for deposit mobilization. The achievement of targets should be reviewed at Branch/Region/H.O. level.</td>
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<tr>
<td>25.</td>
<td>Loans upto 90% of fixed deposits can be sanctioned at interest rate of 1% above the deposit rate.</td>
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<td>26.</td>
<td>SCARDBs to give detailed instructions to PCARDBs and branches regarding books to be maintained, arrangements for transfer of funds to SCARDB, opening of overdraft account with a bank for servicing of deposits including timely refund of deposits on maturity, printing and custody of blank fixed deposit receipts, method of interest application in deposit accounts, procedure regarding premature closing, sanctioning loan on the security of deposits, minimum balance to be maintained in thrift deposits, quarterly statement regarding thrift accounts eligible for quarterly lucky draw, returns to be sent to SCARDB on deposit outstanding, collections, refund etc and the periodicity of the same.</td>
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**Inter-Corporate Loans**

Securities that are purchased by corporations rather than individual investors. Inter-corporate investments allow a company to achieve higher growth rates compared to keeping all of its funds in cash. These investments can also be used for strategic purposes like forming a joint venture or making acquisitions. Companies purchase securities from other companies, banks and governments in order to take advantage of the returns from these securities. Marketable securities that can readily be exchanged for cash, such as notes and stocks, are usually preferred for this type of investment.

**Breakdown of 'Inter-corporate Investment'**

Inter-corporate investments are accounted for differently than other funds held by a company. Short-term investments that are expected to be turned into cash are considered current assets, while other investments are considered non-current assets. When companies buy inter-corporate investments, dividend and interest revenue is reported on the income statement.

**Meaning:**

Inter-company deposit is the deposit made by a company that has surplus funds, to another company for a maximum of 6 months. It is a source of short-term financing.

**Types:**

*Such deposits are of three types:*

1. **Cash Deposit** - Such a type of deposit is withdrawn by the lender by giving a notice of one day. However, in practice, a lender has to wait for at least 3 days.
### A BRIEF NOTE ON MONEY MARKET INSTRUMENTS

**Introduction**

The India money market is a monetary system that involves the lending and borrowing of short-term funds. It is a centre in which financial institutions join together for the purpose of dealing in financial or monetary assets. Money market instruments take care of the borrowers’ short-term needs and render the required liquidity to the lenders. The varied types of India money market instruments are treasury bills, repurchase agreements, commercial papers, certificate of deposit, and banker’s acceptance. Central bank of the country – the Reserve Bank of India (RBI) has always been playing the major role in regulating and controlling the India money market. The money market provides a mechanism for evening out short-term liquidity imbalances within an economy. The development of the money market is, thus, a prerequisite for the growth and development of the economy of a country.

**Money Market vs. Capital Market**

Money Market is a place for short term lending and borrowing, typically within a year. It deals in short term debt financing and investments. On the other hand, Capital Market refers to stock market, which refers to trading in shares and bonds of companies on recognized stock exchanges or buying in primary market (Issue of Security by the Company). Individual players cannot invest in money market as the value of investments is large, on the other hand, in capital market, anybody can make investments through a broker. Stock Market is associated with high risk and high return as against money market which is more secure. Further, in case of money market, deals are transacted on phone or through electronic systems as against capital market where trading is through recognized stock exchanges.

**Money Market Instruments**

- **T-bills**:
  
  A Treasury Bill is an instrument for short-term borrowing by the Government of India. It is issued by the Reserve Bank of India on behalf of the Government of India in the form of a promissory note. The necessity for issuing treasury bills arises because of the periodic nature of receipts of Government while the Government expenditure is on a continuing basis. Taxes are payable to the Government after quarterly intervals or so, but Government has to meet its expenditure on daily or monthly basis. Thus, to bridge this mis-match between the timings of Government receipts and expenditure, Government borrows money on short-term basis by issuing Treasury Bills. The Treasury Bills are issued for different maturity periods. Till May 14, 2001, the maturity periods were 14 days, 91 days, 182 days and 365 days. The

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| **2. Three-month Deposit** | As the name suggests, such type of a deposit provides funds for three months to meet up short-term cash inadequacy. |
| **3. Six-month Deposit** | The lending company provides funds to another company for a period of six months. |

**Features of Inter-corporate Deposits:** The important features of inter-corporate deposits are as follows:

i. It is a popular source of short-term finance.

ii. Procurement procedure is simple.

iii. The rate of interest on such deposits is not fixed. It depends upon the amount involved and the tenure of lending.

iv. It is uncertain source of finance, as deposit can be withdrawn any time—so it is risky also.

**Advantages of Inter-company Deposits:** The advantages of inter-corporate deposits are:

i. Surplus funds can be effectively utilized by the lender company.

ii. Such deposits are secured in nature.

iii. Inter-corporate deposits can be easily procured.

**Disadvantages of Inter-company Deposits:**

Inter-corporate deposits suffer from following disadvantages:

i. A company cannot lend more than 10 per cent of its net worth to a single company and cannot lend beyond 30 per cent of its net worth in total.

ii. The market for such source of financing is not structured.

**Inter Corporate Deposits**

Inter-corporate deposits are deposits made by one company with another company, and usually carry a term of six months. The three types of inter-corporate deposits are: three month deposits, six month deposits, and call deposits.

Three month deposits are the most popular type of inter-corporate deposits. These deposits are generally considered by the borrowers to solve problems of short-term capital inadequacy. This type of short-term cash problem may develop due to various issues, including tax payment, excessive raw material import, breakdown in production, payment of dividends, delay in collection, and excessive expenditure of capital.

The annual rate of interest given for three month deposits is 12%. Six month deposits are usually made with first class borrowers, and the term for such deposits is six months.

The annual interest rate assigned for this type of deposit is 15%. The concept of call deposit is different from the previous two deposits. On giving a one day notice, this deposit can be withdrawn by the lender. The annual interest rate on call deposits is around 10%.

The inter-corporate deposits market shows a number of interesting characteristics. The biggest advantage of inter-corporate deposits is that the transaction is free from bureaucratic and legal hassles. The business world otherwise is regulated by a number of rules and regulations.

The existence of the inter-corporate deposits market shows that the corporate world can be regulated without rules.

The market of inter-corporate deposits maintains secrecy. The brokers in this market never reveal their lists of lenders and borrowers, because they believe that if proper secrecy is not maintained the rate of interest can fall abruptly.

The market of inter-corporate deposits depends crucially on personal contacts. The decisions of lending in this market are largely governed by personal contacts.
Treasury Bills are sold through auctions. While auctions of 91 days Treasury Bills take place on a weekly basis, the auctions for 364 days Treasury Bills are held on a fortnightly basis. The Reserve Bank of India also notifies the amounts in respect of the Treasury Bill auctions.

- **Certificate of Deposit:**
  A Certificate of Deposit is a receipt for a deposit of money with a bank or a financial institution. It differs from a fixed Deposit Receipt in two respects. First, it is issued for a big amount and second, it is freely negotiable. The Reserve Bank of India announced the scheme of Certificate of Deposits in March 1989. Certificate of Deposits are a popular avenue for companies to invest their short-term surpluses because Certificate of Deposits offer a risk-free investment opportunity at rates of interest higher than Treasury bills and term deposits, besides being fairly liquid. For the Issuing Banks, Certificate of Deposits provides another source of mobilizing funds in bulk. CDs are discounted instruments and are issued at a discounted price and redeemed at par value. The tenor of issue can range from 7 days to 1 year, however most CDs are issued by banks for 3, 6 and 12 months. CDs can be issued to individuals (other than minors), corporations, companies, trusts, funds, associations, etc. Non-Resident Indians may also subscribe to CDs. However they are mainly subscribed to by banks, mutual funds, provident and pension funds and insurance companies. The minimum amount of a CD should be Rs. 1 lakh i.e., the minimum deposit that can be accepted from a single subscriber should not be less than Rs 1 lakh and in multiples of Rs 1 lakh thereafter.

- **Commercial Papers:**
  Commercial Paper is a short-term usance promissory note with fixed maturity, issued by creditworthy and highly rated corporations. It is negotiable by endorsement and delivery. The Reserve Bank of India permitted its introduction in January 1990 as an additional source of short-term finance to corporates and also as an avenue for investment of funds by large investors. All eligible issuers are required to obtain a credit rating for issuance of Commercial Paper from a credit rating agency as may be specified by the Reserve Bank of India from time to time. The minimum credit rating should be P-2 of CRISIL or equivalent rating by other agencies. P can be issued for maturities between a minimum of 7 days and a maximum up to one year from the date of issue and can be issued in denominations of Rs. 5 lakh or multiples thereof. CP may be issued to and held by individuals, banking companies, other corporate bodies registered or incorporated in India and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs). However, investment by FIIs would be within the limits set for their investments by Securities and Exchange Board of India. Mutual Funds, Banks, Insurance companies etc are the dominant investors in the CP market. Secondary market trading takes place through the interbank broking market between institutional participants. CPs are issued at a discount to face value, as may be determined mutually by the issuer & investor.

- **Call / Notice & Term Money:**
  The call/notice/term money market is a market for trading very short term liquid financial assets that are readily convertible into cash at low cost. The period of lending may be for a period of 1 day which is known as call money and between 2 days and 14 days which is known as notice money. Term money refers to borrowing/lending of funds for a period exceeding 14 days. The interest rates on such funds depend on the surplus funds available with lenders and the demand for the same which remains volatile. The trades are conducted both on telephone as well as on the NDS Call system, which is an electronic screen based system set up by the RBI for negotiating money market deals between entities permitted to operate in the money market. The settlement of money market deals is by electronic funds transfer on the Real Time Gross Settlement (RTGS) system operated by the RBI. The repayment of the borrowed money also takes place through the RTGS system on the due date of repayment. (To view ongoing rates, search on Google : India Call Money Closing)

- **Intercorporate Deposits:**
  An ICD is an unsecured loan extended by one corporate to another. This market allows corporates with surplus funds to lend to other corporates. Also the better-rated corporates can borrow from the banking system and lend in this market. As the cost of funds for a corporate is much higher than that for a bank, the rates in this market are higher than those in the other markets. Also, as ICDs are unsecured, the risk inherent is high and the risk premium is also built into the rates. The tenor of ICD may range from 1 day to 1 year, but the most common tenor of borrowing is for 90 days. The market of inter-corporate deposits maintains secrecy. The brokers in this market never reveal their lists of lenders and borrowers, because they believe that if proper secrecy is not maintained the rate of interest can fall abruptly.

  The market of inter-corporate deposits depends crucially on personal contacts. The decisions of lending in this market are largely governed by personal contacts.

- **Repo:**
  Repo is a money market instrument, which enables collateralised short term borrowing and lending through sale/purchase operations in debt instruments. Under a repo transaction, a holder of securities sells them to an investor with an agreement to repurchase at a predetermined date and rate. In the case of a repo, the forward clean price of the bonds is set in advance at a level which is different from the spot clean price by adjusting the difference between repo interest and coupon earned on the security. In the money market, this transaction is nothing but collateralised lending as the terms of the transaction are structured to compensate for the funds lent and the cost of the transaction is the repo rate. In other words, the inflow of cash from the transaction can be used to meet temporary liquidity requirement in the short term money market at comparable cost. Repo period could be overnight term, open or flexible. Overnight repos last only one day. If the period is fixed and agreed in advance, it is a term repo where either party may call for the repo to be terminated at any time although requiring one or two days’ notice. Though there is no restriction on the maximum period for which repos can be undertaken generally term repos are for an average period of one week.

(To view RBI Notifications Here)
(To view CDs Traded)
(View RBI Notifications Here)
The world was a different place when the International Finance Corporation (IFC) was established in 1956. No one spoke of emerging markets. There was no worldwide trend toward privatization, no communications revolution, no globalized economy. World population was less than half of what it is today. The economies of poor countries were still in very early stages of development, lacking the human resources, physical infrastructure and sound institutions needed to raise incomes and improve living standards. The responsibility for development was almost universally assigned to the public sector. Private sector investment in developing countries was small and not much thought was given to increasing it. It was into this environment that IFC was born.

For several years officials of the World Bank had been supporting the creation of a new and different entity to complement their own. The Bank had been founded to finance Post-World War II reconstruction and development projects by lending money to member governments and had been doing so effectively. Yet in its initial years, some senior staff had seen the need for creating a related institution to spur greater private sector investment in poor countries.

Major international corporations and commercial financial institutions at the time showed relatively little interest in working in Africa, Asia, Latin America or the Middle East. Entrepreneurs in these regions had few domestic sources of capital to draw upon anti even less from abroad. They needed a catalyst.

At the 1944 Bretton Woods Conference that led to the creation of the Bank and the International Monetary Fund, initial proposals for this kind of support had been made and rejected. These proposals would have given the Bank the ability to meet some of these goals by lending to private companies without government guarantees. Then, in the late 1940s, the concept was greatly refined by Bank President Eugene R. Black and his Vice President, former U.S. banker and General Foods Corporation executive Robert L. Garner.

Garner was an ardent believer in the role of private enterprise, addressing the Inaugural Meeting of IFC’s Board of Governors on November 15, 1956, he said, “I believe deeply that the most dynamic force in producing a better life for people and a more worthy life, comes from the initiative of the individual the opportunity to create, to produce, to achieve for himself and his family each to the best of his individual talents. And this is the essence of the system of competitive private enterprise 20th century model as it has been developed by the most enlightened and successful business concerns. It holds the promise of rewards according to what the individual accomplishes. It is based on the concept that it will benefit most its owners and managers if it best satisfies its customers; if it promotes the legitimate interests of its employees; if in all regards it acts as a good citizen of the community. It is moved by the desire to earn a profit a most respectable and important motive, as long as profit comes from providing useful and desirable goods and services. It is my belief that the best services and the best profits result from a competitive system wherein skill and efficiency get their just reward.”

Gainer worked with his assistant Richard Demuth and others to create a new private sector investment arm affiliated with the Bank, rather than having it lend directly from its own resources to the private sector.

This new multilateral entity, at first internally termed the International Development Corporation, would be owned by governments but act like a corporation and be equally comfortable interacting with the public and private sectors. It would lend money, take equity positions and provide the technical expertise in appraising private investment proposals in developing countries, as the Bank was doing for public sector projects. It also would work alongside private investors, assuming equal commercial risks.

In the process of removing some of the major barriers to new private investment in developing countries, it would encourage the domestic capital formation needed to create jobs, increase foreign exchange earnings and tax revenues and transfer knowledge and technology from north to south.

The idea received its first official backing in the March 1951, report of a United States (U.S) development policy advisory board headed by Nelson Rockefeller. This panel conceived of a package to add considerable value to the Bank’s own product by encouraging the growth of productive private enterprises that would contribute many key components to development.

One such component, Garner wrote, was entrepreneurship “that elusive combination of imagination to see an opportunity and to mobilize the necessary resources to seize it.” Another was the mobilization of new capital from private investors willing to take substantial risks in return for potentially large rewards.

Others included job creation, new labour skills, management capacity and technological advances. In the process business owners in developing countries would “successfully transmute machines, labour and capital into a dynamic going concern, producing at competitive cost goods of a quality that the market will accept.”

Garner actively marketed the concept. After the 1952, presidential elections, the United States reduced its support for the idea, eventually endorsing a modified proposal two years later that left IFC to start business with no equity investment powers (this provision was changed in 1961). Other nations then came aboard and the formal Articles of Agreement were drafted by the Bank in 1955.

**IFC’s Articles of Agreement:**

The IFC Articles of Agreement came into force on July 20, 1956, when the requisite number of at least 30 member countries subscribing at least $75 million to IFC’s capital was attained. The initial total authorized capital was $100 million.

The first thirty-one member countries as of July 20, 1956 were: Iceland, Canada, Ecuador, United States, Egypt, Australia, Mexico, Costa Rica, Ethiopia, Peru, Dominican Republic, United Kingdom, Panama, Ceylon, Haiti, Guatemala, Nicaragua, Bolivia, Honduras, India, El Sal-
IFC’s Articles of Agreement enshrined three critical principles. The founders insisted that IFC adopt a business principle, taking on the full commercial risks of its investments, accepting no government guarantees and earning a profit from its operations; be an honest broker, using its unique abilities as a corporation owned by governments to “bring together investment opportunities, domestic and private capital and experienced management,” and play a catalytic role, investing only in projects for which “sufficient private capital is not available on reasonable terms.

IFC is Launched:
Robert L. Garner was appointed President of IFC by its Board of Directors on July 24, 1956. He holds the distinction of being the only person to hold the position of President of IFC without also being President of the World Bank. All of Garner’s successors have been titled “Executive Vice President”, with the President of the Bank being President of IFC also.

Garner opened IFC’s inaugural press conference the next day by saying that IFC was the first intergovernmental organization, which had as its main objective the promotion of private enterprise. He believed private enterprise to be the most effective and dynamic force for economic development.

IFC would benefit not only the underdeveloped but also the industrial countries. There was increasing interest in overseas investment and expansion on the part of established companies in the developed countries.

Private enterprise was the only weapon the free world possessed which the communists did not. That was one of the reasons, Garner said, why he welcomed the establishment of this new organization, after several years of preparation.

Member Countries: IFC has 181 member countries. To join IFC, a country must:

i. Be a member of the World Bank (IBRD);
ii. Have signed IFC’s Articles of Agreement; and
iii. Have deposited with the World Bank Group’s Corporate Secretariat an Instrument of Acceptance of IFC’s Articles of Agreement.

IFC Staff:
Garner appointed John G. Beevor to be Vice President of IFC, Richard H. Demuth, who had done much to foster the establishment of IFC, to be Assistant to the President and Davidson Sommers to be General Counsel.

Beevor had been engaged in preparatory work on the organization of IFC since March 1956, when he was released from his position as Managing Director of the Commonwealth Development Finance Company Limited of London to join the staff of the Bank.

Demuth was Director of the Bank’s Technical Assistance and Liaison Staff and Sommers was the Bank’s General Counsel. Both Demuth and Sommers had been associated with the Bank since 1946 and would continue to hold their positions in the Bank while serving in IFC. The Treasurer, Secretary, Director of Administration and Director of Information of the Bank were appointed to the same positions in IFC.

Apart from its management, IFC’s own staff consisted of an Engineering Adviser, with one assistant and of each of the following officers, of six different nationalities. IFC also had its own administrative assistants.

Initial Inquiries:
IFC received a large number and variety of inquiries and proposals with reference to possible investments in many of its member countries. As was inevitable with a new type of international financial organization, many inquiries were based on a misunderstanding of its purpose, which is to use its funds for investment in private enterprises and not to finance transactions such as, export credits Instalment sales, ship mortgages and the like.

Other inquiries involving commercial or agricultural projects were declined in view of IFC’s policy to confine its activities, in the earlier years, to the field of industrial enterprise, which includes processing of agricultural products and mining.

A number of investment proposals which at first appeared promising showed, after investigation weaknesses of various types making them unsuitable for IFC financing. On the other hand, several proposals on which considerable work was done were postponed or withdrawn by the sponsors for various reasons. Some decided to do the entire financing themselves; some secured financing from other sources. A few were withdrawn because of inability to agree on financial terms.

First Operations:
On June 20, 1957, IFC reached agreement for a $2 million investment in Siemens Company This investment, together with the equivalent of $8.5 million being invested by Siemens of Germany, was to be used to expand the plant facilities and business of Siemens in Brazil for the manufacture of electric generating equipment, switchgear, transformers, large motors and accessories for utility and industrial application as well as telephone equipment. This was the first integrated plant for manufacture of such, a broad range of heavy electrical apparatus in Brazil.

On August 13, 1957, IFC reached agreement for an investment equivalent to $600,000 in Engranes Industries, a Mexican company owned by Mexican and American stockholders. The investment would help to expand the plant facilities and business for the manufacture and sale of a variety of industrial products and components, to include the addition of machine tooling for the manufacture of automotive and other mechanical parts, a forge shop and an electric steel furnace.

IFC’s Vision, Values, & Purpose:
IFC’s vision is that people should have the opportunity to escape poverty and improve their lives.
IFC’s values are excellence, commitment, integrity and teamwork.
IFC’s Purpose is to create opportunity for people to escape poverty and improve their lives by:

i. Promoting open and competitive markets in developing countries.
ii. Supporting companies and other private sector partners where there is a gap.
### About IFC Financing:

IFC offers a wide variety of financial products for private sector projects in developing countries. To be eligible for IFC funding, a project must meet a number of criteria. The project must:

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<th>Criteria</th>
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<td>i.</td>
<td>Be located in a developing country, that is a member of IFC;</td>
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<td>ii.</td>
<td>Be in the private sector;</td>
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<td>iii.</td>
<td>Be technically sound;</td>
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<td>iv.</td>
<td>Have good prospects of being profitable;</td>
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<td>v.</td>
<td>Benefit the local economy; and</td>
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Be environmentally and socially sound, satisfying IFC environmental and social standards as well as those of the host country. IFC does not lend directly to micro, small and medium enterprises or individual entrepreneurs, but many of our investment clients are financial intermediaries that on-lend to smaller businesses.

### Investment proposal:

A company or entrepreneur seeking to establish a new venture or expand an existing enterprise can approach IFC directly by submitting an investment proposal. After this initial contact and a preliminary review, IFC may proceed by requesting a detailed feasibility study or business plan to determine whether or not to appraise the project.

### Government Co-operation:

Although IFC is primarily a financier of private sector projects, it may provide finance for a company with some government ownership, provided there is private sector participation and the venture is run on a commercial basis. Although IFC does not accept government guarantees for its financing, its work often requires close cooperation with government agencies in developing countries.

### Pricing and Financing Ceilings:

To ensure the participation of investors and lenders from the private sector, IFC limits the total amount of own-account debt and equity financing it will provide for any single project. For new projects the maximum is 25 percent of the total estimated project costs, or, on an exceptional basis, up to 35 percent in small projects. For expansion projects, IFC may provide up to 50 percent of the project cost, provided its investments do not exceed 25 percent of the total capitalization of the project company.

IFC provides a wide variety of financial products and services to its clients and can offer a mix of financing and advice that is tailored to meet the needs of each project. However, the bulk of the funding, as well as leadership and management responsibility, lies with private sector owners.

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Like other private sector investors and commercial lenders, IFC:

- Provides a wide variety of financial products and services.
- Tailors its services to the needs of each project.
- Limits the total amount of own-account debt and equity financing it provides for any single project.
- Offers a mix of financing and advice that is tailored to meet the needs of each project.

IFC’s governance is dynamic, continuously adjusting to the evolving needs of its clients in emerging markets. It is no longer defined predominantly by the role in providing project finance to companies in developing countries.

- **Developed innovative financial products**
- **Broadened our capacity to provide advisory services**
- **Deepened our corporate governance, environmental and social expertise**
- **Developed innovative financial products**
- **Broadened our capacity to provide advisory services**
- **Deepened our corporate governance, environmental and social expertise**

IFC’s purpose is to fight poverty with passion and professionalism for lasting results. To help people help themselves and their environment by providing resources, sharing knowledge, building capacity and forging partnerships in the public and private sectors.

### IFC Governance:

IFC’s corporate powers are vested in the Board of Governors, which delegates most powers to a board of 24 directors. Voting power on issues brought before them is weighted according to the share capital each director represents. The directors meet regularly at World Bank Group headquarters in Washington, DC, where they review and decide on investment projects and provide overall strategic guidance to IFC management.

Directors also serve on one or more standing committees, which help the Board discharge its oversight responsibilities by examining policies and procedures in depth. The Audit Committee advises on financial and risk management, corporate governance and oversight issues.

The Budget Committee considers business processes, administrative policies, standards and budget issues that have a significant impact on the cost-effectiveness of Bank Group operations.

The Committee on Development Effectiveness focuses on operations and policy evaluation and development effectiveness with a view to monitoring progress on poverty reduction. The Personnel Committee advises on compensation and other significant personnel policies. Directors also serve on the Committee on Governance and Executive Directors’ Administrative Matters.

### Products & Services:

IFC is a dynamic organization, constantly adjusting to the evolving needs of its clients in emerging markets. It is no longer defined predominantly by the role in providing project finance to companies in developing countries.

- **Developed innovative financial products**
- **Broadened our capacity to provide advisory services**
- **Deepened our corporate governance, environmental and social expertise**

### IFC’s Shared Mission:

IFC, as the private sector arm of the World Bank Group, shares its mission:

- To fight poverty with passion and professionalism for lasting results. To help people help themselves and their environment by providing resources, sharing knowledge, building capacity and forging partnerships in the public and private sectors.

### IFC’s Shared Mission:

In order to achieve its Purpose, IFC offers development impact solutions through: firm-level interventions (direct investments and advisory services); standard-setting; and business enabling environment work.
i. Seeks profitable returns;
ii. Prices its finance and services in line with the market; and fully shares risks with its partners.

Financial Crisis: IFC's Response:
IFC, the largest multilateral financial institution investing in the private sector in emerging markets, has launched a broad and targeted set of initiatives to help private enterprises cope with the global financial and economic crises. Financing for these initiatives is expected to total more than $31 billion over the next three years, combining IFC funds with contributions mobilized from various sources, including governments and other international financial institutions.

IFC targeted initiatives include:

i. Microfinance Enhancement Facility
ii. Trade Finance Programs
iii. IFC Recapitalization Fund
iv. Infrastructure Crisis Facility
v. IFC Advisory Services
vi. Joint IFC Action Plan for Central & Eastern Europe

IFC's crisis response addresses both the immediate and anticipated needs of its clients, it aims to help restore liquidity, rebuild financial infrastructure, manage troubled assets and alleviate specific regional difficulties.

Our initiatives complement the work of governments and international bodies such as, the International Monetary Fund (IMF) and World Bank. We are also working closely with other international financial institutions and development finance institutions to ensure a coordinated response.

International Finance Corporation (I.F.C.): Objectives and Working

The International Finance Corporation was established in July 1956, with the specific subject of providing finance to the private sector. Though it is affiliated to the World Bank, it is a separate legal entity with separate fund and functions. Members of the World Bank are eligible for its membership.

Objectives:

IFC's objective is to assist economic development by encouraging the growth of productive private enterprise in its member nations, particularly in the underdeveloped areas.

Thus, it laid down the following objectives:

1. To invest in productive private enterprises, in association with private investors, and without government guarantee of repayment, in cases where sufficient private capital is not available on reasonable terms.
2. To serve as a clearing house to bring together investment opportunities, private capital (both foreign and domestic) and experienced management.
3. To help in stimulating the productive investment of private capital, both domestic and foreign.

Working:
The IFC considers only such investment proposals whose objective is the establishment, expansion or improvement of productive private enterprises which will contribute to the development of the economy of the country concerned. Industrial, agricultural, financial, commercial, and other private enterprises are eligible for IFC financing, provided their operations are productive in character.

The IFC is authorised to invest its funds in many forms it deems appropriate, with the exception of capital stocks and shares. It does not have a policy of uniform interest rates for its investments. The interest rate is to be negotiated in each case in the light of all relevant factors, including the risks involved and any right to participation in profits, etc.

IFC makes investments only when it is satisfied that the enterprise has or will have experience and competent management and it looks to that management to conduct the business of the enterprise. It does not itself assume responsibility of managing the enterprise.

In India the IFC has so far made six investment commitments totalling over $7 million. However, the actual working of the IFC has been rather slow. That there is great scope for its work is quite evident from its resources and investment portfolios. It is hoped that IFC will in future be more fully able to play a dynamic investor’s role in the economic development of the poor nations.

Need for a New International Financial Architecture and Suggestions to Achieve it

The world needs a new international financial architecture, including a global economic institution for several reasons. These are:

i. The existing international financial institutions have been inefficient in dealing with the present economic crisis. The IMF was set up with a view to maintain an international monetary system that would promote exchange rate stability. The World Bank was set up to help build war ravaged nations. The prevailing global economic conditions have little or no similarity to the conditions at that time.

ii. Prospects for enhancing the effectiveness of the existing international financial institutions are bleak. There have been indications of delays and failures, not to talk of the role with respect to ‘surveillance’ that the IMF is mandated to perform.

iii. In the wake of the international financial crisis in 2008, at the G-20 Summit towards the end of 2008, an Action Plan has been formulated to meet the situation. The plan consists of both short-term and medium term measures. It, however, appears unlikely that either the IMF or the World Bank is geared to perform this task.

iv. A new international architecture, including a new global economic intuition is required to enable the global economy to become more fair and equitable, and thereby also more sustainable. Present day globlisation has created tremendous potential for creating prosperity and for reducing global inequalities with growth rates of developing countries far outpacing those of the developed world. However, globalisation has been accompanied by accentuation of income inequalities across nations and within nations.

In short, action to build a fair and inclusive globalisation through a new financial architecture is urgently required.
Suggestions for a New International Financial Architecture

It is imperative to design a new international financial architecture.

For this purpose, a few suggestions can be advanced as follows:

1. The process and institutional design that the new architecture develops must be inclusive:
The new institution should give adequate attention and support to both industrial and developing countries, and to both large and small countries. Its governance system must be based on representative institutions, not on any adhoc grouping of countries (e.g. a G-8, a G-13 or a G-20). There is a need for a deeper involvement of the United National (UN) in any reform process, as it is representative of most global institutions.

2. The regulatory deficit of global finance must be corrected:
The crisis in the international financial system is closely associated with inadequate regulation and supervision of financial activities. Asia since the crisis of the 1990s, it has become an established criterion that financial liberalisation must be accompanied by stronger prudential regulation and supervision. This principle has been applied in many parts of the developing world but was entirely disregarded in the US, where further liberalisation was accompanied by deregulation and weak supervision of financial inter-mediation.

It is important, in this context, to follow the following basic regulatory principles:

(a) Regulations must be comprehensive, to avoid the massive loopholes through non-banking inter-mediation that led to the 2008 turmoil. This will include regulating the types of transactions that led to this crisis, particularly securitisation and derivatives, and force all the markets to be open and transparent thus limiting the over-the-counter operations.

(b) Regulations should have strong counter-cyclical focus, which would avoid excessive indebtedness and force the accumulation of increasing capital and provisions during booms.

(c) When pricing assets according to their market value to maintain transparency, the system must have mechanisms to avoid asset price bubbles from feeding into the credit expansion, and asset price busts from feeding into the credit squeeze.

(d) Reliance on the internal models of financial institutions should be discarded. It has already shown how perilous it can be, and how the use of similar risk models by financial institutions can lead to greater instability. The new models should focus on restricting monopoly power, encouraging diversification and avoiding unsafe financial products.

(e) Any system that is designed in this area should be based on a well-functioning network of national and regional authorities and includes truly international supervision of financial institutions with a global reach. The IMF should not be at the centre of the regulatory system.

3. The IMF should be revamped:

Four essential reforms of the IMF should be part of the reform agenda.

The first is the creation of a meaningful and truly global reserve currency, which could be based on the IMF special drawing rights. This would overcome both the inequities and the instability that is inherent in a global reserve system based on a national currency.

The second issue is the need to place the IMF at the centre of global macro-economic co-ordination, not the G-7 or in fact any group. This is the only way to give developing countries a voice on the issue.

The third issue is the need for the IMF to lend during BOP crisis rapidly and without overburdening conditionalities, particularly when the sources of the crisis are a rapid reversal of capital flows and a sharp deterioration in the terms of trade.

As fourth issue, the IMF should encourage and advise countries on what regulations to impose under given circumstances. Indeed, the regulatory structure that must be developed to manage financial stability in the global era should include provisions that apply to cross-border capital movements such as generalised reserve requirements on cross-border flows, minimum stay periods, and prohibitions to lend in foreign currencies to economic agents that do not have revenues in those currencies.

4. A coordinated global macro-economic policy package must be urgently adopted:

Both developed and developing countries should form part of such an effort.

5. An international debt count must be created:
The lack of a regulatory institutional framework to manage debt is one of the major deficiencies of the current international financial architecture. The new international financial architecture should solve this problem by creating an international debt court, which would serve as both mediator and eventual arbitrator of both public and private sector international loans.

6. The system must rely more broadly on regional institutions:

In all areas of reform, the IMF should make more active use of regional institutions and support their creation in other parts of the developing world. Indeed, the IMF of the future should be seen as the apex of a network of regional reserve funds.

The developing countries are in an excellent position to contribute to this task, given their large foreign exchange reserves. These reserves and existing sovereign wealth funds could also be used for creating the multilateral development banks owned by developing countries, and by investing in the capital bonds issued by such institutions.

Other Financial services
Leasing and Hire Purchase

Difference between Lease Financing Vs. Hire Purchase

Lease finance and hire purchase are the options of financing the assets. These options vary from each other in many aspects viz. ownership of the asset, depreciation, rental payments, duration, tax impact, repairs and maintenance of the asset and the extent of finance.
Starting any business involves a lot of financial planning for acquisition of fixed assets like land, plant and machinery etc. Most entrepreneurs are scared of capital intensive projects due to huge financial commitments. When large capital is involved in the business, an entrepreneur wishes to spread his cost of acquisition of fixed assets over a longer period. A longer period would reduce per year commitment towards the cost of an asset.

The intention is to match the commitment with the revenue generated per year so that the payments are easily manageable without any cash flow mismatch.

Lease and Hire purchase is an exact solution to that kind of financial arrangement where the cash commitment is spread over the life of the asset and on the top, lease financing does not even require any initial capital outflow also. Hence under lease, the entrepreneur can use his capital for other working capital requirements.

**Lease:**
In simple words, Lease is a financial contract between the business customer (user) and the equipment supplier (normally owner) for using a particular asset/equipment over a period of time against the periodic payments called “Lease rentals”.

The lease generally involves two parties i.e. the lessor (owner) and the lessee (user). Under this arrangement, the lessor transfers the right to use to the lessee in return of the lease rentals agreed upon. A lease agreement can be made flexible enough to meet the financial requirements of both the parties.

**Hire Purchase:**
Hire Purchase is a kind of instalment purchase where the businessman (hirer) agrees to pay the cost of the equipment in different instalments over a period of time. This instalment covers the principal amount and the interest cost towards the purchase of an asset for the period the asset is utilized. The hirer gets the possession of the asset as soon as the hire purchase agreement is signed. The hirer becomes the owner of the equipment after the last payment is made. The hirer has the right to terminate the agreement anytime before taking the title or the ownership of the asset.

**Difference between Lease and Hire Purchase:**
7. Ownership of the Asset: In a lease, ownership lies with the lessor. The lessee has the right to use the equipment and does not have the option to purchase. Whereas in hire purchase, the hirer has the option to purchase. The hirer becomes the owner of the asset/equipment immediately after the last instalment is paid.
8. Depreciation: In lease financing, the depreciation is claimed as an expense in the books of the lessor. On the other hand, the depreciation claim is allowed to the hirer in the case of hire purchase transaction.
9. Rental Payments: The lease rentals cover the cost of using an asset. Normally, it is derived with the cost of an asset over the asset life. In the case of hire purchase, instalment is inclusive of the principal amount and the interest for the time period the asset is utilized.
10. Duration: Generally lease agreements are done for longer duration and for bigger assets like land, property etc. Hire Purchase agreements are done mostly for shorter duration and cheaper assets like hiring a car, machinery etc.
11. Tax Impact: In the lease agreement, the total lease rentals are shown as expenditure by the lessee. In hire purchase, the hirer claims the depreciation of asset as an expense.
12. Repairs and Maintenance: Repairs and maintenance of the asset in the financial lease are the responsibility of the lessee but in operating lease, it is the responsibility of the lessor. In hire purchase, the responsibility lies with the hirer.
13. The extent of Finance: Lease financing can be called the complete financing option in which no down payments are required but in the case of hire purchase, the normally 20 to 25 % margin money is required to be paid upfront by the hirer. Therefore, we call it a partial finance like loans etc.

Businessmen can opt option of lease finance or the hire purchase but they should be analyzed properly as to how much the option suits to the business requirement and situations.

**Hire Purchase: Meaning, Features, Advantages and Disadvantages**

**Meaning:**
Hire purchase is a method of financing of the fixed asset to be purchased on future date. Under this method of financing, the purchase price is paid in instalments. Ownership of the asset is transferred after the payment of the last instalment.

**Features of Hire Purchase:**
The main features of hire purchase finance are:
1. The hire purchaser becomes the owner of the asset after paying the last instalment.
2. Every instalment is treated as hire charge for using the asset.
3. Hire purchaser can use the asset right after making the agreement with the hire vendor.
4. The hirer has the right to repossess the asset in case of difficulties in obtaining the payment of instalment.

**Advantages of Hire Purchase:**
Hire purchase as a source of finance has the following advantages:

i. Financing of an asset through hire purchase is very easy.
ii. Hire purchaser becomes the owner of the asset in future.
iii. Hire purchaser gets the benefit of depreciation on asset hired by him/her.
iv. Hire purchasers also enjoy the tax benefit on the interest payable by them.

**Disadvantages of Hire Purchase:**
Hire purchase financing suffers from following disadvantages:

i. Ownership of asset is transferred only after the payment of the last instalment.
ii. The magnitude of funds involved in hire purchase are very small and only small types of assets like office equipment, automobiles, etc., are purchased through it.

iii. The cost of financing through hire purchase is very high.

Hire Purchase System: it’s Advantages and Disadvantages

Hire Purchase System: it’s Advantages and Disadvantages!

Under hire purchase system, the purchaser gets the possession of the goods without paying the full price for them. He makes the part payment at the time of purchase and the balance is paid in easy instalments periodically. The important ingredient of this system is that the buyer becomes the owner of the goods only after full and final payment of all the instalments, till then he hires the goods and every instalment is treated as hiring charges paid by him.

If the purchaser makes default in the payment of an instalment, the seller can take back the possession of the goods. Some of the important definitions of hire purchase system are given here:

“Hire Purchase System is a system under which money is paid for goods by means of periodical instalments with the view of ultimate purchase. All money being paid in the mean time is regarded as payment of hire and the goods become the property of the buyers only when all the instalments have been paid.” — Carter

“The hire-purchase is a form of trade in which credit is granted to the customer on the security of a lien on the goods.” — J. Stephenson

From the above mentioned definitions it is clear that the buyer takes the delivery of the article on the payment of first instalment and becomes the owner only after paying the final instalment. Hire purchase type of business is usually carried in the case of durable consumer articles like sewing machines, televisions, desert coolers and refrigerators etc.

Advantages of Hire Purchase System:

1. Convenience in Payment: - The buyer is greatly benefited as he has to make the payment in instalments. This system is greatly advantageous to the people having limited income.

2. Increased Volume Of Sales: - This system attracts more customers as the payment is to be made in easy instalments. This leads to increased volume of sales.

3. Increased Profits: - Large volume of sales ensures increased profits to the seller.

4. Encourages Savings: - It encourages thrift among the buyers who are forced to save some portion of their income for the payment of the instalments. This inculcates the habit to save among the people.

5. Helpful For Small Traders: - This system is a blessing for the small manufacturers and traders. They can purchase machinery and other equipment on instalment basis and in turn sell to the buyer charging full price.

6. Earning Of Interest: - The seller gets the instalment which includes original price and interest. The interest is calculated in advance and added in total instalments to be paid by the buyer.

7. Lesser Risk: - From the point of view of seller this system is greatly beneficial as he knows that if the buyer fails to pay one instalment, he can get the article back.

Disadvantages of Hire Purchase System:

1. Higher Price: - A buyer has to pay higher price for the article purchased which includes cost plus interest. The rate of interest is quite high.

2. Artificial Demand: - Hire purchase system creates artificial demand for the product. The buyer is tempted to purchase the products, even if he does not need or afford to buy the product.

3. Heavy Risk: - The seller runs a heavy risk under such system, though he has the right to take back the articles from the defaulting customers. The second hand goods fetch little price.

4. Difficulties in Recovery of Instalments: - It has been observed that the sellers do not get the instalments from the purchasers on time. They may choose wrong buyers which may put them in trouble. They have to waste time and incur extra expenditure for the recovery of the instalments. This sometimes led to serious conflicts between the buyers and the sellers.

5. Break Up Of Families: - The system puts a great financial burden on the families which cannot afford to buy costly and luxurious items. Recent studies in western countries have revealed that thousands of happy homes and families have been broken by hire purchase buying’s.

Lease Financing: Types, Advantages and Disadvantages

Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee. The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Different Types of Lease:

i. Finance Lease: - It is the lease where the lessor transfers substantially all the risks and rewards of ownership of assets to the lessee for lease rentals. In other words, it puts the lessee in the same condition as he/she would have been if he/she had purchased the asset. Fi-
lease has two phases: The first one is called primary period. This is non-cancellable period and in this period, the lessor recovers his total investment through lease rental. The primary period may last for indefinite period of time. The lease rental for the secondary period is much smaller than that of primary period.

### ii. Features of Finance Lease:
- From the above discussion, following features can be derived for finance lease:
  1. A finance lease is a device that gives the lessee a right to use an asset.
  2. The lease rental charged by the lessor during the primary period of lease is sufficient to recover his/her investment.
  3. The lease rental for the secondary period is much smaller. This is often known as peppercorn rental.
  4. Lessee is responsible for the maintenance of asset.
  5. No asset-based risk and rewards is taken by lessor.
  6. Such type of lease is non-cancellable; the lessee’s investment is assured.

### iii. Operating Lease:
Lease other than finance lease is called operating lease. Here risks and rewards incidental to the ownership of asset are not transferred by the lessee to the lessee. The term of such lease is much less than the economic life of the asset and thus the total investment of the lessor is not recovered through lease rental during the primary period of lease. In case of operating lease, the lessor usually provides advice to the lessee for repair, maintenance and technical knowhow of the leased asset and that is why this type of lease is also known as service lease.

### iv. Features of Operating Lease:
- Operating lease has following features:
  1. The lease term is much lower than the economic life of the asset.
  2. The lessee has the right to terminate the lease by giving a short notice and no penalty is charged for that.
  3. The lessor provides the technical knowhow of the leased asset to the lessee.
  4. Risks and rewards incidental to the ownership of asset are borne by the lessor.
  5. Lessor has to depend on leasing of an asset to different lessee for recovery of his/her investment.

### Advantages and Disadvantages of Lease Financing:

#### i. Advantages:
- Lease financing has following advantages
  - Assured Regular Income: Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income.
  - Preservation of Ownership: In case of finance lease, the lessor transfers all the risk and rewards incidental to ownership to the lessee without the transfer of ownership of asset hence the ownership lies with the lessor.
  - Benefit of Tax: As ownership lies with the lessor, tax benefit is enjoyed by the lessor by way of depreciation in respect of leased asset.
  - High Profitability: The business of leasing is highly profitable since the rate of return based on lease rental, is much higher than the interest payable on financing the asset.
  - High Potentiality of Growth: The demand for leasing is steadily increasing because it is one of the cost efficient forms of financing. Economic growth can be maintained even during the period of depression. Thus, the growth potentiality of leasing is much higher as compared to other forms of business.
  - Recovery of Investment: In case of finance lease, the lessor can recover the total investment through lease rentals.

#### b. To Lessee:
- The advantages of lease financing from the point of view of lessee are discussed below:
  - Use of Capital Goods: A business will not have to spend a lot of money for acquiring an asset but it can use an asset by paying small monthly or yearly rentals.
  - Tax Benefits: A company is able to enjoy the tax advantage on lease payments as lease payments can be deducted as a business expense.
  - Cheaper: Leasing is a source of financing which is cheaper than almost all other sources of financing.
  - Technical Assistance: Lessee gets some sort of technical support from the lessor in respect of leased asset.
  - Ownership: After the expiry of primary period, lessee offers the lessee to purchase the asset—by paying a very small sum of money.

#### ii. Disadvantages:
- Lease financing suffers from the following disadvantages
  - **a. To Lessor:** Lessor suffers from certain limitations which are discussed below:
    - Unprofitable in Case of Inflation: Lessor gets fixed amount of lease rental every year and they cannot increase this even if the cost of asset goes up.
  - **b. To Lessee:** The disadvantages of lease financing from lessee’s point of view are given below:
    - Sales tax may be charged twice: First at the time of purchase of asset and second at the time of leasing the asset.
    - Greater Chance of Damage of Asset: As ownership is not transferred, the lessee uses the asset carelessly and there is a great chance that asset cannot be useable after the expiry of primary period of lease.
    - Compulsion: Finance lease is non-cancellable and even if a company does not want to use the asset, lessee is required to pay the lease rentals.
    - Ownership: The lessee will not become the owner of the asset at the end of lease agreement unless he decides to purchase it.

### Costly:
Lease financing is more costly than other sources of financing because lessee has to pay lease rental as well as expenses incidental to the ownership of the asset.
Understatement of Asset: As lessee is not the owner of the asset, such an asset cannot be shown in the balance sheet which leads to understatement of lessee’s asset.

Debt Securitisation

Debt Securitization – Meaning

In the simplest language, debt securitization is a process where companies raise money by pledging the cash-flows from their current and/or future assets. Unlike a traditional loan, in this case, what is given as collateral to secure the debt is the very present and future receipts/income to be generated from the project (or from any other project) for which the loan is being taken.

The enactment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act) in December 2002 paved the way for securitization in India. On the upside, this allows the company to get cash up front, which can be put to use in the business or be used in order to pay off existing debt.

Types of Debt Securitization

There are 3 types of securitization methods which a company can choose from:

1. **Asset Backed Securitization**: In this method, companies pledge their existing assets with the lending institution to secure the loan.
2. **Mortgage Backed Securitization**: In this method, loans are secured by real estate, wherein the lender has the right to sell the property, if the borrower defaults.
3. **Future Revenue Flow Securitization**: In this, future/prospective cash flows of the company is pledged as security to raise funds, for example – sale of power, toll revenue, rental income etc.

In a lot of industries, particularly infrastructure and power companies, it is common to securitize future earnings (cash flows), to receive loans for current and future expansion. In other words, future cash flows are assigned as collateral against the loan given by the bank or any other financial institutions.

**Example**

Suppose Company ABC wants to open a multiplex and is in need of funds for the same. To raise funds, Company ABC will securitize its future cash flows (cash flows arising from sale of movie tickets and food items in the future) in the form of securities to raise money. This will benefit lenders as they will have a claim over the future cash flows generated from the multiplex. Company ABC will also benefit as loan obligations will be met from cash flows generated from the multiplex itself.

A typical future flow structure involves the **borrowing company selling its future product (receivable) to the financial institution (bank, NBFC etc.)**

Future Flow Securitization – Gaining Importance in Infra Projects

<table>
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<tr>
<th>Sector</th>
<th>Future Flow to be Securitized</th>
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<tr>
<td>Power</td>
<td>Meter rentals</td>
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<td>Receivables from bulk consumers</td>
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<td>Telecom</td>
<td>Phone rentals</td>
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<td>Lease receipt from optical fibers</td>
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<td></td>
<td>Rentals/user charges</td>
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<td>Transport Infrastructure</td>
<td>Toll collection from commercial vehicles</td>
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<td>Airline ticket receivables</td>
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<td>Landing and parking fees for airports</td>
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<td>Coal, Oil &amp; Gas</td>
<td>Revenue from sale of coal, oil, and gas</td>
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<td>Royalty from mining and exploration</td>
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<tr>
<td>Urban Infrastructure</td>
<td>Property tax collection</td>
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This type of securitization provides a new way of financing for many developing countries like India. Sectors like power, infrastructure which require huge capital outlay and where the projects have long gestation periods are increasingly adopting this method of financing.

Infrastructure companies have increasingly started securitizing receivables from their existing projects to arrange funds for setting up new projects. The following table provides a list of future flow securitization opportunities in various sectors:

**Some key features of Future Flow Securitization**

1. **Low interest cost**: Securitization provides a low cost financing option to companies.
2. **Diversification**: Securitization helps the company in diversifying its funding sources.
3. **Uncertain Receivables**: by its very nature, future cash flows are uncertain and depend on various factors like performance of the company, economic conditions, government policies etc.
4. **Credit Risk/default risk**: Since future cash flow transactions involve the transfer of receivables that do not exist at the time of granting of the loan, it is necessary for the lending companies to have a thorough understanding about the borrowing company’s operational record. The lending company always faces a risk as to whether the future cash flows will in fact be generated as per expectations, or at all.

**Securitization of Assets: Concept, Mechanism and Utility**

**Concept of Securitization**

Securitization is a carefully structured process by which a pool of loans and other receivables are packaged and sold in the form of asset-backed securities to the investors to raise the required funds from them. Through this process relatively illiquid assets are converted into securities. Securitization falls under the broad category termed as structured finance transactions. Structured finance refers to securities where the promise to repay the investors is backed by the value of the underlying financial asset or the credit support of a third party to the transaction or some combination of the two. Thus, securitization is nothing but liquefying assets comprising loans and receivables of an institution through systematic issuance of financial instruments.
Structured financing instruments are derivatives of traditionally secured debt instruments where the credit standing of the instrument is supported by a lien on specific assets or by some other form of credit enhancement such as a guarantee. With a conventional secured bond, the primary source of repayment of the bond is still the earning power and cash flow of the issuer.

In a securitized transaction, the burden of repayment on the bond shifts away from the issuer to a pool of assets or to a third party. The cash flows from the pools of assets which have been securitized provide the funds for repayment to the bond.

Securitization is said to have taken place when a company's assets are removed in one way or another from its balance sheet and are funded instead by investors. The investors receive tradable financial instruments evidencing the investment without recourse to lending institution. The entire transaction, from the accounting point of view, is carried out on the asset side of the balance sheet, that is, one asset gets converted into another.

**Mechanism of Securitization:**

Typically, the mechanism of securitization is outlined below:

(i) The process of securitization starts with identification by the company (the originator) the loans or bills receivable in its portfolio, to prepare a basket or pool of assets to be securitized. The package usually forms an optimum mix so as to ensure fair marketability of the instrument to be issued.

Further, the maturities are also so chosen that the package represents one homogeneous lot. The pool of receivables is backed by the underlying securities held by the originator (in the form of mortgage, pledge, charge, etc.).

(ii) The pool of assets so identified is then sold to a specific purpose vehicle (SPV) or trust. Usually an investment banker performs the task of an SPV, which is also called an issuer, as it ultimately issues the securities to investors.

(iii) Once the assets are acquired by SPV, the same are split into individual shares/securities which are reimbursed by selling them to investors. These securities are called 'Pay or Pass Through Certificates' (PTC) which are so structured as to synchronize for redemption with the maturity of the securitized loans or bills.

A PTC thus represents a sale of an undivided interest to the extent of the face value of the PTC in the aggregate pool of assets acquired by the SPV from the originator.

(iv) Repayments under the securitized loans or bills keep on being received by the originator and passed on to the SPV. To this end, the contractual relationship between the originator and the borrowers/obligors is allowed to subsist in terms of the pass through transaction; alternatively a separate agency arrangement is made between the SPV (Principal) and the originator (agent).

(v) Although a PTC could be with recourse to its originator, the usual practice has been to make it without recourse. Accordingly, a PTC holder takes recourse to the SPV and not the originator for payment to the principal and interest on the PTCs held by him. However, a part of the credit risk, as perceived (and not interest risk), can be absorbed by the originator, by transferring the assets at a discount, enabling the SPV to issue the PTCs at a discount to face value.

(vi) The debt to be securitized and the PTC issues are got rated by rating agencies on the eve of the securitization. The issues by the SPV could also be guaranteed by external guarantor-institutions to enhance creditability of the issues. The PTCs, before maturity, are tradable in a secondary market to ensure liquidity for the investors.

From the above, it is evident that the primary participants involved in the issuance of securitization transaction are the originator, obligors, the SPV, the servicer and the credit enhancer. The originator has the assets which are sold or used as collateral for the assets backed securities. Originators are generally manufacturing companies, financial institutions, banks and non-banking finance companies. The term obligors' refers to borrowers who have taken loans from the originators resulting in the creation of the underlying asset. The SPV or trust raises funds to buy assets from the originator by selling securities to investors. It uses the cash flow generated by the financial assets in the pool to pay interest and principal to investors and covers its own costs. The servicer/receiving and paying agent is responsible for collecting principal and interest payments on assets when due and for pursuing the collection from delinquent accounts.

Securitization as a financial instrument is becoming extremely popular the world over with more and more issuers resorting to raising funds through this route. This is for this fact that it confers lot of benefits on the parties to the process.

Securitization serves as handmade to organization in raising additional funds to finance their growth programme. Companies with poor credit standing and therefore finding it difficult to procure resources from the market can obtain funds by issuing asset back securities at lower interest cost due to higher credit rating on such securities. Even if the issuer is not an AAA rated company, it can issue an AAA rated securitized asset.

This can be done by carefully selecting the portfolio on the basis of criteria stipulated by the rating agency. What is more useful is that relatively illiquid assets are converted into marketable securities providing liquidity and alternate funding sources. Another advantage to the company is economy in the use of funds and greater recycling of resources leads to higher business turnover and profitability.
Further, cost of raising funds by way of securitization is cheaper than that involved in funding by way of conventional fund-raising instruments like shares, bonds, debentures, and commercial papers. Through its novel mechanism of diversifying the risk factors, enhancing the credit and removing uncertainties for investors, structured securitization facilitates the originator to access the securities market at debt ratings higher than its overall corporate rating. As a result, the company can secure funds at lower cost.

The cost of raising funds against securitized assets depends essentially on quality of assets to be securitized and image of the issuer in the minds of investors. Obviously, the price at which an asset based securities is sold or the discount which the buyer gets differs from deal to deal. Further, bargaining powers of the negotiations bear upon the cost of acquiring funds through securitization.

Securitization also facilitates strengthening of capital adequacy of the originating company by isolating the loan-assets from the originator’s balance sheet and by removing or replacing them. Securitization is equally useful to investors. It offers multiple new investment instruments for mutual funds, insurance companies, pension funds and general investors to cater to their needs and preferences. Besides widening the choice and availability, it also provides for higher return and liquidity for the instrument.

The unique benefit which investors derive from securitization is that they can look past the issuing entity to the collateral pool that the issue represents. This transparency reduces uncertainty for the investor as to the risk element. Being a structured asset backed security, the instrument provides higher protection against rating down-grades of the originator, as compared to traditional debt securities.

It also provides opportunity for matching cash flows and managing ALM since securitized instrument carries regular monthly cash flows and has varying maturities. The prevalence of secondary markets would offer liquidity.

As a product of raising funds against receivables, securitization is far superior to bills discounting or factoring. Bill discounting has emerged as a working capital product employed to raise funds out of short-term trade receivables. In contrast, securitization is a medium to long-term source. Even in a mature bill market, the sheer quantum of paper work in raising money against bills of long maturities would be a deterrent. Although factoring appears to be similar to securitization as the factor buys the receivables of a company at a discount, there has traditionally been no intention to rate the portfolio or create a secondary market for the receivables.

Further, factoring has emerged as a trade financing tool rather than for medium or long-term financing. However, the securitization process, if not carried out prudently, can leave risks with the originating bank without allocating capital to back them. While all banking activity entails operational and legal risks, these may be greater under more complex activity.

It is felt that the main risk a bank may face in a securitization scheme arises if a true sale has not been achieved and the selling institution is forced to recognize some or all of the losses if the assets subsequently cease to perform. Also, funding risks and constraints on liquidity may arise if assets designed to be securitized have been originated, but because of disturbances in the market, the securities cannot be placed.

Securitization in India: An Overview

This article provides an overview on Securitization in India. After reading this article you will learn about: 1. Introduction to Securitization 2. RBI Policy Guidelines on Asset Securitization 3. Future of Securitization Market in India 4. Suggestions to Strengthen Securitization in India.

Introduction to Securitization:

Despite cataclysmic reforms in financial sector leading to deregulation and disintermediation and widening performances of investors as to return, risk, maturity liquidity, securitization has made little progress in India.

The first widely reported securitization deal in India dates back to 1990 when Citibank securitized auto loans and placed a paper with GIC mutual fund. Fund to the tune of Rs. 15 crore was raised in the transaction in which Citibank acted as the agent of ICICI for issue and redemption of the PTC.

However, as the PTC was in the form of a receipt, it was not freely transferable and there was no secondary market except that premature redemption by Citibank is provided.

Since then there have been a few cases of securitization, important being:

(i) Hire purchase portfolio of TELCO securitized by Citibank;
(ii) Securitization of Citibank’s own portfolio of ‘Citi mobile’ scheme receivables;

According to some estimates, 35 percent of all securitization deals between 1992-1998 related to hire purchase, receivables of trucks and the rest towards other auto/transport segment receivables. Apart from these, some innovative deals were also struck.

Earlier in 1994-95, SBI Cap structured an innovative deal where a pool of future cash flows of high value customers of Rajasthan State Industrial and Development Corporation was securitized. An oil monetization deal has been structured where the future flows of oil receivables accruing to a company were securitized.

Real estate developers have securitized receivables arising out of Instalment sales. The recent securitization deal of Larsen & Toubro has opened a new vista for financing power projects. The deal was a securitization of lease receivables even before the plant was completed. Thus, this securitization deal financed even the asset creation.

The ICICI securitized assets to the tune of Rs. 2750 crore in its books at the end of March, 1999. CRISIL is reported to have rated about Rs. 200 crore of securitized transactions up to 1998. Towards the end of August, 2002, IDBI had floated a securitized product to raise resources by transferring loan assets of L & T and National Hydroelectric Power Corporation to a special purpose vehicle.
SBI capital market was appointed as adviser for Rs. 265 crore issue. Since IDBI was finding tough to raise resources through the bond market due to its poor rating and lack of appetite for IDBI paper among investors, it thought it proper to sell the loan assets to SBI capital markets which enjoyed high credit rating from Crisil. In October, 2002, Reliance Industries approached the LIC for mopping up about Rs. 1,50 crore through a securitization deal. The India’s largest private sector company also raised fund against energy receivables or cash flows from the Panna Mukta and Tapti Oil and Gas Fields.

In recent years, increasing number of commercial banks are selling their stressed assets. In financial year 2005-06, ICICI Bank, HSBC and SBI have sold a part of their NPA’s. The value of the loans put on the black was about Rs. 2,000 crore. SBI has already sold more than Rs. 1,000 crore of its NPA’s to a host of banks including Kotak Mahindra Bank, Standard Chartered Bank, J.P. Morgan and Asset Reconstruction Company.

It is interesting to note that the ICICI Bank has emerged as the biggest institution dealing in securitization. It commands 40 percent of the securitization transactions amounting to Rs. 1929.9 crore backed by its new and old car loans. The ICICI Bank and the HDFC Bank have been securitizing their assist to foreign banks. These banks typically securitize retail loans under portfolios like housing, personal and auto loans. This frees up their funds for further business.

According to Crisil, securitization issuances including corporate single loan sell-downs during 2006-07 were Rs. 22,000 crore and in 2007-08, were expected to be a around Rs. 35000 Rs. 40,000 crore. Mortgage-based securities issued in 2006-07 were about Rs. 1800 crore 5-10 percent of corporate bond issuance in 2006-07.

On the basis of Indian experience, the following features of securitization appear noteworthy:

(i) Most deals have involved the transfer of beneficial interest on the asset and not the legal title.

(ii) Most transactions have followed the pass-through mechanism.

(iii) In-fact, many transactions have followed the escrow mechanism where receivables are transferred to an escrow account for payment to the buyer.

(iv) According to Duff & Phelps India, a rating agency past deals have mostly been direct purchases of receivables by institutions and bigger NBFCs.

(v) Routing the transaction through SPV is yet to gain popularity.

(vi) The market is unregulated and lacks transparency in terms of volume, price, parties to the transaction, etc.

(vii) The settlement procedures are not clear.

(viii) There appears to be no secondary market for securitized debt.

(ix) There are no standard accounting and valuation norms.

The overall progress in the field of securitization has, however, been relatively very slow in India. The current penetration is estimated to be between 2 percent and 5 percent of the total retail assets A securitization market in India is less than 1 percent of the U.S. market. One of the most important reasons for slow growth of securitization in India has been inadequate legal framework which has proved a heavy drag on securitization. For instance, as per transfer of Property Act, 1881 and the definition in the General Clauses Act, the interest in a mortgage in immovable property and the money debt itself backed by the mortgage are both regarded as immovable property. Accordingly, writing ad valorem stamping and registration of documents are automatically attracted whenever the debt and the interest in mortgage are sought to be transferred by the originator to the SPV and the SPV to the investors. Further, in terms of Indian Stamp Act, 1899 and the relative state amendments, stamp duty is liveable on mortgage transactions. In addition to this, the stamp duty is liveable on the PTC an instrument.

The duty is very high if the format of the PTC is either a bond or a promissory note. If it is in the form of a receipt, the negotiability may be difficult although the stamp duty is nominal. High rates of stamp duty in most of Indian states and lack of liquidity in the secondary market have been other deterrents.

Further, the Transfer of Property Act, according to some legal views, has held that assignment of a debt should be in whole and not a part assignment. Furthermore, both the Transfer of Property Act and the Sale of Goods Act hold that only a property currently in existence is capable of being transferred. These laws impede development of securitization in future receivables as transfer of future property does not fall under the definition of debt.

The existing set of foreclosure laws are said to increase the risks of mortgage backed securities by making it difficult to transfer property in cases of default. Some provisions of the Income Tax Act, 1961 are reported to have an impact on securitization. For instance, section 60 of the Act contemplates transfer of income without transfer of assets which are the source of the income. In such a case, the income so transferred is chargeable to income tax as the income of the transfer and is included in his total income. Similarly, there are other sections in the Act which inhibit the progress of securitization.

**RBI Policy Guidelines on Asset Securitization:**

So as to protect interests of investors in securitized debt, the RBI issued guidelines are February 2006, important among these are outlined below:

i. The liquidity facility should be capable of being drawn only where there is a sufficient level of non-default assets to cover drawings or the full amount of assets that may turn non-performing assist covered by a substantial credit enhancement.

ii. The liquidity facility to meet temporary mismatches in receivables should not be drawn for the purposes of providing credit enhancement, covering losses of SPV, serving as a permanent revolving funding and covering any losses incurred in the underlying pool up exposures.

iii. Securities issued to SPV would be in the nature of non- SLR securities. The counter party for investors will not be SPV but the underlying assets of which the cash flows are expected from the borrowers. Such investments will be included to reckon overall exposure to any
individual or group borrowers, industry or geographical areas wherever the obligations in the pool constitute 5% or more of the receivables or Rs. 5 crore whichever is lower. These guidelines hit the market affecting active players like Citibank, Standard Chartered Bank and ICICI Bank because they have prohibited banks to book profit up front on the sale of assets through securitization.

Future of Securitization Market in India:

Although there has been tardy progress of securitization in India it has tremendous scope for growth. This is for the fact that Basel II would need to free up capital and securitization can play an important role in freeing up capital and help capital adequacy. Under Basel II, the capital requirement is likely to increase in the case of unsecured assets such as credit card loans and personal loans and fall for secured assets.

There is also scope for increase in volumes of securitization deal in secondary market which is still in its infancy or virtually nil. The SEBI guidelines regarding listing of ‘pass through certificates is’ also expected to increase trades.

Suggestions to Strengthen Securitisation in India

Development and strengthening of securitization in India, call for concerted efforts on the part of the Central Government, State Governments, RBI and SEBI. The provisions of the Transfer of Property Act, Stamp Act, Registration Act and the Income Tax Act shall have to be examined in detail so as to facilitate securitization in a cost effective manner.

At present, there is no comprehensive regulatory framework for securitization in India. SPV can, therefore, be formed as a company under the Companies Act, 1956 or a Trust under the Indian Trusts Acts 1982. Hence, SPV formed as a company will have to be registered as an NBFC under the RBI Act and is subject to RBI’s regulatory framework. To the extent banks and financial institutions are involved in securitization, they will continue to fall under RBI regulations.

There is a case for widening the market for securitized debt. SEBI has, of late, permitted mutual funds to invest in these securities. A similar extension to FIIs to invest in securitized debt within existing ceilings could be examined. These FIIs, being already familiar with these instruments in other markets, are expected to contribute significantly to the development of this market.

For faster development of a securitized debt market in India, it is necessary to develop suitable infrastructure. The most crucial factor which could popularize the market is credit enhancement which involves use of a guarantor to make sure that principal and interest payments are received by the investing community on a timely basis even when the servicer does not collect these payments from the underlying obligors.

Credit enhancement by way of pool insurance provision for recourse to seller, use of spread accounts, over centralisation, arrangement for stand-by letters of credit from third parties, etc. render the transaction attractive. Securitization of debt on sound and healthy lines is contingent upon market making of securitized debt.

Market making implies providing two-way quotations for selling and buying of these securities in the market. Market makers will have to ensure liquidity for the instruments which have backing of varying types of assets including mortgages.

There is a strong case for evolving suitable accounting norms for recognition of trust created for securitized debt. This becomes more important since the real benefits of securitization could accrue to the originator only when the securitized assets are removed from its balance sheet. The accounting norms, for all practical purposes, should facilitate clearly the removal of assets from the balance sheet of the originator along with transfer of the asset to the newly created trust or SPV.

Accordingly, both the Companies Act, 1956 and the Banking Regulation Act, 1949 need to be amended. The Institute of Chartered Accountants should also lay down norms for treatment of transactions in order to maintain uniformity.

It is also necessary to reduce stamp duty which at present varies between 3 and 5 per cent of the transaction account in general. It is because of this that Maharashtra Govt. reduced in 1994 stamp duty from 3 per cent to 0.10 per cent.

So as to facilitate development of a healthy market for securitized debt in the country, it would be in fitness of things for the regulatory authorities to frame guidelines addressing various aspects of the securitization process. These guidelines should broadly elaborate on its implication for risk based capital framework, selection of assets for securitization, instruments evolved and their residual interests in pools of assets in relation to risk characteristics, etc.

Besides micro level measures, steps at the micro level should also be undertaken. For instance, the most crucial decision which an issuing organisation will have to take is with respect to choice of assets for securitization. The assets will need ranking when the selection itself will be based on least losses to provide for maximum protection to the investor.

The issuer has also to take care of itself from credit risks involved as a default by the original and inability to enforce security could lead to loss of principal and income resulting in a shortfall in funds required to pay on securities created by way of principal and interest.

5 Main Aspects of Debt Instruments


Aspect #1. Interest Rate:

Interest rate can be fixed or floating. Floating rates are variously linked with call rates, bank rate or government security rate, though a firm reference note is not yet available in the market. There are also instruments where interest rates are linked with index of inflation so that real interest rate return stands protected.

Interest rate stated on the face of the debt instrument is called coupon rate. Some debentures/bonds are issued with step-up coupons, where interest rate varies from period to period within the maturity date—generally on an ascending scale from year to year.

Aspect #2. Security:

Debentures/bonds may be secured or unsecured. While conventionally, security is by way of mortgage, or floating charge on fixed assets, some of the new instruments are structured with charge on receivables (generally deposited in an escrow account) pertaining to a specific...
Housing Finance

What are the Important Objectives of National Housing Bank (NIHB)?

The NHB started its operation from July, 1988. The Golden Jubilee Rural Housing Finance Scheme is being implemented through scheduled banks, HFCs and co-operative sector institutions. NIHB is wholly owned by Reserve Bank of India, which contributed the entire paid-up capital.

The general superintendence, direction and management of the affairs and business of NHB vest, under the Act, in a Board of Directors.

NHB has been established to achieve, inter alia, the following objectives:

(a) To promote a sound, healthy viable and cost effective housing finance system to cater to all segments of the population and to integrate the housing finance system with the overall financial system.
(b) To promote and develop specialised housing finance institutions for mobilising resources and extending credit for housing.
(c) To augment resources for the sector and channelise them for housing.
(d) To make housing credit more affordable.
(e) To regulate the activities of housing finance companies based on regulatory and supervisory authority derived under the Act.
(f) To encourage augmentation of supply of buildable land and also building materials for housing and to upgrade the housing stock in the country.
(g) To encourage public agencies to emerge as facilitators and suppliers of serviced land, for housing.
(h) Against a target of 3.50 lakh dwelling units set by the Government of India for the year 2009-10, 3,87,546 units were financed during the period.

Small Industries Development Bank of India (SIDBI):

The SIDBI was established as a wholly owned subsidiary of Industrial Development Bank of India (IDBI) and started its operations on April 2, 1990. It took over the responsibility of administering Small Industries Development Fund and National Equity Fund which were earlier administered by IDBI.

It is engaged in providing assistance to the small scale industrial sector in the country through other institutions like state finance corporations, commercial banks and state industrial development corporations. The financial assistance sanctioned and disbursed by SIDBI during the financial year 2009-10 aggregated to Rs. 421 crore during the financial year 2009-10. Functions of SIDBI:

(i) SIDBI refinance loans extended by the primary lending institutions to small scale industrial units, and also provides resources support to them.
(ii) SIDBI discounts and rediscounts bills arising from sale of machinery to or manufactured by industrial units in the small scale sector.
(iii) SIDBI extends seeds capital/soft loans assistance under National Equity Fund, Mahila Udyam Nidhi and Mahila Vikas Nidhi and seed capital schemes through specified lending agencies.
(iv) It provides services like leasing, factoring etc. to industrial concerns in the small scale sector.

The National Housing Bank has the Following Functions:

The National Housing Bank has the following functions:

i. To promote and develop specialised housing finance institutions for mobilising resources and extending credit for housing
ii. To provide refinance facilities to housing finance institutions and scheduled banks
iii. To provide guarantee and underwriting facilities to housing finance institutions
iv. To formulate schemes for mobilisation of resources and extension of credit for housing, especially catering to the needs of economically weaker sections of society
v. To provide guidelines to housing finance institutions to ensure their healthy growth
vi. To co-ordinate the working of all agencies connected with housing

According to the National Housing Bank Act, the NHB is empowered to raise funds through
(i) The issue of bonds and debentures
(ii) Borrowings from the Central Government and other institutions approved by the Central Government
(iii) Acceptance of deposits of long-term duration
(iv) Short-term accommodation from the Reserve Bank
(v) Long-term loans out of the National Credit (Long-Term Operations) Fund to be established by the RBI for supporting the business of NHB
(vi) Borrowings in foreign currency from banks or financial institutions in India or abroad.

The NHB has a 15-member Board of Directors, who are experts in the fields of housing, architecture, engineering, sociology, finance, law, management and corporate planning, financing institutions involved in housing finance, officials of the Central/State Governments and the Central Board of Directors of the RBI.

Till June 1990, the NHB has disbursed refinance amounting to nearly Rs. 132 crores. It has cleared 56 project proposals for land development and shelter construction involving a total outlay of Rs. 414 crores. This is just a beginning. The NHB has to accelerate its activities to solve the housing problem of the vast country like India. During 1995-96, the NHB formulated a refinance scheme for RRBs to augment the flow of credit for housing activities.

Essay on Housing Problems in Urban Areas (1683 Words)

Essay on Housing Problems in Urban Areas!

Shelter is the basic human requirement. Even after 57 years of independence, the country is still grappling with the growing shelter problem, especially of the poor. The problem has further been compounded by the rapid increase in urban population. Constant migration of rural population to cities in search of jobs is causing unbearable strain on urban housing and basic services. There is a severe housing shortage in the urban areas with demand – supply gap increasing day-by-day. The National Building Organization (NBO) had estimated the 1991 urban housing shortage at 8.23 million, and had expected the absolute shortage to decline progressively to 7.57 million in 1997 and 6.64 million in 2001.

In some small towns in India, the problem is not the lack of housing facilities but the lack of adequate housing facilities. Here, there is a surplus of houses when compared with households but these houses are unfit to reside. The people who are most likely to become homeless are those who have least resources as providing housing is a profit-oriented industry. They cannot purchase houses nor can they afford high rent, so they live in unfit accommodation, as the rents demanded for such an accommodation is much low. Some very poor people prefer to squat rather than even rent an accommodation, thus leading to the growth of slums.

Homelessness:

Homelessness is a complex problem; the circumstances of homeless people vary greatly. Homelessness is sometimes a product of shortage of houses, but in some cases homelessness is caused due to other reasons also. Four main issues are found to be the causes for homelessness:

(i) Shortages of housing: If there are not enough places for people to live, then someone has to go without and those who are excluded are generally the poorest people.

(ii) Entitlement to land: People erect temporary shelters rather than be homeless. Squatters usually build temporary shelters at first, but over time these settlements are given concrete shape and become more established.

(iii) Entitlement to housing: If people are not entitled to use the houses which exist, they may be homeless, even when there is no apparent shortage. Some people are excluded because of their circumstances—street children are an example. The main reason for exclusion, however, is financial—homeless people are those who cannot afford the housing which is available.

(iv) Personal situation of homeless people: Homelessness is often attributed to the characteristics of the homeless person, such as alcoholism and psychiatric illness, or to the social situation of homeless people, such as unemployment and marital breakdown (this condition mostly happens with women in India). People in these situations only become homeless if they are excluded from housing, or do not have enough resources to secure alternative housing.

Congestion:

Many households in urban areas have to cope with increasingly crowded conditions, although this is certainly not true for everyone. The housing conditions improve when people build high buildings, sometimes more than five storeys, to increase the number of houses. Many urban centres have very high population densities. The house owners therefore rent out numerous rooms to migrants. Poor migrants live under the most crowded conditions. They do not have access to ancestral residential land. Therefore, they depend on the rented accommodation, which they often share with many others to save money. Some poor households of the original population also live in very crowded dwellings for two other reasons. First, many families expand and split up into multiple households, while the land available for construction becomes unaffordable. They are thus forced to fit more people into the same space.
or house or else to split up the existing plots and dwellings to accommodate a new household. Second, in the absence of sufficient income from other sources, some households are inclined to rent out a portion of their living space or sheds to tenants.

Consequences of Congestion:
Some of the consequences of congestion (overcrowdedness) are as follows:

i. According to official estimates, the present shortage of houses is about 7 million in urban areas. About 19 per cent of the Indian families live in less than 10 square metres of space leading to congestion. For example, about 44 per cent of families in the urban areas live in one room only.

ii. The economics and health costs of congestion and haphazard movement of traffic are very heavy, besides exposing commuters and pedestrians to a high risk of accidents. Urban environment also suffers from degradation caused due to overpopulation. The dust load in the air in these cities is very high.

iii. Crowding (higher density of population) and peoples' apathy to other persons' problems is another problem growing out of city life. Some homes (which consist of one single room) are so overcrowded that five to six persons live in one room. Overcrowding has very deleterious effects. It encourages deviant behaviour, spreads diseases and creates conditions for mental illness, alcoholism and riots. One effect of dense urban living is people's apathy and indifference. Most of the city dwellers do not want to get involved in others affairs even if others are involved in accidents, or are molested, assaulted, abducted and sometimes even murdered.

Means to Overcome the Problem:
In India, housing is essentially a private activity. The state intervenes only to provide legal status to the land. The state intervention is also necessary to meet the housing requirements of the vulnerable sections and to create a positive environment in achieving the goal of 'shelter for all' on self-sustainable basis.

In view of the above aim, the government introduced Housing and Habitat Policy in 1998, which aimed at ensuring the basic need 'Shelter for all' and better quality of life to all citizens by harnessing the unused potentials in the public, private and household sectors. The central theme of the policy was creating strong Public/Private partnership for tackling the housing and habitat issues.

Under the new policy, government would provide fiscal concessions, carry out legal and regulatory reforms, in short government as a facilitator would create the environment in which access to all the requisite inputs will be in tune in adequate quantum and of appropriate quality and standards.

The private sector, as the other partner, would be encouraged to take up the land for housing construction and invest in infrastructure facilities. Cooperative sector and Public Housing Agencies are also being encouraged to share the responsibility of providing housing facilities. The government has even repealed the Urban Land Ceiling and Regulation Act (ULCRA), 1976, to facilitate land for housing activity.

Upgradation and renewal of old and dilapidated housing is also encouraged.

Another major problem is the lack of resources especially with people belonging to the middle class. To overcome this problem, housing finance institutions such as National Housing Bank, a subsidiary of the Reserve Bank of India, was established in July 1988. The Housing and Urban Development Corporation (HUDCO) also started functioning with the financial support provided by the Government of India. HUDCO's focus is on providing housing facilities for economically weaker sections (EWS) and for low income group (LIG). With the advent of many private banks, a number of schemes such as providing tax concessions and lower interest rates have been introduced to promote the housing sector.

The government has also introduced some schemes to curb the housing problem. They are as follows.

i. Subsidized industrial housing scheme: - This scheme was started in September 1952, to provide houses to the labourers who worked before 1948 and 1952. The Government of India gave loans to the extent of 65 per cent to various industries, state government, legal housing construction societies and cooperative societies to construct houses for the labourers. The labourers could purchase these houses according to the rules framed by the government. But these houses could not be sold or alienated without prior permission of the government. But this scheme did not succeed much because of the lack of cooperation of mill owners. In the third Five-Year-Plan, it was made obligatory for mill owners to provide housing facilities to their labourers. In the fourth Five-Year-Plan, a provision of Rs. 45 crore was made for this purpose. The fifth plan also included similar provisions. Apart from the central government, state governments have also formed various Housing Boards and implemented societies and various schemes.

ii. LIG housing schemes: - This scheme was started in 1954. Persons who have income less than Rs. 600 per annum could get a loan up to 80 per cent. Local and cooperative bodies are given such loans.

iii. Slum clearance and improvement scheme: - This scheme was started in the year 1956 to give financial assistance to the state governments and local bodies for improving the slum areas. It was estimated then that about 12 lakh houses were not fit for dwelling. Hence, the long-term and short-term schemes were started. But as it was not possible to provide houses to all the people living in slum areas, this scheme could not progress satisfactorily.

iv. Middle-income group housing scheme: - Under this scheme, the people of middle-income group are given loans for constructing the houses. The state government also gives loans on low rates of interest.

v. Rental housing schemes: - This scheme was started in 1959 to provide houses on rent to the state government employees.

vi. Land acquisition and development scheme: - The government felt that the LIG and middle-income group people could construct houses if land was made available to them on a reasonable price. For this purpose, a plan was set up under which the state governments could acquire land and plots at suitable places, develop them and give them away to the needy people.

Conclusion:
The government has now started focusing on providing housing facilities but has not thought much about solving problems that are connected with human settlements, such as the problems of improving and managing the civic services, constructing inexpensive houses and conserving energy and recycling waste. Lack of proper water supply and sanitation facilities for drainage system and garbage disposal are major problems in most of the modern urban centres of today.

Credit Cards

WHAT IT IS:
A credit card is a plastic card issued by a financial institution that allows its user to borrow pre-approved funds at the point of sale in order to complete a purchase.

HOW IT WORKS (EXAMPLE):
Credit cards have a maximum amount — or credit limit — the user can borrow during a given period. The credit limit is pre-determined by the card issuer based on the cardholder's credit rating and credit history.

When an individual uses a credit card to make a purchase, he or she is authorizing the credit card issuer to pay the merchant on their behalf. Merchants are required by law to verify that the individual using the card is its rightful owner by obtaining proper identification via a Personal Identification Number (PIN), and/or a driver's license or state-issued ID card.

Merchants generally prefer payment by credit card because they are immediately paid by the card issuer — despite the fee the merchant must pay to the card processing company for each transaction.

Credit card issuers require the cardholder to pay his or her balance in full, usually on a monthly basis. If the user does not pay the balance in full, the issuer adds interest to the balance, and this interest compounds for as long as the balance is outstanding.

As with credit limits, the cardholder's credit rating and credit history can influence the interest rate on the card. In some cases, the issuer can raise the interest rate. There is no federal limit on the interest rates credit card issuers can charge, although many states impose different caps. Many card issuers offer “teaser rates” that start out very low and increase over time.

Issuers use several methods to calculate interest, and it is important for the cardholder to read and understand the issuer’s disclosure statement in order to avoid unpleasant surprises. Many credit cards also charge an annual fee, late payment fees, fees for going over the credit limit, cash-advance fees and foreign-currency conversion fees.

WHY IT MATTERS:
Credit card interest rates are higher than personal loans or lines of credit. Many credit cardholders underestimate the time and money it takes to pay off outstanding balances — especially when interest rates are high and minimum payments are low.

It is important that cardholders not only use credit cards in moderation, but also take preventative action against identity thieves in order to protect their privacy and identity.

Credit cards allow cardholders to avoid carrying cash, earn frequent-flier miles, or accumulate other “rewards” that can be used almost anywhere around the world. With many credit card types, the cardholder can also get cash advances through ATMs.

Credit card

A credit card is a payment card issued to users (cardholders) as a method of payment. It allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card (usually a bank) creates a revolving account and grants a line of credit to the cardholder, from which the cardholder can borrow money for payment to a merchant or as a cash advance.

A credit card is different from a charge card, where it requires the balance to be repaid in full each month. In contrast, credit cards allow the consumers a continuing balance of debt, subject to interest being charged. A credit card also differs from a cash card, which can be used like currency by the owner of the card. A credit card differs from a charge card also in that a credit card typically involves a third-party entity that pays the seller and is reimbursed by the buyer, whereas a charge card simply defers payment by the buyer until a later date.

Technical specifications

The size of most credit cards is 85.60 mm × 53.98 mm (3.370 in × 2.125 in) and rounded corners with a radius of 2.88–3.48 mm, conforming to the ISO/IEC 7810 ID-1 standard, the same size as ATM cards and other payment cards, such as debit cards.

Credit cards have a printed or embossed bank card number complying with the ISO/IEC 7812 numbering standard. The card number's prefix, called the Bank Identification Number, is the sequence of digits at the beginning of the number that determine the bank to which a credit card number belongs. This is the first six digits for MasterCard and Visa cards. The next nine digits are the individual account number, and the final digit is a validity check code.

Both of these standards are maintained and further developed by ISO/IEC JTC 1/SC 17/WG 1. Credit cards have a magnetic stripe conforming to the ISO/IEC 7813. Many modern credit cards have a computer chip embedded in them as a security feature.

In addition to the main credit card number, credit cards also carry issue and expiration dates (given to the nearest month), as well as extra codes such as issue numbers and security codes. Not all credit cards have the same sets of extra codes nor do they use the same number of digits.

Usage

A credit card issuing company, such as a bank or credit union, enters into agreements with merchants for them to accept their credit cards. Merchants often advertise which cards they accept by displaying acceptance marks — generally derived from logos — or this may be
communicated in signage in the establishment or in company material (e.g., a restaurant’s menu may indicate which credit cards are accepted). Merchants may also communicate this orally, as in "We take (brands X, Y, and Z)" or "We don’t take credit cards".

**Visa, Master Card, American Express**
The credit card issuer issues a credit card to a customer at the time or after an account has been approved by the credit provider, which need not be the same entity as the card issuer. The cardholders can then use it to make purchases at merchants accepting that card.

When a purchase is made, the cardholder agrees to pay the card issuer. The cardholder indicates consent to pay by signing a receipt with a record of the card details and indicating the amount to be paid or by entering a personal identification number (PIN). Also, many merchants now accept verbal authorizations via telephone and electronic authorization using the Internet, known as a card not present transaction (CNP).

Electronic verification systems allow merchants to verify in a few seconds that the card is valid and the cardholder has sufficient credit to cover the purchase, allowing the verification to happen at time of purchase. The verification is performed using a credit card payment terminal or point-of-sale (POS) system with a communications link to the merchant’s acquiring bank. Data from the card is obtained from a magnetic stripe or chip on the card; the latter system is called Chip and PIN in the United Kingdom and Ireland, and is implemented as an EMV card.

For card not present transactions where the card is not shown (e.g., e-commerce, mail order, and telephone sales), merchants additionally verify that the customer is in physical possession of the card and is the authorized user by asking for additional information such as the security code printed on the back of the card, date of expiry, and billing address.

Each month, the cardholder is sent a statement indicating the purchases made with the card, any outstanding fees, and the total amount owed. In the US, after receiving the statement, the cardholder may dispute any charges that he or she thinks are incorrect. The Fair Credit Billing Act gives details of the US regulations. The cardholder must pay a defined minimum portion of the amount owed by a due date, or may choose to pay a higher amount. The credit issuer charges interest on the unpaid balance if the billed amount is not paid in full (typically at a much higher rate than most other forms of debt). In addition, if the cardholder fails to make at least the minimum payment by the due date, the issuer may impose a “late fee” and/or other penalties. To help mitigate this, some financial institutions can arrange for automatic payments to be deducted from the cardholder’s bank account, thus avoiding such penalties altogether, as long as the cardholder has sufficient funds.

Many banks now also offer the option of electronic statements, either in lieu of or in addition to physical statements, which can be viewed at any time by the cardholder via the issuer’s online banking website. Notification of the availability of a new statement is generally sent to the cardholder’s email address. If the card issuer has chosen to allow it, the cardholder may have other options for payment besides a physical check, such as an electronic transfer of funds from a checking account. Depending on the issuer, the cardholder may also be able to make multiple payments during a single statement period, possibly enabling him or her to utilize the credit limit on the card several times.

**Advertising, solicitation, application and approval**
Credit card advertising regulations in the US include the Schumer box disclosure requirements. A large fraction of junk mail consists of credit card offers created from lists provided by the major credit reporting agencies. In the United States, the three major US credit bureaus (Equifax, TransUnion and Experian) allow consumers to opt out from related credit card solicitation offers via its Opt Out Pre-Screen program.

**Interest charges**
Credit card issuers usually waive interest charges if the balance is paid in full each month, but typically will charge full interest on the entire outstanding balance from the date of each purchase if the total balance is not paid.

For example, if a user had a $1,000 transaction and repaid it in full within this grace period, there would be no interest charged. If, however, even $1.00 of the total amount remained unpaid, interest would be charged on the $1,000 from the date of purchase until the payment is received. The precise manner in which interest is charged is usually detailed in a cardholder agreement which may be summarized on the back of the monthly statement. The general calculation formula most financial institutions use to determine the amount of interest to be charged is APR/100 x ADB/365 x number of days revolved. Take the annual percentage rate (APR) and divide by 100 then multiply to the amount of the average daily balance (ADB) divided by 365 and then take this total and multiply by the total number of days the amount revolved before payment was made on the account. Financial institutions refer to interest charged back to the original time of the transaction and up to the time a payment was made, if not in full, as a residual retail finance charge (RRFC). Thus after an amount has revolved and a payment has been made, the user of the card will still receive interest charges on their statement after paying the next statement in full (in fact the statement may only have a charge for interest that collected up until the date the full balance was paid, i.e. when the balance stopped revolving).

**Grace period**
A credit card’s grace period is the time the cardholder has to pay the balance before interest is assessed on the outstanding balance. Grace periods may vary, but usually range from 20 to 55 days depending on the type of credit card and the issuing bank. Some policies allow for reinstatement after certain conditions are met.

Usually, if a cardholder is late paying the balance, finance charges will be calculated and the grace period does not apply. Finance charges incurred depend on the grace period and balance; with most credit cards there is no grace period if there is any outstanding balance from the previous billing cycle or statement (i.e. interest is applied on both the previous balance and new transactions). However, there are some credit cards that will only apply finance charge on the previous or old balance, excluding new transactions.
Parties involved
1. **Cardholder**: The holder of the card used to make a purchase; the consumer.
2. **Card-issuing bank**: The financial institution or other organization that issued the credit card to the cardholder. This bank bills the consumer for repayment and bears the risk that the card is used fraudulently. American Express and Discover were previously the only card-issuing banks for their respective brands, but as of 2007, this is no longer the case. Cards issued by banks to cardholders in a different country are known as offshore credit cards.
3. **Merchant**: The individual or business accepting credit card payments for products or services sold to the cardholder.
4. **Acquiring bank**: The financial institution accepting payment for the products or services on behalf of the merchant.
5. **Independent sales organization**: Resellers (to merchants) of the services of the acquiring bank.
6. **Merchant account**: This could refer to the acquiring bank or the independent sales organization, but in general is the organization that the merchant deals with.
7. **Credit Card association**: An association of card-issuing banks such as Discover, Visa, MasterCard, American Express, etc. that set transaction terms for merchants, card-issuing banks, and acquiring banks.
8. **Transaction network**: The system that implements the mechanics of the electronic transactions. May be operated by an independent company, and one company may operate multiple networks.
9. **Affinity partner**: Some institutions lend their names to an issuer to attract customers that have a strong relationship with that institution, and get paid a fee or a percentage of the balance for each card issued using their name. Examples of typical affinity partners are sports teams, universities, charities, professional organizations, and major retailers.
10. **Insurance providers**: Insurers underwriting various insurance protections offered as credit card perks, for example, Car Rental Insurance, Purchase Security, Hotel Burglary Insurance, Travel Medical Protection etc.

The flow of information and money between these parties — always through the card associations — is known as the interchange, and it consists of a few steps.

**Transaction steps**
1. **Authorization**: The cardholder presents the card as payment to the merchant and the merchant submits the transaction to the acquiring bank. The acquiring bank verifies the card number, the transaction type and the amount with the issuer (card-issuing bank) and reserves that amount of the cardholder's credit limit for the merchant. An authorization will generate an approval code, which the merchant stores with the transaction.
2. **Batching**: Authorized transactions are stored in "batches", which are sent to the acquiring bank. Batches are typically submitted once per day at the end of the business day. If a transaction is not submitted in the batch, the authorization will stay valid for a period determined by the issuer, after which the held amount will be returned to the cardholder's available credit. Some transactions may be submitted in the batch without prior authorizations; these are either transactions falling under the merchant's floor limit or ones where the authorization was unsuccessful but the merchant still attempts to force the transaction through. (Such may be the case when the cardholder is not present but owes the merchant additional money, such as extending a hotel stay or car rental.)
3. **Clearing and Settlement**: The acquiring bank sends the batch transactions through the credit card association, which debits the issuers for payment and credits the acquiring bank. Essentially, the issuer pays the acquiring bank for the transaction.
4. **Funding**: Once the acquiring bank has been paid, the acquiring bank pays the merchant. The merchant receives the amount totaling the funds in the batch minus the "discount rate", "mid-qualified rate", or "non-qualified rate" which are tiers of fees the merchant pays the acquiring bank for processing the transactions.
5. **Chargebacks**: A chargeback is an event in which money in a merchant account is held due to a dispute relating to the transaction. Chargebacks are typically initiated by the cardholder. In the event of a chargeback, the issuer returns the transaction to the acquiring bank for resolution. The acquiring bank then forwards the chargeback to the merchant, who must either accept the chargeback or contest it.

**Credit card register**
A credit card register is a transaction register used to ensure the increasing balance owed from using a credit card is enough below the credit limit to deal with authorization holds and payments not yet received by the bank and to easily look up past transactions for reconciliation and budgeting.

The register is a personal record of banking transactions used for credit card purchases as they affect funds in the bank account or the available credit. In addition to check number and so forth the code column indicates the credit card. The balance column shows available funds after purchases. When the credit card payment is made the balance already reflects the funds were spent. In a credit card's entry, the deposit column shows the available credit and the payment column shows total owed, their sum being equal to the credit limit.

Each check written on debit card transaction, cash withdrawal, and credit card charge is entered manually into the paper register daily or several times per week. Credit card register also refers to one transaction record for each credit card. In this case the booklets readily enable the location of a card's current available credit when ten or more cards are in use.

**Features**
As well as convenient credit, credit cards offer consumers an easy way to track expenses, which is necessary for both monitoring personal expenditures and the tracking of work-related expenses for taxation and reimbursement purposes. Credit cards are accepted in larger establishments in almost all countries, and are available with a variety of credit limits, repayment arrangements. Some have added perks (such as insurance protection, rewards schemes in which points earned by purchasing goods with the card can be redeemed for further goods and services or cashback).
Consumers’ limited liability

Some countries, such as the United States, the United Kingdom, and France, limit the amount for which a consumer can be held liable in the event of fraudulent transactions with a lost or stolen credit card.

Types

Business credit cards

Business credit cards are specialized credit cards issued in the name of a registered business, and typically they can only be used for business purposes. Their use has grown in recent decades. In 1998, for instance, 37% of small businesses reported using a business credit card; by 2009, this number had grown to 64%.

Business credit cards offer a number of features specific to businesses. They frequently offer special rewards in areas such as shipping, office supplies, travel, and business technology. They can be harder to apply for than personal cards, however, and often carry high credit score requirements.

Business credit cards are offered by almost all major card issuers—like American Express, Visa, and MasterCard in addition to local banks and credit unions. Charge cards for businesses, however, are currently only offered by American Express.

Secured credit cards

A secured credit card is a type of credit card secured by a deposit account owned by the cardholder. Typically, the cardholder must deposit between 100% and 200% of the total amount of credit desired. Thus if the cardholder puts down $1,000, they will be given credit in the range of $500–1,000. In some cases, credit card issuers will offer incentives even on their secured card portfolios. In these cases, the deposit required may be significantly less than the required credit limit, and can be as low as 10% of the desired credit limit. This deposit is held in a special savings account. Credit card issuers offer this because they have noticed that delinquencies were notably reduced when the customer perceives something to lose if the balance is not repaid.

The cardholder of a secured credit card is still expected to make regular payments, as with a regular credit card, but should they default on a payment, the card issuer has the option of recovering the cost of the purchases paid to the merchants out of the deposit. The advantage of the secured card for an individual with negative or no credit history is that most companies report regularly to the major credit bureaus. This allows building a positive credit history.

Although the deposit is in the hands of the credit card issuer as security in the event of default by the consumer, the deposit will not be debited simply for missing one or two payments. Usually the deposit is only used as an offset when the account is closed, either at the request of the customer or due to severe delinquency (150 to 180 days). This means that an account which is less than 150 days delinquent will continue to accrue interest and fees, and could result in a balance which is much higher than the actual credit limit on the card. In these cases the total debt may far exceed the original deposit and the cardholder not only forfeits their deposit but is left with an additional debt.

Prepaid cards

A “prepaid credit card” is not a true credit card, since no credit is offered by the card issuer: the cardholder spends money which has been “stored” via a prior deposit by the cardholder or someone else, such as a parent or employer. However, it carries a credit-card brand (such as Discover, Visa, MasterCard, American Express, or JCB) and can be used in similar ways just as though it were a credit card.

Unlike debit cards, prepaid credit cards generally do not require a PIN. An exception are prepaid credit cards with an EMV chip. These cards do require a PIN if the payment is processed via Chip and PIN technology.

Digital cards

A digital card is a digital cloud-hosted virtual representation of any kind of identification card or payment card, such as a credit card.

Benefits and drawbacks

Benefits to cardholder

The main benefit to the cardholder is convenience. Compared to debit cards and checks, a credit card allows small short-term loans to be quickly made to a cardholder who need not calculate a balance remaining before every transaction, provided the total charges do not exceed the maximum credit line for the card.

Different countries offer different levels of protection. In the UK, for example, the bank is jointly liable with the merchant for purchases of defective products over £100.

Many credit cards offer rewards and benefits packages, such as enhanced product warranties at no cost, free loss/damage coverage on new purchases, various insurance protections, for example, rental car insurance, common carrier accident protection, and travel medical insurance.

Credit cards can also offer a loyalty program, where each purchase is rewarded with points, which may be redeemed for cash or products. Research has examined whether competition among card networks may potentially make payment rewards too generous, causing higher prices among merchants, thus actually impacting social welfare and its distribution, a situation potentially warranting public policy interventions.

Currently, there are credit cards a 0% intro APR on Balance Transfers and no late fees.

Comparison of credit card benefits in the US

The table below contains a list of benefits offered in the United States for consumer credit cards. Benefits may vary in other countries or business credit cards.

Detriments to cardholders
High interest and bankruptcy
Low introductory credit card rates are limited to a fixed term, usually between 6 and 12 months, after which a higher rate is charged. As all credit cards charge fees and interest, some customers become so indebted to their credit card provider that they are driven to bankruptcy. Some credit cards often levy a rate of 20 to 30 percent after a payment is missed. In other cases, a fixed charge is levied without change to the interest rate. In some cases, universal default may apply: the high default rate is applied to a card in good standing by missing a payment on an unrelated account from the same provider. This can lead to a snowball effect in which the consumer is drowned by unexpectedly high interest rates. Further, most card holder agreements enable the issuer to arbitrarily raise the interest rate for any reason they see fit. First Premier Bank at one point offered a credit card with a 79.9% interest rate; however, they discontinued this card in February 2011 because of persistent defaults.

Complex fee structures in the credit card industry limit customers’ ability to comparison shop, help ensure that the industry is not price-competitive and help maximize industry profits.
Research shows that a substantial fraction of consumers (about 40 percent) choose a sub-optimal credit card agreement, with some incurring hundreds of dollars of avoidable interest costs.

Weakens self regulation
Several studies have shown that consumers are likely to spend more money when they pay by credit card. Researchers suggest that when people pay using credit cards, they do not experience the abstract pain of payment. Furthermore, researchers have found that using credit cards can increase consumption of unhealthy food.

Detriment to society
Inflated pricing for all consumers
Merchants that accept credit cards must pay interchange fees and discount fees on all credit-card transactions. In some cases merchants are barred by their credit agreements from passing these fees directly to credit card customers, or from setting a minimum transaction amount (no longer prohibited in the United States, United Kingdom or Australia). The result is that merchants are induced to charge all customers (including those who do not use credit cards) higher prices to cover the fees on credit card transactions. The inducement can be strong because the merchant’s fee is a percentage of the sale price, which has a disproportionate effect on the profitability of businesses that have predominantly credit card transactions, unless compensated for by raising prices generally. In the United States in 2008 credit card companies collected a total of $48 billion in interchange fees, or an average of $427 per family, with an average fee rate of about 2% per transaction.

Benefits to merchants
An example of street markets accepting credit cards. Most simply display the acceptance marks (stylized logos, shown in the upper-left corner of the sign) of all the cards they accept.
For merchants, a credit card transaction is often more secure than other forms of payment, such as cheques, because the issuing bank commits to pay the merchant the moment the transaction is authorized, regardless of whether the consumer defaults on the credit card payment (except for legitimate disputes, which are discussed below, and can result in charges back to the merchant). In most cases, cards are even more secure than cash, because they discourage theft by the merchant’s employees and reduce the amount of cash on the premises. Finally, credit cards reduce the back office expense of processing checks/cash and transporting them to the bank.
Prior to credit cards, each merchant had to evaluate each customer’s credit history before extending credit. That task is now performed by the banks which assume the credit risk. Credit cards can also aid in securing a sale, especially if the customer does not have enough cash on his or her person or checking account. Extra turnover is generated by the fact that the customer can purchase goods and/or services immediately and is less inhibited by the amount of cash in his or her pocket and the immediate state of his or her bank balance.
Much of merchants' marketing is based on this immediacy.
For each purchase, the bank charges the merchant a commission for this service and there may be a certain delay before payment (except for legitimate disputes, which are discussed below). In some cases merchants may charge users a "credit card supplement" (or surcharge), either a fixed amount or a percentage, for payment by credit card. This practice was prohibited by most credit card contracts in the United States until 2013, when a major settlement between merchants and credit card companies allowed merchants to levy surcharges. Most retailers have not started using credit card surcharges, however, for fear of losing customers. Surcharging is actually illegal in 10 states.

Banking and Insurance
Commercial Banks: Functions and Role in Economic Development | Banking
Functions of Commercial Banks:
Though there are many types of banks; yet commercial banks stand out as the most prominent and popular category of banks. Function of commercial banks may be described by classifying these into the following three categories:

(a) Primary functions
(b) Secondary functions
(c) Modern functions

Following is a brief account of the functions comprised in the above-stated three categories:

(a) Primary Functions: Following are the primary functions of a commercial bank:

(I) Accepting deposits: - Accepting deposits is the main function of a commercial bank. Banks accept deposits of money from people who have surplus money. Banks offer the following types of deposit schemes to attract money from all quarters of public.

(II) Savings deposits: - The aim of savings deposits scheme is to mobilize the small savings of the public. A person can open a savings bank account, by depositing a small amount of money. He/she can withdraw money from his/her account and also make additional deposits. However, there may be restrictions on the number of withdrawals and the amount to be withdrawn, in a given period. The rate of interest on saving deposits is lower than payable on fixed deposits.

(III) Recurring deposits: - The aim of recurring deposit scheme is to encourage regular savings by people. A person can deposit a fixed amount say Rs. 100, every month for a fixed period. The amount deposited, together with interest, is repayable on maturity.

(IV) Current deposit accounts: - Current deposit accounts are opened by businessmen. The account holder can deposit and withdraw money, whenever required. No interest is paid on current deposit accounts. Rather, a certain charge is made by the bank from the account holder, for the services provided by the bank.

(ii) Lending money Banks lend money, usually, in the following ways:

(I) Loans: - Banks advance a certain sum of money to a customer; which is called a loan. A loan, by a bank, is granted against some security or mortgage. Normally banks do not advance loans for long periods. However, of late, there is a change in this policy.

(II) Overdraft: - Under the overdraft facility, a customer having a current account is allowed to withdraw more than what he has deposited. The excess amount withdrawn by the customer is known as overdraft. The overdraft is allowed up to a certain limit and for an agreed period. Interest is charged by the bank on the amount actually withdrawn by the borrower, and not on the sanctioned amount.

(iii) Cash credit: - Under cash credit scheme, a loan limit is sanctioned and a cash credit account opened in the name of the borrower. The borrower can withdraw money from the account from time to time—subject to the sanctioned limit. Interest is charged by the bank on the amount actually withdrawn by the borrower.

(iv) Discounting of bills: - Under this form of lending money, banks en-cash customers’ bills of exchange, before they become actually due for payment. For this, banks charge what is known as a nominal discount.

(b) Secondary Functions: - Following are the important secondary functions of banks:

(i) Collection of cheques and bills: - Banks collect cheques of their customers drawn on other banks; and credit their proceeds to the accounts of their customers. Banks also collect bills of exchange on behalf of their customers from the acceptors of bills on due dates; and credit the proceeds to the accounts of their customers.

(ii) Agency functions: - Banks, under instructions of the customers:

1. Undertake to pay insurance premiums
2. Collect dividend, interest etc. on their investments
3. Undertake to buy or sell shares, debentures etc. on behalf of their customers.

(iii) Provision of remittance facilities: - Banks provide remittance facilities for transfer of funds from one place to another, usually through bank drafts. The banks charge commission for issuing bank drafts.

(iv) Issuing letters of credit: - Letters of credit are most useful in import trade. They give a proof of the credit worthiness of the importer. A letter of credit issued by the importer’s bank contains an undertaking by the bank to honour the bills of exchange drawn by the exporter on the importer up to the amount specified, in the letter of credit.

(v) Letter of reference: - Through a letter of reference, a bank provides information about the financial condition of the customer to traders of the same country or other countries.

(vi) Traveller’s cheques: - Banks provide the facility of traveller’s cheques to their customers who are travelling. With this facility, the customer need not carry cash (which is risky) with him and can travel safely.

(vii) Lockers facility: - Banks provide lockers facility to their customers, where customers can keep their gold, silver ornaments and important documents safely.

(c) Modern Functions: - Some modern functions of a commercial bank are:

(i) Electronic Funds Transfer System (EFTs): - This system enables employers to transfer salary/wages to the accounts of employees directly from the company (i.e. employer) bank account.

(ii) Automated Teller Machines (ATMs): - It is freestanding self-service terminal. To use an ATM, one has to insert a plastic card into the terminal and then enter an identification code.

<table>
<thead>
<tr>
<th>Functions of commercial banks - at a glance</th>
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<tbody>
<tr>
<td>(a) Primary functions</td>
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<tr>
<td>1. Accepting deposits</td>
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<td>2. Lending money</td>
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<td>(b) Secondary functions</td>
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<td>3. Collection of cheques and bills</td>
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<td>4. Agency functions</td>
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<tr>
<td>5. Provision of remittance facilities</td>
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<td>6. Issuing letters of credit</td>
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<td>7. Letter of reference</td>
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<td>8. Traveller’s cheques</td>
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<td>9. Locker facility</td>
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<td>(c) Modern functions</td>
</tr>
<tr>
<td>10. Electronic Funds Transfer (EFT)</td>
</tr>
<tr>
<td>11. Automated Teller Machines (ATM)</td>
</tr>
<tr>
<td>12. Credit card</td>
</tr>
<tr>
<td>13. Debit card</td>
</tr>
<tr>
<td>14. Collection of information</td>
</tr>
</tbody>
</table>
The machine responds by:
1. Giving cash 2. Taking deposits 3. Handling other simple banking transactions

### (iii) Credit card:
Credit card enables the card holders to have overdraft facilities of a certain amount. It can be used (by cardholders) for making payments of goods and services. Credit cards are issued to selected customers of the bank. The credit card is a plastic card having the photo identity and signatures of the customer. It includes the issuing bank’s name and validity period of the card.

### (iv) Debit card:
Debit cards are issued by bank to those customers who keep deposits with it. The card holder can buy goods from the designated retail store and make payment through his/her debit card. A debit card is a plastic card, bearing banks’ name and customer’s name, identity and signatures.

### (v) Collection of information:
- Banks collect information about trade and industry and supply it to interested parties. They also offer advice on financial matters.

### Role of Commercial Banks in Economic Development:
Commercial banks play a great role towards the economic development of a country. Their role in economic development could be stated, in terms of the following points:

1. Commercial banks encourage the habit of savings in the community; and channelize funds into productive uses. In fact, the tremendous growth of any nation has been possible only after the establishment of a sound banking system, in that nation. Banks are the carriers of the vehicle of economic development.
2. Banks create credit. Credit creation done by banks is the basis of economic development of a modern capitalist society.
3. Banks promote trade, especially foreign trade: by providing funds and helping in the payment and transfer of money.
4. Banks help in allocation of funds; and ensure optimum utilization of savings in the economy, leading to economic development.

Through the lending rates of interest determined by market mechanism or fixed by the central bank, credit advanced by banks gets rationed among various potential borrower and sectors.

### Venture Capital

**Venture Capital - Concept, Characteristics and Functions**

**Concept of Venture Capital:**
Narrowly speaking, venture capital refers to the risk capital supplied to growing companies and it takes the form of share capital in the business firms. Both money provided as start-up capital and as development capital for small but growing firms are included in this definition.

In developing countries like India, venture capital concept has been understood in this sense. In our country venture capital comprises only seed capital, finance for high technology and funds to turn research and development into commercial production.

In broader sense, venture capital refers to the commitment of capital and knowledge for the formation and setting up of companies particularly to those specialising in new ideas or new technologies. Thus, it is not merely an injection of funds into a new firm but also a simultaneous input of skills needed to set the firm up, design its marketing strategy, organise and manage it.

In western countries like the USA and UK, venture capital perspective scans a much wider horizon along the above sense. In these countries, venture capital not only consists of supply of funds for financing technology but also supply of capital and skills for fostering the growth and development of enterprises.

Much of this capital is put behind established technology or is used to help the evolution of new management teams. It is this broad role which has enabled venture capital industry in the West to become a vibrant force in the industrial development. It will, therefore, be more meaningful to accept broader sense of venture capital.

**Characteristics of Venture Capital:**
Venture capital as a source of financing is distinct from other sources of financing because of its unique characteristics, as set out below:

1. Venture capital is essentially financing of new ventures through equity participation. However, such investment may also take the form of long-term loan, purchase of options or convertible securities. The main objective underlying investment in equities is to earn capital gains there on subsequently when the enterprise becomes profitable.
2. Venture capital makes long-term investment in highly potential ventures of technical savvi entrepreneurs whose returns may be available after a long period, say 5-10 years.
3. Venture capital does not confine to supply of equity capital but also supply of skills for fostering the growth and development of enterprises. Venture capitalists ensure active participation in the management which is the entrepreneur’s business and provide their marketing, technology, planning and management expertise to the firm.
4. Venture capital financing involves high risk return spectrum. Some of the ventures may yield very high returns to more than Compensates for heavy losses on others which may also have earning prospects.

In nutshell, a venture capital institution is a financial intermediary between investors looking for high potential returns and entrepreneurs who need institutional capital as they are yet not ready/able to go to the public.

**Dimensions of Venture Capital:**
Venture capital is associated with successive stages of the firm’s development with distinctive types of financing, appropriate to each stage of development. Thus, there are four stages of firm’s development, viz., development of an idea, start up, fledgling and establishment. The first stage of development of a firm is development of an idea for delineating precise specification for the new product or ser-
venture and to establish a business-plan. The entrepreneur needs seedling finance for this purpose. Venture capitalist finds this stage as the most hazardous and difficult in view of the fact that majority of the business projects are abandoned at the end of the seedling phase. Start-up stage is the second stage of the firm's development. At this stage, entrepreneur sets up the enterprise to carry into effect the business plan to manufacture a product or to render a service. In this process of development, venture capitalist supplies start-up finance.

In the third phase, the firm has made some headway, entered the stage of manufacturing a product or service, but is facing enormous teething problems. It may not be able to generate adequate internal funds. It may also find its access to external sources of finance very difficult. To get over the problem, the entrepreneur will need a large amount of fledgling finance from the venture capitalist.

In the last stage of the firm's development when it stabilizes itself and may need, in some cases, establishment finance to explicit opportunities of scale. This is the final injection of funds from venture capitalists. It has been estimated that in the U.S.A., the entire cycle takes a period of 5 to 10 years.

**Functions of Venture Capital:**

Venture capital is growingly becoming popular in different parts of the world because of the crucial role it plays in fostering industrial development by exploiting vast and untapped potentialities and overcoming threats.

Venture capital plays this role with the help of the following major functions:

Venture capital provides finance as well as skills to new enterprises and new ventures of existing ones based on high technology innovations. It provides seed capital to finance innovations even in the pre-start stage.

In the development stage that follows the conceptual stage, venture capitalist develops a business plan (in partnership with the entrepreneur) which will detail the market opportunity, the product, the development and financial needs.

In this crucial stage, the venture capitalist has to assess the intrinsic merits of the technological innovation, ensure that the innovation is directed at a clearly defined market opportunity and satisfies himself that the management team at the helm of affairs is competent enough to achieve the targets of the business plan.

Therefore, venture capitalist helps the firm to move to the exploitation stage, i.e., launching of the innovation. While launching the innovation, the venture capitalist will seek to establish a time frame for achieving the predetermined development marketing, sales and profits targets.

In each investment, as the venture capitalist assumes absolute risk, his role is not restricted to that of a mere supplier of funds but that of an active partner with total investment in the assisted project. Thus, the venture capitalist is expected to perform not only the role of a financier but also a skilled faceted intermediary supplying a broad spectrum of specialist services - technical, commercial, managerial, financial and entrepreneurial.

Venture capitalist fills the gap in the owner’s funds in relation to the quantum of equity required to support the successful launching of a new business or the optimum scale of operations of an existing business. It acts as a trigger in launching new business and as a catalyst in stimulating existing firms to achieve optimum performance.

Venture capitalists role extends even as far as to see that the firm has proper and adequate commercial banking and receivables financing. Venture capitalist assists the entrepreneurs in locating, interviewing and employing outstanding corporate achievers to professionalize the firm.

**Venture Capital: Meaning, Features, Advantages and Disadvantages**

This is a very important source of financing for a new business. Here money is provided by investors to start a business that has strong potentiality of high growth and profitability. The provider of venture capital also provides managerial and technical support. Venture capital is also known as risk capital.

**Features of Venture Capital:**

**Venture capital has the following features:**

1. Venture capital investments are made in innovative projects.
2. Benefits from such investments may be realized in the long run.
3. Suppliers of venture capital invest money in the form of equity capital.
4. As investment is made through equity capital, the suppliers of venture capital participate in the management of the company.

**Advantages of Venture Capital:** The advantages of venture capital are as follows:

i. New innovative projects are financed through venture capital which generally offers high profitability in long run.
ii. In addition to capital, venture capital provides valuable information, resources, technical assistance, etc., to make a business successful.

**Disadvantages of Venture Capital:** The disadvantages of venture capital are:

i. It is an uncertain form of financing.
ii. Benefit from such financing can be realized in long run only.

**Role of Professionals in Venture Capital Funding**

Small venture funds are highly dependent on their initial contacts in the industry, but larger venture funds are able to expand their list of contacts by employing a larger group of professionals.

Even though there may be a lot of variance in the roles defined in different venture funds, generally, the roles fall within the following categories.

1. **General Partners**: Generally known as the venture capitalists (VCs), these are the core executives of the firm. They are investment professionals, but many may have varying business backgrounds. In many technology-oriented firms, the general partners have a tech-
2. **Investors:** - Also known as limited partners, these can be high net worth individuals or institutional investors such as banks, NBFCs, and pension funds. Some influential investors are also known to keep a close watch on the health of their investments in a venture capital.

3. **Venture Partners:** - Venture partners present potential deals to the venture fund and receive income on the deals that materialize. They act as some sort of agent or broker. Entrepreneurs-in-residence are industry experts temporarily employed by a VC. They are expected to work closely with a firm and develop and improve on their ideas.

Many other professionals such as lawyers, accountants, and technicians might be called on by VCs from time to time to help in the due diligence and valuation of their investments.

4. **Compensation:** - General partners receive an annual management fee which is equivalent to about 2 per cent of the capital committed to the fund. All salaries and expenses are to be met from this 2 per cent. Currently, there seems to be no downward pressure on this figure.

At the end of a fund’s life, the general partners receive a portion of the net profits as a success fee, also known as carried, interest. This success fee is usually at about 20 per cent of the net profits but there are many funds that charge about 30 per cent.

The investors or limited partners are looking for returns in the range of 25 to 35 per cent per annum. A lot of venture funds have a good track record of being able to satisfy the expectations of the investor. Typically, in the portfolio of a VC, a number of firms go bust and the fund loses most of its investments. Some firm’s exhibit healthy results and stable growth but the bulk of the returns comes from the few star performers who grow spectacularly and allow the VCs to harvest their investment through an IPO.

### Factoring forfaiting and Bill Discounting

**Difference Between Bill Discounting and Factoring**

Bill Discounting and Factoring are two types of short-term finance through which the financial requirements of a company can be fulfilled quickly. Due to less knowledge, many finance students get puzzled when they are asked to distinguish the two. The former is related to the borrowing from the commercial bank while the latter is associated with the management of book debts. Apart from the above-mentioned difference, there are many other differences between Bill Discounting and Factoring, which are as under.

#### Comparison Chart

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>BILL DISCOUNTING</th>
<th>FACTORING</th>
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</thead>
<tbody>
<tr>
<td><strong>Meaning</strong></td>
<td>Trading the bill before it becomes due for payment at a price less than its face value is known as Bill Discounting.</td>
<td>A financial transaction in which the business organization sells its book debts to the financial institution at a discount is known as Factoring.</td>
</tr>
<tr>
<td><strong>Arrangement</strong></td>
<td>The entire bill is discounted and paid, when the transaction takes place.</td>
<td>The factor gives maximum part of the amount as advance when the transaction takes place and the remaining amount at the time of settlement.</td>
</tr>
<tr>
<td><strong>Parties</strong></td>
<td>Drawer, Drawee and Payee</td>
<td>Factor, Debtor and Client</td>
</tr>
<tr>
<td><strong>Type</strong></td>
<td>Recourse only</td>
<td>Recourse and Non Recourse</td>
</tr>
<tr>
<td><strong>Governing statute</strong></td>
<td>The Negotiable Instrument Act, 1881</td>
<td>No such specific act.</td>
</tr>
<tr>
<td><strong>Financier’s Income</strong></td>
<td>Discounting Charges or interest</td>
<td>Financier gets interest for financial services and commission for other allied services.</td>
</tr>
</tbody>
</table>

**Definition of Bill Discounting**

Bill Discounting is a process of trading or selling the bill of exchange to the bank or financial institution before it gets matured, at a price which is less than its par value. The discount on the bill of exchange will be based on the remaining time for its maturity and the risk involved in it.

First of all the bank satisfies himself regarding the credibility of the drawer, before advancing money. Having satisfied with the creditworthiness of the drawer, the bank will grant money after deducting the discounting charges or interest. When the bank purchases the bill for the customer, it becomes the owner of the respective bills. If the customer delays the payment, then he has to pay interest as per prescribed rates. Further, if the customer defaults payment of the bills, then the borrower shall be liable for the same as well as the bank can exercise pawnee’s rights over the goods supplied to the customer by the borrower.
### Definition of Factoring

Factoring is a transaction in which the client or borrower sells its book debts to the factor (financial institution) at a discount. Having purchased the receivables the factor finances, money to them after deducting the following:

- An appropriate margin (reserve)
- Commission charges for the supplementary services.
- Interest charges for the financial services

Now, the client forwards the collection from the customer to the financial institution or he gives the instruction to forward the payment directly to the factor and settles the balance dues. The bank provides the following services to the client: Credit Investigation, Debtors Ledger Maintenance, Collection of Debts, Credit Reports on Debtors and so on.

#### The types of factoring are as under:

- **Disclosed Factoring**: All the parties know about the factoring arrangement.
- **Undisclosed Factoring**: The parties do not know about the factoring arrangement.
- **Non-recourse Factoring**: The factors himself bears the amount of bad debt, and that is why the commission rate is higher.

#### Key Differences Between Bill Discounting and Factoring

- Selling of bills at a discount to the bank, before its maturity is known as Bill Discounting. Selling of the debtors to a financial institution at a discount is Factoring.
- The bill is discounted, and the whole amount is paid to the borrower at the time of the transaction. Conversely, the maximum part of the amount is provided as advance, and the rest of the amount is given as balance when the dues are realized.
- The parties to bill discounting are a drawer, drawee, and payee whereas the parties to factoring are the factor, debtor, and borrower.
- The bill discounting is always recourse, i.e. if the customer defaults in payment of debt, then the payment is made by the borrower. On the other hand, the factoring can be recourse and non-recourse.
- The Negotiable Instrument Act, 1881 contains the rules relating to bills discounting. In contrast to factoring which is not covered under any act.
- In bill discounting the financier gets the discounting charges for financial services, but in the case of factoring the factor gets interest and commission.
- In factoring, the debts are assigned which is not done in bill discounting.

#### Conclusion

In bill discounting, bills are traded while in the case of factoring accounts receivable are sold. There is a big difference between these two topics. In bill discounting the bank provides a particular service of financing, but if we talk about factoring additional services are also provided by the financier.

### Difference Between Factoring and Forfaiting

Since the last few decades, **factoring** and **forfaiting** have gained immense importance, as one of the major sources of export financing. For a layman, these two terms are one and the same thing. Nevertheless, these two terms are different, in their nature, concept and scope. The first and foremost distinguishing point amidst these two terms is that factoring can be with or without recourse, but forfaiting is always without recourse. Have a glance at this article, to know about some more differences between factoring and forfaiting.

#### Comparison Chart

<table>
<thead>
<tr>
<th>BASIS FOR COMPARISON</th>
<th>FACTORING</th>
<th>FORFAITING</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Meaning</strong></td>
<td>Factoring is an arrangement that converts your receivables into ready cash and you don't need to wait for the payment of receivables at a future date.</td>
<td>Forfaiting implies a transaction in which the forfaiter purchases claims from the exporter in return for cash payment.</td>
</tr>
<tr>
<td><strong>Maturity of receivables</strong></td>
<td>Involves account receivables of short maturities.</td>
<td>Involves account receivables of medium to long term maturities.</td>
</tr>
<tr>
<td><strong>Goods</strong></td>
<td>Trade receivables on ordinary goods.</td>
<td>Trade receivables on capital goods.</td>
</tr>
<tr>
<td><strong>Finance up to</strong></td>
<td>80-90%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Type</strong></td>
<td>Recourse or Non-recourse</td>
<td>Non-recourse</td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>Cost of factoring borne by the seller (client).</td>
<td>Cost of forfaiting borne by the overseas buyer.</td>
</tr>
<tr>
<td><strong>Negotiable Instrument</strong></td>
<td>Does not deals in negotiable instrument.</td>
<td>Involves dealing in negotiable instrument.</td>
</tr>
<tr>
<td><strong>Secondary market</strong></td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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**Definition of Factoring**
Factoring is defined as a method of managing book debt, in which a business receives advances against the accounts receivables, from a bank or financial institution (called as a factor). There are three parties to factoring i.e. debtor (buyer of goods), the client (seller of goods) and the factor (financier). Factoring can be recourse or non-recourse, disclosed or undisclosed.

In a factoring arrangement, first of all, the borrower sells trade receivables to the factor and receives an advance against it. The advance provided to the borrower is the remaining amount, i.e. a certain percentage of the receivable is deducted as the margin or reserve, the factor’s commission is retained by him and interest on the advance. After that, the borrower forwards collections from the debtor to the factor to settle down the advances received.

**Definition of Forfaiting**

Forfaiting is a mechanism, in which an exporter surrenders his rights to receive payment against the goods delivered or services rendered to the importer, in exchange for the instant cash payment from a forfaiter. In this way, an exporter can easily turn a credit sale into cash sale, without recourse to him or his forfaiter.

The forfaiter is a financial intermediary that provides assistance in international trade. It is evidenced by negotiable instruments i.e. bills of exchange and promissory notes. It is a financial transaction, helps to finance contracts of medium to long term for the sale of receivables on capital goods. However, at present forfaiting involves receivables of short maturities and large amounts.

**Key Differences Between Factoring and Forfaiting**

The major differences between factoring and forfaiting are described below:

1. Factoring refers to a financial arrangement whereby the business sells its trade receivables to the factor (bank) and receives the cash payment. Factoring is a form of export financing in which the exporter sells the claim of trade receivables to the forfaiter and gets an immediate cash payment.
2. Factoring deals in the receivable that falls due within 90 days. On the other hand, Forfaiting deals in the accounts receivables whose maturity ranges from medium to long term.
3. Factoring involves the sale of receivables on ordinary goods. Conversely, the sale of receivables on capital goods are made in forfaiting.
4. Factoring provides 80-90% finance while forfaiting provides 100% financing of the value of export.
5. Factoring can be recourse or non-recourse. On the other hand, forfaiting is always non-recourse.
6. Factoring cost is incurred by the seller or client. Forfaiting cost is incurred by the overseas buyer.
7. Forfaiting involves dealing with negotiable instruments like bills of exchange and promissory note which is not in the case of Factoring.
8. In forfaiting, there is no secondary market, whereas in the factoring secondary market exists, which increases the liquidity in forfaiting.

**Conclusion**

As we have discussed that factoring and forfaiting are two methods of financing international trade. These are mainly used to secure outstanding invoices and account receivables. Factoring involves the purchase of all receivables or all kinds of receivables. Unlike Forfaiting, which is based on transaction or project.

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**Insurance**

**Insurance: Concept, Significance and Principles**

**Concept of the Term Insurance:**

A contract of insurance is a contract under which the insurer (i.e. insurance company) in consideration of a sum of money paid by the insured (called the premium) agrees:

(i) To make good the loss suffered by the insured against a specific risk (for which the insurance is effected), such as fire or,
(ii) To pay a pre-fixed amount to the insured or his/her beneficiaries on the happening of specified event e.g. death of the insured.

**Salient Features of Insurance:**

Salient features of the concept of insurance are:

(a) **Life insurance**: It is different from all other types of insurances (i.e. general insurance), in that it is a sort of investment. Under a contract of life insurance, there is a guarantee on the part of the insurance company to pay a fixed amount to the assured (if he is alive) or to his beneficiaries; because death against which insurance is affected is sure to take place – sooner or later, i.e. in case of life insurance risk is certain.

All other insurances are contracts of indemnity i.e. the insurance company agrees to make good the loss to the insurance, only when risk (for which insurance is affected) takes place i.e. in other types of insurances, the risk is uncertain.

No claim on the insurance company arises, if the risk does not take place. The latter part (i.e. ii) of the definition given above points out to life insurance; while the former part (i.e. i) points out to other types of insurances.

**Point of comment:**

In view of this distinction between the nature of risk in life insurance and other types of insurances, life insurance is technically called life assurance (and not insurance). However, practically the distinction between the terms, insurance and assurance is not observed now-a-days, in that even the Life Insurance Corporation (LIC) uses the term insurance and not assurance – as part of its name.

(b) Some Terms in Context of the Term Insurance:

(i) **Insurer**: One who undertakes the responsibility of risks i.e. the insurance company.
(ii) **Insured**: One for whose benefit the insurance is effected i.e. one whose risk is undertaken by the insurance company.
(iii) **Premium**: It is the consideration (i.e. the price) payable by the insured to the insurer, for the responsibility of risk undertaken by the insurer.

(iv) **Policy**: Policy is the document containing terms and conditions of the contract of insurance.

(v) **Sum assured**: It is the amount for which insurance policy is taken.

### Basic Philosophy of Insurance:

The basic philosophy of insurance is that it is device for spreading a risk among a number of persons, who are exposed to that risk. For example, let us say that there are 1000 houses in a locality. The owners of all these houses decided to get their houses insured against fire. All the 1000 persons will pay premium to the insurance company, in consideration of the insurance company agreeing to compensate for loss caused by fire. Thus there will be a pool of funds with the insurance company built from premiums paid by all policy-holders. Out of this fund, the insurance company will compensate for loss due to fire caused to those unfortunate ones whose houses are exposed to the risk of fire. It will be a rarity that all houses of the locality are exposed to the risk of fire. Thus insurance is a social device of sharing risks. According to Sir William Beveridge, therefore, "The collective bearing of risk is insurance."

### Significance of Insurance:

We can highlight the significance of insurance, in terms of the following advantages offered by it:

1. **Concentration on Business Issues**: Insurance help businessmen to concentrate their attention on business issues, as their risks are undertaken by the insurance company. Insurance gives them peace of mind. Thus due to insurance, business efficiency increases.

2. **Better Utilization of Capital**: - Businessmen, in the absence of insurance, will maintain funds for meeting future contingencies. Insurance does away with this need to maintain contingency funds by them. Thus businessmen can better utilize their funds for business purposes.

3. **Promotion of Foreign Trade**: - There are many risks in foreign trade much more than involved in home trade. Insurance of risks involved in foreign trade gives a boost to it which is a healthy feature of economic development.

4. **Feeling of Security to Dependents**: - Life insurance provides a feeling of economic security to the dependents of the insured, on whose life insurance is affected.

5. **Social Welfare**: - Life insurance also provides for policies in respect of education of children, marriage of children etc. Such special policies provide a sense of security to the poor who take these policies. Thus life insurance is a device for ensuring social welfare.

6. **Speeding Up the Process of Economic Development**: - Insurance companies mobilize the savings of the community through collection of premiums, and invest these savings in productive channels. This process speeds up economic development. Huge funds at the disposal of LIC (Life Insurance Corporation) available for investment purposes support the above-mentioned point of advantage of insurance.

7. **Generation of Employment Opportunities**: - Insurance companies provide a lot of employment in the economy. This is due to ever growing business done by insurance companies.

### Concepts of Double Insurance:

It is quite possible for a person to take more than one insurance policy to cover the same risk. This is known as double insurance.

In the case depicted above, Mr. A, the insured has taken three insurance policies for the same subject matter of risk, with three insurance companies - I, II & III.

The implications of double insurance are:

(a) **In Case of Life Insurance**: In case of life insurance, the insured or his dependents can claim the full amount of policy from each insurance company. This is so because life insurance is a sort of investment; and a person can take any number of insurance policies on his life and claim full amount under each policy.

(b) **In Case of Other Types of Insurances**: In case of fire or marine insurance, the insured cannot recover more than the amount of actual loss from all insurance companies, taken together; because he is not allowed to make any profit out of the transaction of insurance. Suppose Mr. A insures his house against fire from three insurance companies - I, II & III for Rs.50,000, 1,00,000 and 1,50,000 respectively. His house is destroyed by fire entailing a loss of Rs.60,000. He can claim in all Rs.60,000 the actual amount of loss in the ratio of 1:2:3 i.e. Rs.10,000, Rs.20,000 and Rs.30,000 from insurance companies I, II and III respectively.

If he claims the full amount of loss i.e. Rs.60,000 from Insurance Co. I then insurance company II can claim proportionate contribution from Insurance Co. I and III i.e. Rs. 10,000 from Co. I and Rs. 30,000 from Co. III.

### Re-insurance:

When an insurance company finds that the risk it has undertaken is too heavy for it, it may get itself insured with some other insurance company. This is called re-insurance.

In this case, there are two contracts of insurance:

1. **One between the insured and the insurance company called the contract of insurance.**

2. **The other between the insurance co. and the re-insurance company called the contract of re-insurance.**

The implications of re-insurance are:

<table>
<thead>
<tr>
<th>Insured</th>
<th>Insurance Co. I</th>
<th>Insurance Co. II</th>
<th>Insurance Co. III</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

**Significance of insurance - at a glance**

1. Concentration on business issues
2. Better utilization of capital
3. Promotion of foreign trade
4. Feeling of security to dependents
5. Social welfare
6. Speeding up the process of economic development
7. Generation of employment opportunities
(1) The insured has no relationship with the re-insurance company. He can claim loss only for the insurance company, with whom he has entered into a contract of insurance.
(2) The insurance company can claim loss (paid by it to the insured) from the re-insurance company.

**General (or Fundamental) Principles of Insurance:** The fundamental principles of insurance are the following:

(i) **Principle of Utmost Good Faith:** - A contract of insurance is based on the principle of utmost good faith to be observed by both the parties – the insured and the insurance company – towards each other. If one party conceals any material information from the other party, which may influence the other party's decision to enter into the contract of insurance; the other party can avoid the contract.

The principle of utmost good faith is equally applicable to both the parties. However, the onus (i.e. burden) of making a full and fair disclosure of all material facts usually rests primarily upon the insured; because the insured is supposed to have an intimate knowledge of the subject-matter of insurance.

The duty of disclosing material facts is not a continuing obligation i.e. the insured is under no obligation to disclose any material fact which comes to his knowledge after the conclusion of the contract of insurance.

(ii) **The Principle of Indemnity:** - Except life insurance, all other contracts of insurance are contracts of indemnity; which means that in the event of the loss caused to the subject matter of insurance, the insured can recover only the actual amount of loss-subject to a maximum of sum assured.

Suppose A insured his house against fire with an insurance company for Rs. 1, 00,000. The loss caused to the house due to fire is Rs. 80, 000 only. A can recovery only Rs. 80, 000 from the insurance company.

**The objectives of the principle of indemnity are:**

1. To put the insured in the same position in which he would have been; had there been no loss.
2. Not to allow the insured to make any profit, out of the transaction of insurance.

In case of life insurance, however, it is not possible to estimate the loss caused due to the death of the insured; as life is invaluable. Hence, the full amount of insurance policy can be claimed from the insurance company.

(iii) **Principle of Insurable Interest:** - The principle of insurable interest is the foundation of a contract of insurance. In the absence of insurable interest, the contract of insurance is a mere gamble and not enforceable in a court of law.

Insurable interest may be defined as follows:

A person is said to have insurable interest in the subject matter of insurance; when with respect to the subject matter he is so situated that he will benefit from its existence and lose from its destruction.

Insurable interest must exist in life, fire and marine insurances, as per the following rules:

1. In case of life insurance; insurable interest must exist at the time of making the contract.
2. In case of fire insurance; insurable interest must exist both at the time of making the contract and also at the time of loss.
3. In case of marine insurance; insurable interest must exist, at the time of loss.

(iv) **Principle of Contribution:** - The principle of contribution applies in cases of double-insurance. In case of double insurance, each insurer will contribute to the total payment in proportion to the amount assured by each. In case, one insurer has paid the full amount of loss; he can claim proportionate contribution from other insurers.

Suppose, A insures his house against fire with two insurance companies, X and Y, for Rs.40, 000 and Rs.80, 000 respectively. If the houses catches fire and the actual loss amount to Rs.48, 000, then

<table>
<thead>
<tr>
<th>X will pay Rs. 16,000 to A</th>
<th>And Y will pay Rs.32, 000 to A</th>
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</thead>
<tbody>
<tr>
<td>i.e. the loss of Rs.48, 000 is divided between X and Y in the ratio of 40:000:80,000 or 1:2.</td>
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</table>

If X pays the whole loss of Rs.48, 000 to A; it can recover Rs.32, 000 from Y. And if Y pays Rs.48, 000 to A; it can recover Rs. 16,000 from X.

The principle of contribution does not apply to life insurance; where each insurer will pay the full amount of policy to the insured; because life insurance is a sort of investment and life insurance contract is not a contract of indemnity.

(v) **Principle of Subrogation:** - According to the principle of subrogation, after the insurance company has compensated for the loss caused to the insured; the insurance company steps into the shoes of the insured i.e. the insurance company acquires all the rights of the insured, in respect of the damaged property.

Suppose A insures his house for Rs.2, 00,000 against fire. The house is fully damaged by fire and the insurance company pays Rs.2, 00,000 to A. Later on, the damaged house is sold for Rs.25, 000. The insurance company is entitled to receive this sum of Rs.25, 000. Suppose further, it is found that someone tried to put the house on fire.

The insurance company can take action against that person also; because the insurance company acquires all the rights and remedies available to the insured i.e. Mr. A.

**Implications of the principle of subrogation are:**

1. The insurance company gets the rights of the insured, only after compensating for the loss caused to the insured.
2. This principle does not apply to life insurance.

(vi) **Principle of Cause Proximate (i.e. the Proximate Cause):** - According to this principle, we find out which is the proximate cause or the nearest cause of loss to the insured property. If the nearest cause of loss is a factor which is insured against; then only the insurance company is liable to compensate for the loss, otherwise not. This principle is significant in cases when the loss is caused by a series of events.
Suppose X has taken a marine insurance policy against loss or damage to goods caused by sea water. During the voyage rats made a hole in the bottom of the ship, through which sea water seeped into the ship and caused damaged to the goods. Here, the insurance company is liable to compensate for loss caused to goods; because the proximate cause of loss is sea-water against which insurance is affected. Making of a hole in the bottom of the ship by rats is only the remote cause of loss.

(vii) Principle of Mitigation of Loss: - (Mitigation means making something less harmful). According to the principle of mitigation of loss, it is the duty of the insured to take all possible steps to minimize the loss caused to the property covered by the insurance policy. He should behave as a prudent person and must not become careless after taking the insurance policy.

Suppose a house is insured against fire and a fire breaks out. The owner must immediately inform the Fire Brigade department and do each and every thing to extinguish fire; as if the house were not insured. That is, he must make all efforts to minimize the loss caused by fire.

Types of Insurance:

(1) Life Insurance:

(i) Definition of life insurance:
Life insurance is a contract under which the insurance company – in consideration of a premium paid in lump sum or periodical Installments undertakes to pay a pre-fixed sum of money on the death of the insured or on his attaining a certain age, whichever is earlier.

(ii) Certain important concepts vis-a-vis life insurance:

(a) Insurable interest:-- A person can insure a life, in which he has insurable interest. Insurable interest exists in the following cases:
1. A person has an unlimited insurable interest in his own life.
2. A husband has insurable interest in the life of his wife; and a wife has insurable interest in the life of her husband.
3. A father has insurable interest in the life of his son or daughter, on whom he is dependent.
4. A son has insurable interest in the life of his parents who support him.
5. A creditor has insurable interest in the life of the debtor, to the extent of the debt.

There are many more cases of insurable interest, in case of life insurance, other than those stated above.

Note:
Insurable interest must exist, at the time of making a contract of life insurance:

(b) Proof of age: - In case of life insurance, proof of age is required; because rate of premium depends on age at entry. Proof of age may be given in the form of a school certificate, horoscope, birth certificate from the municipal authority or other legitimate sources.

(c) Surrender value: - The insured can nominate anyone who will get the amount of policy, in the event of the death of the assured.

(d) Surrender value: - Surrender value is the amount which the insurance company would pay to the policy-holder; if he wants to discontinue the policy before the date of its maturity.

(e) Loan on policy: - In case, a certain number of premiums has been paid on a life policy; the policy holder may obtain a loan against the policy from the insurance company. The policy holder may pay back the loan within a certain period, or else the loan and interest on it will be adjusted against the payment due on the maturity of the policy.

(2) Fire Insurance:

(i) Definition of fire insurance:
Fire insurance is a contract, under which the insurance company, in consideration of a premium payable by the insured, agrees to indemnify the assured for the loss or damage to the property assured against fire, during a specified period of time and up to an agreed amount.

Points of comment:

(1) In fire insurance, the insurable interest must exist at both the time of contract and the time of loss.

(2) Fire insurance is a contract of indemnity, and the insured cannot claim more than the amount of actual loss subject to a maximum of the sum assured. Further, the insurance company may compensate in the form of money or in form of replacement or repairs to the property damaged by fire.

(3) Loss by fire also includes the following losses:

(i) Goods spoiled by water used to extinguish fire
(ii) Pulling down of adjacent buildings by Fire Brigade to prevent the progress of flames
(iii) Breakage of goods in the process of removal from the building where a fire is raging e.g. damage caused by throwing furniture out of the window.
(iv) Wages paid to workers employed for extinguishing fire.

(ii) Average clause in fire insurance policy:
To take care of the cases of under insurance, there is usually an average clause in a fire policy. According to this clause, in case of loss the insured will himself bear a part of loss. In fact, for the difference between the actual value of the subject matter and the sum assured; the insured has to be his own insurer. Suppose a house worth Rs. 1, 00,000 is insured only for Rs.60, 000 and the insurance policy contains the average clause.

Now, if the loss to the property due to fire is Rs.40, 000 then the insurance company will pay only Rs.24,000 as per the following formula:
The Role and Importance of Insurance

The following point shows the role and importance of insurance:

1. **Provide safety and security**: Insurance provides financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

2. **Generates financial resources**: Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

3. **Life insurance encourages savings**: Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

4. **Promotes economic growth**: Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those result into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

5. **Medical support**: A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

6. **Spreading of risk**: Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

7. **Source of collecting funds**: Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation.

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**The Tax Environment and Financial Services**

The current tax and business environment
Tax is higher on the international business – and media - agenda than ever before. Governments are facing increasing fiscal pressures and businesses are changing their operating models to reduce costs, increase market share, and drive growth opportunities.

In this challenging economic environment, businesses are under increased scrutiny to explain their tax affairs transparently, manage risk and manage multiple stakeholders in a cost effective way.

Traditionally tax professionals have focused on practical answers to complex tax questions and structuring arrangements. But the new tax environment and the need to improve the quality of controls has seen senior management become more interested in how tax risk is being managed and its alignment to the goals of the organisation. So it’s vital that your organisation understands the effectiveness of its tax operating model and tax control framework.

You need to understand the key tax risks within your business and be able to account for the effective and hopefully efficient controls you have in place to mitigate these risks and maximise opportunities. This will enable the business to develop a mandate for tax and ensure the organisation meets its wider strategic objectives, rather than being undermined by uncontrolled and misunderstood tax risks creating unexpected tax exposures.

### Fiscal Policy: Meaning, Objectives and Other Information | Article on Economics

The role of fiscal policy for economic growth relates to the stabilization of the rate of growth of an advanced country. Fiscal policy through variations in government expenditure and taxation profoundly affects national income, employment, output and prices.

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#### 1. Meaning of Fiscal Policy

Fiscal policy means the use of taxation and public expenditure by the government for stabilisation or growth. According to Culbarston, “By fiscal policy we refer to government actions affecting its receipts and expenditures which we ordinarily taken as measured by the government’s receipts, its surplus or deficit.” The government may offset undesirable variations in private consumption and investment by compensatory variations of public expenditures and taxes.

Arthur Smithies defines fiscal policy as “a policy under which the government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment.” Though the ultimate aim of fiscal policy is the long-run stabilisation of the economy, yet it can be achieved by moderating short-run economic fluctuations. In this context, Otto Eckstein defines fiscal policy as “changes in taxes and expenditures which aim at short-run goals of full employment and price-level stability.”

#### 2. Objectives of Fiscal Policy - The following are the objectives of fiscal policy:

1. To maintain and achieve full employment.
2. To stabilise the price level.
3. To stabilise the growth rate of the economy.
4. To maintain equilibrium in the balance of payments.
5. To promote the economic development of underdeveloped countries.

#### 3. Fiscal Policy for Economic Growth

The role of fiscal policy for economic growth relates to the stabilization of the rate of growth of an advanced country. Fiscal policy through variations in government expenditure and taxation profoundly affects national income, employment, output and prices. An increase in public expenditure during depression adds to the aggregate demand for goods and services and leads to a large increase in income via the multiplier process; while a reduction in taxes has the effect of raising disposable income thereby increasing consumption and investment expenditure of the people.

The compensatory fiscal policy aims at continuously compensating the economy against chronic tendencies towards inflation and deflation by manipulating public expenditures and taxes. It, therefore, necessitates the adoption of fiscal measures over the long-run rather than once-for-all measures it a point of time.

When there are inflationary tendencies in the economy, the government should increase its expenditures through deficit budgeting and reduction in taxes. This is essential to compensate for the lack in private investment and to raise effective demand, employment, output and income within the economy.

On the other hand, when there are inflationary tendencies, the government should reduce its expenditures by having a surplus budget and raising taxes in order to stabilise the economy at the full employment level.

The compensatory fiscal policy has two approaches:

1. Built-in stabilisers; and
2. Discretionary fiscal policy.

**Built-in Stabilisers:** - The technique of built-in flexibility or stabilisers involves the automatic adjustment of the expenditures and taxes in relation to cyclical upswings and downswings within the economy without deliberate action on the part of the government. Under this system, changes in the budget are automatic and hence this technique is also known as one of automatic stabilisation.

The various automatic stabilisers are corporate profits tax, income tax, excise taxes, old age, survivors and unemployment insurance and unemployment relief payments. As instruments of automatic stabilisation, taxes and expenditures are related to national income. Given
an unchanged structure of tax rates, tax yields vary directly with movements in national income, while government expenditures vary inversely with variations in national income.

In the downward phase of the business cycle when national income is declining, taxes which are based on a percentage of national income automatically decline, thereby reducing the tax yield. At the same time, government expenditures on unemployment relief and social security benefits automatically increase. Thus there would be an automatic budget deficit which would counteract deflationary tendencies.

On the other hand, in the upward phase of the business cycle when national income is rising rapidly, the tax yield would automatically increase with the rise in tax rates. Simultaneously, government expenditures on unemployment relief and social security benefits automatically decline. These two forces would automatically create a budget surplus and thus inflationary tendencies would be controlled automatically.

**It's Merits:** Built-in stabilisers have certain advantages as a fiscal device:

1. The built-in stabilisers serve as a cushion for private purchasing power when it falls and lessen the hardships on the people during deflationary period.
2. They prevent national income and consumption spending from falling at a low level.
3. There are automatic budgetary changes in this device and the delay in taking administrative decisions is avoided.
4. Automatic stabilisers minimise the errors of wrong forecasting and timing of fiscal measures.
5. They integrate short-run and long-run fiscal policies.

**It's Limitations:** It has the following limitations:

1. The effectiveness of built-in stabilisers as an automatic compensatory device depends on the elasticity of tax receipts, the level of taxes and flexibility of public expenditures. The greater the elasticity of tax receipts, the greater will be the effectiveness of automatic stabilisers in controlling inflationary and deflationary tendencies. But the elasticity of tax receipts is not so high as to act as an automatic stabiliser even in advanced countries like America.
2. With low level of taxes even a high elasticity of tax receipts would not be very significant as an automatic stabiliser doing a downswing.
3. The built-in stabilisers do not consider the secondary effects of stabilisers on after-tax business incomes and of consumption spending on business expectations.
4. This device keeps silent about the stabilising influence of local bodies, state governments and of the private sector economy.
5. They cannot eliminate the business cycles. At the most, they can reduce its severity.
6. Their effects during recovery from recession are unfavourable. Economists, therefore, suggest that built-in stabilisers should be supplemented by discretionary fiscal policy.

**(2) Discretionary Fiscal Policy:** Discretionary fiscal policy requires deliberate change in the budget by such actions as changing tax rates or government expenditures or both.

It may generally take three forms:

(i) Changing taxes with government expenditure constant,
(ii) changing government expenditure with taxes constant, and
(iii) variations in both expenditures and tax simultaneously.

(i) When taxes are reduced, while keeping government expenditure unchanged, they increase the disposable income of households and businesses. This increase private spending. But the amount of increase will depend on whom the taxes are cut, to what extent, and on whether the taxpayers regard the cut temporary or permanent.

If the beneficiaries of tax cut are in the higher middle income group, the aggregate demand will increase much. If they are businessmen with little incentive to invest, tax reductions are temporary. This policy will again be less effective. So this is more effective in controlling inflation by raising taxes because high rates of taxation will reduce disposable income of individuals and businesses thereby curtailing aggregate demand.

(ii) The second method is more useful in controlling deflationary tendencies. When the government increases its expenditure on goods and services, keeping taxes constant, aggregate demand goes up by the full amount of the increase in government spending. On the hand, reducing government expenditure during inflation is not so effective because of high business expectations in the economy which are not likely to reduce aggregate demand.

(iii) The third method is more effective and superior to the other two methods in controlling inflationary and deflationary tendencies. To control inflation, taxes may be increased and government expenditure be raised to fight depression.

**It’s Limitations:**

The discretionary fiscal policy depends upon proper timing and accurate forecasting:

1. Accurate forecasting is essential to judge the stage of cycle through which the economy is passing. It is only then that appropriate fiscal action can be taken. Wrong forecasting may accentuate rather than moderate the cyclical swings. Economics is not an exact science in correct forecasting. As a result, fiscal action always follows after the turning points in the business cycles.
2. There are delays in proper timing of public spending. In fact, discretionary fiscal policy is subject to three time lags.

(i) There is the “decision lag,” the time required in studying the problem and taking the decision. The lag involved in this process may be too long.

(ii) Once the decision is taken, is an “execution lag.” It involves expenditure which is to be allocated for the execution of the programme. In a country like the USA it may take two years and less than a year in the U.K.
(ii) Certain public work projects are so cumbersome that it is not possible to accelerate or slow them down for the purpose of raising or reducing spending on them.

Conclusion:

Despite the higher multiplier effect of government spending as against changes in tax rates, the latter can be operated more promptly than the former. Emphasis has thus shifted to taxation as the best fiscal device for controlling cyclical fluctuations. Thus when the turning point of a business cycle is already underway, discretionary fiscal action tends to strengthen the built-in stabilisers, as has been the experience of developed countries like the USA.

4. Budgetary Policy—Contra-cyclical Fiscal Policy

The budget is the principal instrument of fiscal policy. Budgetary policy exercises control over size and relationship of government receipts and expenditures. We discuss below the common budgetary policies that can be adopted for stabilising the economy.

(1) Budget Deficit—Fiscal Policy during Depression:

- Deficit budgeting is an important method of overcoming depression. When government expenditures exceed receipts, larger amounts are put into the stream of national income than they are withdrawn. The deficit represents the net expenditure of the government which increases national income by the multiplier times the increase in net expenditures. If the MPC is 2/3, the multiplier will be 3; and if the net increase in government expenditure is Rs.100 crores it will increase national income to Rs. 300 crores (= 100 x 3).

Thus the budget deficit has an expansionary effect on aggregate demand whether the fiscal process leaves marginal propensities unchanged or whether a redistribution of disposable receipts occurs. The expansionary effect of a budget deficit is shown diagrammatically in Figure 1. C is the consumption function. C + I+ G represent consumption, investment and government expenditure (the total spending function) before the budget is introduced. Suppose government expenditure of ΔG is injected into the economy.

As a result, the total spending function shifts upward to C +1 + G. Income increases from OF to OF1 when the equilibrium position moves from E1 to E1. The increase in income YY1 (= EA = MI E1A) is greater than the increase in government expenditure E1B (=ΔG). BA (E1A – E1B) represents increase in consumption. Thus the budget deficit is always expansionary, the rise in national income being YY1 greater than the actual amount of government spending (ΔG = E1B). In this method of budget deficit, taxes are kept intact. Budget deficit may also be secured by reduction in taxes and without government spending. Reduction in taxes tends to leave larger disposable income in the hands of the people and thus stimulates increase in consumption expenditure. This, in turn, would lead to increase in aggregate demand output, income and employment. This is illustrated in Figure 2, where C is the original consumption function. Suppose tax is reduced by ET, it will shift the consumption function upward to C1. Income will increase from OY to OY1.

However, reduction in taxes is not so expansionary via increased consumption expenditure because the tax relief may be saved and not spent on consumption. Businessmen may not also invest more if the business expectations are low. Therefore, to safeguard against such eventualities the government should follow the policy of reduction in taxes with increased government spending and its multiplier effect will be much higher in case we also assume that some consumption and investment expenditures increase due to tax relief.

(2) Surplus Budget—Fiscal Policy during Boom:

- Surplus in the budget occurs when the government revenues exceed expenditures. The policy of surplus budget is followed to control inflationary pressures within the economy. It may be through increase in taxation or reduction in government expenditure or both. This will tend to reduce income and aggregate demand by the multiplier times the reduction in government or/and private consumption expenditure (as a result of increased taxes).

This is explained with the aid of Figure 1, where the economy is at the initial equilibrium position E1. Suppose the government expenditure is reduced by ΔG so that the total spending function C + I + G shifts downward to C + I + G. Now E is the new equilibrium position which shows that the income has declined to OY from OY1 as a result of reduction in government expenditure by E1B. The fall in income Y1 Y 1 (= AE) > E1 B the reduction in expenditure because consumption has also been reduced by BA.

There may be budget surplus without government spending when taxes are raised. Enhanced taxes reduce the disposal income with the people and encourage reduction in consumption expenditure. The result is fall in aggregate demand, output income and employment. This is illustrated in Figure 3. C is the consumption function before the imposition of the tax. Suppose a tax equal to ET is introduced. The consumption function shifts downward to C1. The new equilibrium position is E1. As a result, income falls from OY to OY1.

(3) Balanced Budget:

- Another expansionist fiscal policy is the balanced budget. In this policy the increase in taxes (ΔT) and in government expenditure (ΔG) are of an equal amount. This has the impact of increasing net national income. This is because the reduction in consumption resulting from the tax is not equal to the government expenditure.

The basis for the expansionary effect of this kind of balanced budget is that a tax merely tends to reduce the level of disposable income. Therefore, when only a portion of an economy’s disposable income is used for consumption purposes, the economy’s consumption expenditure will not fall by the full amount of the tax. On the other hand, government expenditure increases by the full amount of the tax. Thus the government expenditure rises more than the fall in consumption expenditure due to the tax and there is net increase in national income.
The balanced budget theorem is based on the combined operation of the tax multiplier and the government-expenditure multiplier. In this, the tax multiplier is smaller than the government-expenditure multiplier. The government-expenditure multiplier is

\[ \frac{\Delta Y}{\Delta G} = 1 / (1 - c) \]

Where \( \Delta Y \) is the change in income and \( \Delta G \) is the change in autonomous government expenditure. The tax multiplier is

\[ \frac{\Delta Y}{\Delta T} = -c / (1 - c) \]

Which indicates that the change in income (\( \Delta Y \)) will equal the multiplier \((1/1 - c)\) times the change in autonomous government expenditure?

The tax multiplier is

\[ \Delta Y = -c \Delta T / (1 - c) \]

\[ \Delta Y / \Delta T = -c / (1 - c) \]

Which shows that the change in income (\( \Delta Y \)) will equal multiplier \((1/1 - c)\) times the product of the marginal propensity to consume \((c)\) and the change in taxes (\( \Delta T \)).

A simultaneous change in public expenditure and taxes may be expressed as a combination of equations (1) and (2). Thus the balanced budget multiplier

\[ kb = \frac{c \Delta G + c/1-c \Delta T}{1/1-c} = 1 \]

This balanced budget multiplier or unit multiplier is explained with the help of Figure 4. It is the consumption function before the imposition of the tax with income at \( OY_0 \) level. Tax of \( AG \) amount is imposed. As a result, the consumption function shifts downward by an amount equal to the tax yield \( AG \) at point \( E \).

The new government expenditure line is \( C + G \) which determines \( OY \) income at point \( E \). The increase in income \( Y_0 \) equals the tax yield \( AG \) and the increase in government expenditure \( GE \). This proves that income has risen by 1 (one) times the amount of increase in government expenditure which is a balanced budget expansion.

### Government and economic influences on business

#### The impact of business activity on society

All business activity has benefits and undesirable effects on society. These reasons are why governments want to have some control over business activity:

- **Possible benefits:**
  - Production of **useful goods** to satisfy customer wants.
  - Create **employment**/increases workers **living standards**.
  - Introduction of new products or processes that **reduce costs** and **widen product range**.

- **Possible undesirable effects:**
  - Business might **ruin** cheap but **beautiful areas**.
  - **Low wages** and **unsafe working** conditions for workers because businesses want to **lower costs**.
  - **Pollution**

Governments tend to pass laws that restrict **undesirable** activities while supporting **desirable** activities.

#### Governments and the economy

**Government economic objectives:**

Governments all have aims for their country, and this is what they are:

- **Low inflation.**
- **Low unemployment.**
- **Economic growth.**
- **Balance of payments.**

**Low inflation:**

- Inflation occurs when prices rise. When prices rise rapidly many bad things could happen:
  - Workers wages **buy less** than before. Therefore their real income (how much you can buy with so much money) falls. Workers will be unhappy and demand for higher wages.
  - Prices of local goods will **rise more** than that of other countries with lower inflation. People may start buying **foreign goods** instead.
  - It would **cost more** for businesses to **start** or **expand** and therefore it does not employ as many people.
  - Some people might be made **redundant** so that the business can cut costs.
  - **Standards of living** will fall.

This is obviously why governments want to keep inflation as low as possible.

**Low levels of unemployment:**

- When people are **unemployed**, they **want** to work but cannot **find a job**. This causes many problems:
  - Unemployed people do not work. Therefore **national output** will be **lower** than it should be.
The government will have to pay for unemployment benefits. This is expensive and money cannot be used for other purposes. If the level up unemployment is low, it will increase national output and improve standards of living for workers.

**Economic growth**
A country is said to grow when its GDP (Gross Domestic Product) is increasing. This is the total value of goods produced in one year. The standards of living tend to increase with economic growth. Problems arise when a country's GDP fall:
- The country's output is falling, fewer workers are needed and unemployment occurs.
- Standards of living will fall.
- Businesses will not expand because they have less money to invest.

Economic growth is not achieved every year. There are years where the GDP falls and the trade cycle explains the pattern of rises and falls in national GDP.

**The trade cycle has 4 main stages:**
- **Growth:** This is when GDP is rising, unemployment is falling, and the country has higher standards of living. Businesses tend to do well in this period.
- **Boom:** Caused by overspending. Prices rise rapidly and there is a shortage of skilled workers. Business costs will be rising and they are uncertain about the future.
- **Recession:** Because overspending caused the boom, people now spend too little. GDP will fall and businesses will lose demand and profits. Workers may lose their jobs.
- **Slump:** A long drawn out recession. Unemployment will peak and prices will fall. Many firms will go out of business.

After all of this happens the economy recovers and begins to grow again. Governments want to avoid a recession and a slump. Currently, the government of China is spending a lot of money so that their economy would continue to grow and avoid a boom.

**Balance of payments**
Exports earn foreign currency, while imports are paid for by foreign currency (or vice versa). The difference between the value of exports and imports of a country is called balance of payments. Governments try to achieve a balance in imports and exports to avoid a trade deficit, when imports are higher than exports. Of course, the government will lose money and their reservoir of foreign currency will fall.

This results in:
- If the country wants to import more, they will have to borrow foreign currency to buy goods.
- The country's currency will now worth less compared to others and can buy less goods. This is called exchange rate depreciation.

**Government economic policies**
Governments want to influence the national economy so that it would achieve their aforementioned objectives. They have a lot of power over business activity and can pass laws to try to achieve their goals. The main ways in which governments can influence business activity are called economic policies. They are:
- **Fiscal Policy:** taxes and public spending.
- **Monetary policy:** controlling the amount of money in the economy through interest rates.
- **Supply side policies:** aimed at increasing efficiency.

**Fiscal policy**
Government spending could benefit some firms such as:
- Construction firms (road building)
- Defense industries (Iraq war)
- Bus manufacturers (public transport)

Governments raise money from taxes. There are Direct taxes on income and Indirect taxes on spending. There are four common taxes:
- Income tax
- Profits tax
- VAT (Value Added Tax)
- Import tariffs

**Income tax**
Income tax is based on a percentage of your income. Income tax is usually progressive, meaning that the percentage of tax you have to pay rises with your income. Effects on business and individuals if there was a rise of income tax:
- People will have less disposable income.
- Sales fall because people have less money to spend.
- Managers will cut costs for more profit. Workers might be made redundant.
- Businesses producing luxury goods will lose the most, while others producing everyday needs will get less affected.

**Profits tax or corporation tax**
This is a percentage of the profit a business makes. A rise in it would mean:
- Managers will have less retained profit, making it harder for the business to expand.
- Owners will get less return on capital employed. Potential owners will be reluctant to start their own business if the profit margin is too low.

**Indirect taxes**
These taxes are a percentage on the price of goods, making them more expensive. Governments want to avoid putting them on essential goods such as foods. A rise in it would mean:
- The effect would be almost the same as that of an increase in income tax. People would buy less but they would still spend money on essential goods.
- Again, real incomes fall. Costs will rise when workers demand higher wages.
### Import tariffs and quotas

Governments put tariffs on imports to make local goods look more competitive and also to reduce imports. When governments put import tariffs on imports:

- Sales of local goods become cheaper than imports, leading to increased sales.
- Businesses who import raw materials will suffer higher costs.
- Other countries may retaliate by putting tariffs on the country's exports, making it less competitive.

### Monetary policy and interest rates

Governments usually have to power to change interest rates through the central bank. Interest rates affect people who borrow from the bank. When interest rates rise:

- Businesses who owe to bank will have to pay more, resulting in less retained profit.
- People are more reluctant to start new businesses or expand.
- Consumers who took out loans such as mortgages will now have less disposable income. They will spend less on other goods.
- Demand will fall for businesses who produces luxury or expensive goods such as cars because people are less willing to borrow.
- Higher interest rates will encourage other countries to deposit money into local banks and earn higher profits. They will change their money into the local currency, increasing its demand and causing exchange rate appreciation.

### Supply side policies

These policies aim to make the countries economy more efficient so that they can produce more goods and compete in the international economy. In doing so their GDP will rise. Here are some policies:

- Privatisation: Its aim is to use profit as an incentive to increase efficiency.
- Improve training and education: This obviously increases efficiency. This is crucial to countries with a big computer software industry.
- Increase competition: Competition causes companies to be more efficient to survive. Governments need to remove any monopolies.

### Private sector

Governments also influence major areas of business activity:

- what goods can be produced
- responsibilities to consumers
- responsibilities to employees and working conditions
- location decisions

Undesirable effects created by business activity make governments want to control business activity:

- Business might ruin cheap but beautiful areas. *Monopolies.
- Advertising can mislead customers.

### Government controls over business activity

Government also influence major areas of business activity:

### Why government control business activity

Production of certain goods and services:

Governments can pass laws to restrict and ban certain dangerous goods such as:

- Weapons like guns and explosives.
- Drugs
- Goods that harm the environment

Consumer protection:

Consumers are easily misled by advertising. It is because consumers lack the technical knowledge and advertising can be very persuasive.

In the UK, these laws are passed to protect customers from being exploited by businesses:

- **Weights and Measures Act**: to stop underweight goods being sold to customers.
- **Trade Descriptions Act**: all advertisements must be truthful.
- **Consumer Credit Act**: makes it illegal to not give customers their copy of the credit agreement to check how much money they really have.
- **Sale of Goods Act**: Makes it illegal to sell:
  - Goods which have serious flaws or problems.
  - Products that are not fit for the purpose intended by the consumer.
  - Products that do not function as described on their label or by the retailer.
- **Consumer Protection Act**: Make false pricing claims illegal. Consumers can sue producers or retailers if their products cause harm to them.

### Competition policy: Control of monopolies

Monopolies could cause a lot of harm to an economy because there are nobody to compete against them:

- They exploit consumers with high prices.
- They prevent new firms from starting up.
- Monopolies are not encouraged to be efficient because there are no competitors.

In some countries, monopolies are banned and must be broken up into smaller firms. In the UK, monopolies can be investigated by the **Competition Commission**. This government body reports two main types of problems:

- Business decisions that are against consumer interests, such as trying to eliminate all competitors.
- Proposed mergers or takeovers that will result in a monopoly.

### Protecting employees

Employees need protection in the following areas:

- Unfair discrimination
- Health and safety at work
- Unfair dismissal
- Wage protection

### Protection against unfair discrimination

- Wage protection
- Health and safety at work
- Unfair dismissal
- Unfair discrimination
Often workers are discriminated in a job because of various reasons. There are laws that protect the employee from such reasons to be discriminated against:

- **Sex Discrimination Act:** people of different genders must have equal opportunities.
- **Race Relations Act:** people of all races and religions must have equal opportunities.
- **Disability Discrimination Act:** it must be made suitable for disabled people to work in businesses.
- **Equal Opportunities Policy:** That is what everything is all about.

The UK is currently working on an age discrimination act.

### Health and Safety at work:

Laws protect workers from:

- protect workers from dangerous machinery.
- provide safety equipment and clothing.
- do not insist on excessively long shifts and provide breaks in the work timetable.

Managers not only provide safety for their employees only because laws say so. Some believe that keeping employees safe and happy improves their motivation and keeps them in the business. Others do it because it is present in their moral code. They are then considered making an ethical decision. However, in many countries, workers are still exploited by employers.

### Protection against unfair dismissal

Employees need protection from being dismissed unfairly. The following reasons for the employee to be dismissed is unreasonable:

- for joining a trade union.
- for being pregnant.
- when no warnings were given beforehand.

Workers who thing they have been dismissed unfairly can take their case to the **Industrial Tribunal** to be judged and he/she might receive compensation if the case is in his/her favour.

### Wage Protection

Employers must pay employees the same amount that has been stated on the **contract of employment**, which states:

- Hours of work.
- The wage rate to be paid.
- How frequently wages will be paid.
- What deduction will be made from wages, e.g. income tax.
- Minimum wage rate is present in many Western countries and the USA. There are pros and cons of the minimum wage:

**Pros:**

- Prevents strong employees to exploit unskilled workers who could not easily find work.
- Encourages employers to train unskilled employees to increase efficiency.
- Encourages more people to seek work.
- Low-paid workers can now spend more.

**Cons:**

- Increases costs, increases prices.
- Owners who cannot afford these wages might make employees redundant instead.
- Higher paid workers want higher wages to keep on the same level difference as the lower paid workers. Costs will rise.

### Location of Industry

How governments want to locate businesses:

- They encourage businesses to move to areas with a high level of **unemployment**, or called development areas.
- They discourage firms from locating in overcrowded cites or sites noted for their natural beauty.

How governments will influence the decisions of firms to locate:

- Businesses will be refused **planning permission** (permit to build in a place) if they wish to locate in overcrowded cities or beautiful areas.
- Building in these areas might be banned altogether.
- Governments can provide **regional assistance**, such as grants and subsidies to encourage firms to locate in undeveloped areas.

### Governments can help businesses too

Governments can help businesses to:

- to encourage businesses to locate in poorer regions.
- to encourage businesses to export.
- to encourage enterprise by helping small businesses set up and survive.

### Regional Assistance:

Governments want development to be spread evenly over the whole country.

- Grants and subsidies can be used to attract firms to an area.

#### Small firms

Small firms are important for and economy because:

- They provide most of the employment because they are usually labour intensive.
- Small firms operate in rural areas where unemployment tends to be high.
- They can grow into very important businesses employing thousands of workers and producing output worth millions of dollars.
- Provides more choice for customers. They compete against bigger companies.
- They are often managed in a very flexible way, and is quicker to adapt to changing demands.

Governments help them by:
• Lower rates of profits tax, so they can have more retained profit.
• Giving grants and cheap loans.

Exporting goods and services
Why governments want businesses to export:
• Exports earn foreign currency, which can be used to buy imports.
• More exports means more people need to produce them, increasing employment and standards of living.
• Successful exporters earn more money and have to pay more profits tax.

Governments can support exporters by:
• Encouraging banks to lend to exporting businesses at lower interest rates.
• Offering subsidies or lower taxes to firms. However, other countries would retaliate and there would be no overall advantage.
• Trying to keep the local currency as stable as possible to make it easier for businesses to know how much they are going to make from exports.
• Organising trade fairs abroad to encourage foreign businesses to buy the country's exports.
• Offering credit facilities. This means that if a foreign customer refuses to pay for goods, the company could be compensated by the government.

Businesses in the economic and legal environment
Businesses could not ignore the power of the government in controlling business activity. Multinationals are an exception although normally businesses cannot afford to move to other countries. Government decisions create the environment in which businesses will have to operate and adapt to. The environment created by legal and economic controls are one of the constraints to managers when making decisions.

Money vs. Capital Markets
- Money Market – Short-term, high quality debt securities are traded here.
- Capital Market – Long-term securities traded in the capital markets.

2. Capital Market:
- Capital market deals with the grant of medium and long term loans.
- The capital market refers to the institutional arrangements which facilitate the lending and borrowing of medium and long term loans.