Biyani's Think Tank

Concept based notes

Management of Financial Services

MBA-III

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Preface

I am glad to present this book, especially designed to serve the needs of the students. The book has been written keeping in mind the general weakness in understanding the fundamental concepts of the topics. The book is self-explanatory and adopts the “Teach Yourself” style. It is based on question-answer pattern. The language of book is quite easy and understandable based on scientific approach.

Any further improvement in the contents of the book by making corrections, omission and inclusion is keen to be achieved based on suggestions from the readers for which the author shall be obliged.

I acknowledge special thanks to Mr. Rajeev Biyani, *Chairman* & Dr. Sanjay Biyani, *Director* (*Acad.*) Biyani Group of Colleges, who are the backbones and main concept provider and also have been constant source of motivation throughout this Endeavour. They played an active role in coordinating the various stages of this Endeavour and spearheaded the publishing work.

I look forward to receiving valuable suggestions from professors of various educational institutions, other faculty members and students for improvement of the quality of the book. The reader may feel free to send in their comments and suggestions to the under mentioned address.

B.K Jain

SYLLABUS

Section A

Introduction to financial services marketing: Concept of financial services, financial services and GDP, reforms in financial sector, recent issues and challenges in financial services in India. Indian financial system: an overview of Indian financial institutions, types of financial services – fund and fee based. An overview of the different activities performed by a bank. Risk in financial services and changing perception of intermediaries regarding financial services.

Capital markets: government securities market, monetary money market.

Merchant banking: nature and scope, regulation, overview of current Indian merchant banking scene-structure of merchant banking industry, primary market in India and abroad, SEBI guidelines, pricing and timing of public issues, pre-issue management-advertising and marketing, post issue management-rights issues.

Introductory, conceptual, evaluation, marketing and legal aspects of the following financial services: Lease, Hire purchase, consumer finance, factoring, bill financing, credit cards, securitization/mortgages.

Section B
Case and Problems

MANAGEMENT OF FINANCIAL SERVICES

CONTENTS

Chapter 1

Introduction to Financial Services Marketing

Q.1 What do you understand by Financial Services? Explain in brief fee based and fund based financial services.

Ans. **Financial Services** – In general, all types of activities which are of a financial nature can be brought under the term "financial services". In broad sense, it means "mobilizing and allocating savings". Thus it involves all activities involved in the transformation of savings into investment. It can also be called financial intermediation which is a process by which funds are mobilized by large number of sectors and make them available to all those who are in need particularly corporate customers. Thus financial service sector is a key area and is vital for industrial development.

Financial service help not only to raise required funds but also ensure their efficient deployment. In order to ensure efficient management of funds, services such as bill discounting, factoring, parking of short term funds in money market, securitization of debt are provided by financial service firms. Besides banking and insurance, this sector provides specialized services such as credit rating, venture capital financing, lease financing, merchant banking, credit cards, housing finance etc. Hence, in brief, these are the services rendered by financial institutions and intermediaries operating in the market.

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

(i) Traditional activities
(ii) Modern activities.

Traditional activities can be further classified as :

(i) Fund based activities/services

(ii) Fee based activities /services

Fund based activities / services are those where funds of financial institutions are involved such as:

- Underwriting of investments in shares, debentures
- Advancing different types of loans (short term, medium term, long term) and in the form of clean loan, pledge, hypothecation, housing, education, consumption loan etc.
- Investing / participating in money market instruments like CPs, CDs bill discounting, treasury bills etc.
- Providing finance like leasing, hire purchase, venture capital, seed capital etc.

Non-Fund based activities/services are those where funds are not involved and financial institution gets income in the form of fee such as:

- Commission on demand draft.
- Guarantee/Letter of credit
- Managing capital issue (pre-issue & post issue management services)
- Advisory/Consultancy services
- Project preparation/appraisal/arranging finance through projects from financial institutions
- Assisting in the process of getting clearances from Govt/Govt bodies.

Modern activities/services provided by financial institutions are like advisory role in corporate restructuring, acting as trustees for debentures, rehabilitation and restructuring sick units, portfolio management of large corporate risk management services, hedging of risks, guiding management in cost minimization efforts, safe custody of securities etc.

Q.2 What do you understand by Indian Financial System?

Ans. Financial system consists of two words i.e. Finance & system. Finance means study of money, its nature, its creation, behavior, regulations and administration and system means set of instructions, markets, practices, transaction, claims & liabilities in the economy. Hence financial system refers to area in which all those activities, bodies and instruments dealing in finance are organized in to a system.

Indian Financial System includes many institutions and mechanism that effect the generation of savings and distribution of savings amongst all those who demand these funds for investment purpose. Thus financial system is a broader term which brings under its fold financial markets and financial institutions which support the system and major assets/instruments traded in the system. An efficient functioning of financial system facilitates free flow of funds to more productive activities and promotes faster economic growth. Hence financial system plays a crucial role in converting savings into investment and making surplus money available to core sectors of economy i.e. agriculture, industry, infrastructure development and thereby helps in overall development of economy.

Thus, Indian Financial consists of following :

1. Financial markets
2. Financial institutions/intermediaries
3. Financial assets/instruments

Financial markets can be further divided into :

1. Organized sector
2. Unorganized sector

Organized sector markets can be further divided into :

1. Money Market
2. Capital Market (Primary Market & Secondary Market)

Financial institutions / Intermediaries can also be divided into :

1. Regulatory Bodies – Key regulatory bodies are :
   - RBI
   - Securities & Exchange Board of India (SEBI)
   - Insurance Regulatory & Development Authority (IRDA)
   - Govt. of India (Dept. of Banking & Insurance, Ministry of Finance)

2. Intermediaries – Which may be :
   - Money Market Intermediaries.
   - Capital market intermediaries

Detailed explanation of financial markets, financial intermediaries is there in subsequent portion of this book.

Q.3 What do you understand by Financial Intermediaries? Explain in brief about financial intermediaries in capital market and money market.

Ans. The term Financial Intermediary includes all kinds of organizations which intermediate and facilitate Transactions of both individual and corporate customers as well as transactions of both banking and non banking nature. Thus intermediaries refers to all kinds of financial institutions as well investing institutions which facilitate financial transactions in financial markets. These intermediaries & transactions may be in the organized sector or unorganized sector. These intermediaries may also be classified into two :

1. Capital Market Intermediaries
2. Money Market Intermediaries

Capital Market Intermediaries – are those which mainly provide long term funds to individuals and corporate customers. They consist of term lending institutions, Development banks, financial corporations and investment institutions like LIC.

Money Market Intermediaries – are those which supply only short term funds to individuals and corporate customers. They consist of commercial banks and cooperative banks.

Charts showing details of following types of institutions working as intermediaries in above both types are enclosed in annexures.

Types of financial intermediaries

- Commercial banks
- Cooperative banks
- Development banks

Q.4 Enumerate various reforms taken place in financial sector in India.

Ans. From the year 1991-92 and onwards lot of reforms have taken place in financial sector in India. Some important reform measures are listed below:

1. The Reserve Bank of India has introduced the system of **deregulation of interest rates** and as a result banks are free to decide their interest rates on deposits and loans and advances

2. **Introduction of Liberalization, Privatization and globalization** – (LPG) in economy has also effected financial sector. There is a greater increase in participation of private sector in banking, mutual fund and public sector undertakings.

3. **Disinvestment** from public sector undertakings is another key step taken by Govt. of India towards privatization. For this purpose, a statutory body in the name of "Disinvestment Commission" was established in 1996 and even a Contract Committee on Disinvestment (CCD) was constituted to decide matters pertaining to disinvestment in public sector undertakings.

4. **Free pricing of issues** was introduced by SEBI and issuing companies were brought out of controller of capital issues in this regard. This has resulted in lot of new issues coming in the market and capital market has been activated a lot . SEBI has also liberalized other stringent conditions to boost up capital market.

5. **Liberalized tax structure** has started giving lot of relief in direct and indirect taxe3s to entrepreneurs particularly in remote and hard areas.

6. **Recognized credit rating agencies** have started working in financial sector for looking after the interest of investors as well as making the task of issuing companies easy.

7. There is a lot of emphasis on **financial inclusion** by Govt. and as a result banking sector is making serious efforts to bring more people in banking net work. Even the policy of zero balance has been introduced by banks to make financial inclusion policy a success.

8. Due to these reforms and need of investors, new and innovative financial instruments are coming in market.

Q.5 What are the challenges before financial services sector?

Ans. Some of the important challenges faced by financial services sector are as follows:

1. **Lack of qualified personnel –** There is a dearth of qualified and trained personnel & it is a important impediment in the growth of financial service sector. A proper and comprehensive training need to be given to various financial intermediaries.

2. **Lack of investors awareness –** Many innovative financial products/instruments are coming in market but the investors are not aware about their advantages. Hence, financial intermediaries need to educate investors about various products.

3. **Lack of specialization –** Each financial intermediary is dealing in different financial service lines without specializing in one or two areas as is the condition in foreign countries. Hence financial intermediaries have to go for such specialization.

4. **Lack of recent data –** Most of the intermediaries do not spend more time on research and lack adequate data base required for financial creativity.

5. **Lack of efficient risk Management system –** With the opening up of economy to Multinationals and exposure of Indian companies to international competition, much importance is given to foreign portfolio flows involving multi currency transactions exposing the client to exchange rate risk, interest rate risk, economic and political risk. Hence it is essential that they should introduce futures, options , swaps and other derivative products which are necessary for an effective risk management system.

Q.6 What key activities are performed by banks?

Ans. The Banking Regulation act 1949 defines banking as "accepting for the purpose of lending or investment of deposits of money from public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise." The key activities which a bank performs can easily be derived from this definition which are as follows:

- Accepting deposits from public
- Advancing loans/investment of deposit money.
- Deposits are repayable only on demand.
- Allowing withdrawal of deposits through various modes.

Different type of deposits accepted by bank are mainly of following types.
- Saving deposit
- Current deposit
- Fixed deposit
- Recurring deposit
- Deposits under various deposit schemes like deposits from retiring Govt. employees, public sector employees etc.

Another key area of activity is **lending money to public** which may be against security or unsecured loans. The secured loans may be against:
- Commodities
- Financial instruments
- Real Estate
- Document of title
- Consumer durable goods, automobiles

Other type of loans given by banks are ;
- Cash credit account
- Overdraft
- Bill discounting
- Term loans
- Education loans

Another key activity is **investment of money.** Here it would be pertinent to mention that as per BR Act, banks are required to maintain statutory liquid ratio (SLR) under which banks are required to invest 25% of its total time and demand liabilities in Govt. or Govt. approved securities. Further, as per RBI Act, banks are required to keep 4.75% in the form of cash Reserve Ratio (CRR) with R.B.I Besides these two statutory investments, banks are investing money in other avenues which are known as non-SLR investments.

Besides above three key activities i.e. accepting deposits, lending to public and investment of deposits, banks are undertaking various other activities such as:

- Transfer money from one place to other (remittance facility)
- Acting as Trustees
- Keeping valuables in safe custody
- Collection business
- Working as an agent of customers
- Govt. business

In addition to above, banks are providing various services to customers e.g. debit card, credit card etc.

Q.7 Narrate key risk areas under Financial services.

Ans. Generally, following types of risks are faced by financial institutions while providing various financial activities.

1. **Credit Risk –** The risk of default by the borrowing firm. There can be a systematic credit risk which is associated with general economy-wide macro-economic conditions effecting all borrowers e.g. economic recession, downfall of capital market due to some internal reasons in the country.

2. **Liquidity risk –** It arises when all liability claim holders seek to withdraw funds which can lead to solvency problem for a financial institution.

3. **Interest rate risk –** This risk arises when a financial institution mismatches its assets and liabilities.

4. **Market risk –** This risk arises due to sudden changes in interest rates, exchange rates in the market.

5. **Off-balance risks** – Risk relating to contingent assets and liabilities e.g. risk in case of letter of credit issued but due to some problems, financing institutions is required to make payment.

6. **Foreign exchange risk** – Which arises due to changes in exchange rates.

7. **Country or sovereign risk** – Which arises by a sudden interference from foreign governments.

8. **Insolvency risk** – Due to continuation of one or more of above risk, such risk may arise in a financial institution.

All these risks are inter related and to minimize such risks, financial institutions have started recruiting Chief Risk Officers (CRO's) who can keep track on these risks.

The cycle of risk is as follows ;

Identify the risk

↓

Assess the impact of risk

↓

Analyze risk Control measures.

↓

Make/Take control decisions

↓

Implementation of risk control decisions

↓

Supervise and review risk measures.

Q.8 Explain in brief changing perception of intermediaries regarding financial services.

Ans. Financial intermediaries are coming out with innovative financial instrument in the market which are more investor friendly and these products are offering multiple benefits to the investor. These innovative products are more :

- Safe

- Economical
- Less risky
- Providing good return
- Package of return is attractive as it provides multiple benefits.
- Highly liquid i.e easily convertible into cash.
- Less time consuming on maturity
- Procedure of converting them into cash is less cumbersome.

Hence growing need for innovations has assumed great importance in recent times. This process of innovation is also called "financial engineering". The term "financial engineering is the design, development and the implementation of innovative financial instruments and processes and formulation of creative solutions to problems in finance".

To quote some examples, many financial institutions have come out with saving plans where money can be taken back after 3 years lock in period with guarantee bonus, benefits under income tax, coupled with insurance benefit, health insurance and accident insurance benefit.

The Financial instruments are not only attractive but also the procedure is being constantly simplified with quick/fast services through use of modern technology.

This change in perception of financial intermediaries like banks, insurance companies, particularly in private sector is visible. The degree of competition and privatization has forced even public sector financial intermediaries to change their perception and come out with innovative products.

Case study

On Financial Services

A Financing institution/bank is providing various types of services to its customers to earn revenue to meet its expenses. In some of the services, funds of banks are involved, while in others, bank is charging fee/commission/service charge. You are a student of MBA opting finance as area of specialization in MBA.

1. How you would distinguish between funds based & fee based services?
2. Give 5 examples each of fee based and fund based services by a bank to its customers.
3. What considerations are to be kept in mind which extending these services to customers?
4. Which of the risks need to be avoided while providing these services?

Chapter 2

Capital Markets : Govt Security Market, Monetary Money Market

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Q.1 What do you understand by Capital Market & Money Market?

Ans. Capital Market and Money Market are parts of financial markets. Financial Markets can be referred as to those centers and arrangements which facilitate buying and selling of financial assets, claims and services. The financial Markets can be broadly classified into:

(i) **Unorganized Markets** – Consists of Money lenders, indigenous bankers, traders etc. who lend money to public Indigenous bankers also collect deposits from public. There are also private finance ;companies, chit funds etc. whose activities are not controlled by RBI. Though RBI has taken steps to bring private finance companies and chit funds by issuing non-banking finance companies directions 1998 but still these steps are still inadequate.

(ii) **Organized Markets** – In the organized markets, there are standardized rules and regulations governing their financial dealings. These markets are subject to strict supervision and control by the RBI and other regulatory bodies. These organized markets can be further classified into two i.e. Capital Market and Money Market.

Capital Market : Capital market is a market for financial assets which have a long or indefinite maturity. Generally it deals with long term securities having a maturity period of above one year. Capital market may be further divided into three i.e.

(i) Industrial security market
(ii) Govt. securities market

(iii) Long term loan market

Capital market serves as a important source for the productive use of economy's savings and investment. These savings and investments facilitates capital formation and through this facilitates increase in production and productivity in the economy. A capital market thus serves as a important link between those who saves and those who aspire to invest their savings.

The details of different types of capital markets have been explained in subsequent portion of this material.

Money market – It is a market for dealing with financial assets and securities which have a maturity period of up to one year. Hence, it is a market for purely short term funds. Money market can be further sub divided into :

- Call money market
- Commercial bill market
- Treasury bill market
- Short term loan market
- Commercial paper market
- Certificate of deposit market

The key objective of money market is to provide balancing mechanism for short term surpluses and deficits.

The details regarding different types of money markets has been covered in subsequent question.

Q.2 Differentiate between money market and capital market.

Ans. The difference between money market and capital market is briefly given below :

Money Market	Capital Market
1. It is a market for short term loan able funds for a period not exceeding one year.	It is a market for long term funds exceeding a period of one year.
2. This market supplies ;funds to current business operations, working capital requirements of industries and short period	This market supplies funds for fixed capital requirements of trade and commerce as well as long term requirements of

requirements of the government.	government.
3. The instsruments dealt in money market are bills of exchange, treasury bills, commercial papers and certificate of deposits	This market deals in instruments like shares, debentures, govt. bonds etc
4. Each single money market instrument is of large amount. A certificate of deposit or commercial paper is for a minimum of Rs.25 lacs and a treasury bill is for a minimum of Rs.1 lac.	Each single capital market instrument is of small amount. Each share is of Rs.10 or a debenture of Rs.100 only.
5. The central bank of the country i.e. Reserve Bank of India are major institutions in the Money Market.	Development banks and insurance companies play a dominant role in capital market.
6. Money market instruments generally do not have secondary market.	Capital market instruments generally have secondary market.
7. Transactions take place over the phone and there is no formal place for market.	Transactions take place at a formal plae viz Stock Exchange.
8. Transaction have to be conducted without the help of brokers.	Transactions have to be conducted only through authorized dealers.

Q.3 Write in brief about key types of markets pertaining to money market and capital market.

Ans. Money Market can be broadly divied into two i.e.

- Unorganised
- Organised

Unorganised monery market consists of indigenous bankers, unregulated non banking finance intermediaries, money lenders etc. The organized money market have following main types / components.

(i) **Call Money Market** – Also known as Inter-bank money market. In this, day to day surplus funds mostly of banks are traded. It is a market for extremely short period loans say one day to fourteen days. Such loans are repayable on demand at the option of either the lender or the borrower. Interest rates changes hour to hour or day to day based on the demand and supply of money.

(ii) **Commercial Bill Market** – It is a market where commercial bills or trade bills are handled. In case of credit sale, the seller may draw a bill of exchange on buyer. The buyer accepts & pays money to seller at a later date. The seller has to wait for due date or he can get the bill discounted from a bank. Hence, commercial banks play a key role in market.

(iii) **Treasury bill Market** – Treasury bills are promissory notes of short term maturity (91 days to 364 days) issued by RBI on behalf of Govt. and is a permanent source of funds for the Govt to meet deficits. These treasury bills are issued to public, banks and other financial institutions. Financial intermediaries can park their temporary surpluses in these instruments and earn income.

(iv) **Commercial Paper Market** – This CP Market was introduced in India in 1990. These CPs can be issued by listed companies ;which have working capital of not less than Rs.5 crores. The maturity period of CPs ranges between 3 months to 6 months and are issued in the multiple of Rs.25 lakhs with a minimum size of Rs.1 crore. They are freely transferable by endorsement and delivery.

(v) **Certificate of Deposit Market (CD's**) – The scheme of CD's was introduced by RBI in 1989 to enable commercial banks to raise money/funds from market. These CD's are also issued in the multiples of Rs.25 lakhs with a minimum size of Rs.1 crore. The CD's are issued at discount.

(vi) **Short term loan market** – It is a market where short term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play a significant role by providing loans in the form of cash credit and overdrafts.

Capital markets – Types

(i) Industrial Security Market – It is market where industrial concerns raise their capital or debt by issuing instruments like equity hares or ordinary shares, preference shares, debentures or bonds. This market can be sub divided into :

(a) Primary Market or new issue market
(b) Secondary Market or stock Exchange

Primary Market is a market for new issues and hence it is called new issue market. It deals with securities which are issued to the public for the first time. There are three ways through which capital is raised in primary market. These are :

- Public issue
- Right Issue
- Private placement

Secondary market is a market for secondary sale of securities i.e. securities which already passed through the new issue market are traded in this secondary market. Generally, such securities are quoted in stock exchange and it provides a continuous ;and regular market for buying and selling of securities.

(ii) Govt. Security Market – It is a market where Long term Govt securities are traded which are issued by central Govt, State Govt, Semi Govt authorities like City Corporations, Port Trusts, Improvement Trusts, State Electricity Boards, All India and State level financial institutions and public sector organizations/enterprises are dealt in this market. Govt. Securities are in many forms such as :

- Stock Certificates or inscribed stock
- Promissory Notes
- Bearer bonds.

Govt securities are sold through public debt office of RBI. Interest on these securities influences price and yield in market.

(iii) **Long Term loan market** – Commercial banks and development banks play a significant role in this market by supplying long term loans to corporate customers. Long term loan market may further be classified into :

- Term loan market
- Mortgage Market
- Financial guarantee Market.

Term Loan Market – In India many industrial finance institutions have been created by Central and State Govts which provide medium and long term loans to corporate customers. Institutions like IDBI, IFCI, ICICI and other state financial corporations come in this category.

Mortgage Market – Refers to those centres which supply mortgage loan mainly to individual customers against security of immovable property like real estate.

Financial guarantee Market – Refers to centres where finance is provided against the guarantee of reputed person in financial circle. This guarantee may be in the form of (i) Performance guarantee or (ii) Financial guarantee. Performance guarantee covers the payment of earnest money retention money, advance payments and non compilation of contracts etc. The financial guarantee covers only financial contracts.

Q.4 Write brief notes on Treasury Bill (TB), Commercial Paper (CP) and Certificate of Deposit (CD).

Ans. **Treasury Bill (T.B)** – Treasury Bill represents short term borrowing of the Govt. T.B. is nothing but a promissory note issued by Govt under discount for a specified period stated therein. The Govt. promises to pay the specified amount mentioned therein to the bearer of instrument on the due date. T.B's are issued by the RBI on behalf of Govt. for meeting the temporary Govt deficits. The rate of discount on a T.B. is fixed by RBI. . The rate of discount is lowest because of short term maturity, high degree of liquidity and security.

There are two types of T.Bs
- Ordinary T.Bs
- Adhoc T.Bs

On the basis of periodicity, T.Bs may be classified in to three types i.e.

- 91 days Treasury bills
- 182 days Treasury bills
- 364 days Treasury bills

Institutional investors like commercial banks, Discount Finance house of India (DFHI) and State Trading Corporation of ;India (STCI) maintain subsidiary ledger account (SGL) with RBI thorugh which purchase and sale of TB's are automatically recorded through SGL Account. DFHI is actively participated in the auction of TBs on behalf of investors.

Various participants in TB market are RBI, SBI, Commercial banks, State Govts, DFHI, STCI, LIC, GIC, Nabard etc.

Key advantages of TBs are : Safety, liquidity, ideal short term investment, ideal for fund management meets SLR requirements of banks as per RBI decision, non-inflationary investment.

COMMERCIAL PAPER (CP)

A CP is unsecuired promissory note issued with a fixed maturity, issued by a company approved by RBI negotiable by endorsement and delivery, issued in bearer form and issued at such discount on the face value as may be determined by issuing company.

Features of CP are :
- Short term money market instrument with a fixed maturity.
- Unsecured corporate debt
- Issued at discount in interest bearing form
- Issuer promises to pay buyer some fixed amount on future period.
- Issued directly by a company to investor or thorugh bank/merchant banker.

Investors in CPs are :
Individuals, banks, corporate,s NRIs, Public sector units.

Issued by : Private sector companies, public sector companies, non banking finance companies(NBFCs). In India, CPs were introduced w.e.f. 1.1.1990. The issuing company has to fulfill conditions prescribed by RBI. Only very financially sound companies are permitted to issue CPs.

Periods – The CPs are used for a minimum period of 7 days with a maximum period of 6 months and a grace period on maturity.

Amount – CPs are issued in the multiples of Rs.25 lacs and a investor has to invest minimum amount of Rs.1 crore.

Issuing company : has to comply with provisions of Indian companies Act, Income Tax Act , negotiable instruments Act and guidelines prescribed by RBI in this regard.

Advantages : Simple to issue, flexibility, easy to raise funds, high return.

CERTIFICATE OF DEPOSIT (CD)

CDs are short term deposit instruments issued by banks and financial institutions with a maturity period ranging from 3 months to one year. These CDs are in the form of promissory note and are transferable from one party to another. Due to their negotiable nature, they are also known as negotiable certificate of deposit. CDs are available for subscription by individuals, corporations, trusts, associations etc. They are issued at discount to face value repayable on a fixed date without grace days and are subject to stamp duty. Banks have to maintain CRR & SLR on the issue price of CDs.

The RBI has issued detailed guidelines on issue of CDs according to which CD could be in the multiple of Rs. 5 lacs, they are freely transferable by endorsement and delivery after 45 days of issue to a primary investor. Three financial institutions i.e. Industrial Dev. Bank of India, Industrial Credit & Investment Corporation of India and Industrial Finance Corporation of India have been permitted by RBI to issue CDs for more than one year upto 3years. In 1992, RBI also permitted Industrial Reconstruction Bank of India to issue CDs upto a limit of Rs.100 crores..

Advantages of CDs –

- Most convenient instrument to earn higher return.
- Offer maximum liquidity as they are transferable by endorsement and delivery.
- It is an ideal instrument for banks with short term surplus funds to invest at attractive rates.

DISCOUNT & FINANCE HOUSE OF INDIA (DFHI)

DHFI has been set up as a specialized money market institution with the object of providing liquidity to money market instruments and to develop a secondary market. The DFHI is a joint stock company owned by RBI, public sector banks and All India Financial Institutions which have contributed towards its paid up capital of Rs.150 crores.

Main functions of DFHI

- To discount, rediscount, buy, sell, underwrite or acquire or sell marketable securities and negotiable instruments.
- To undertake buy back arrangements in trade and Treasury Bills.
- To carry on business as a lender, borrower broker or as a broking house in the inter-bank call money market.
- To promote development of short term money market.
- To advise banks, govt, financial institutions or business houses in evolving schemes of growth, development and expansion of money market

The operations of DFHI aimed at imparting greater flexibility to banks in their fund management. It participates in call, notice and term market as a borrower and lender. It also purchases and sells TBs at auction, commercial bills, commercial papers and certificate of deposits. All transactions are done through exchange of cheques drawn on RBI to facilitate same day settlement.

Case study
On Financial Services

You are working as a Manager of a nationalized bank branch. On 31.03.2012, your branch received fixed deposits of Rs. 5 crores and on the same day, this entire amount of Rs. 5 crores was used in providing loans at an attractive interest rate of 14%. Bank branch could not maintain addition CRR on this deposit with RBI as bank was not left with surplus to remit to RBI for additional CRR. If RBI notices this default, branch is likely to attract heavy penalty for violating legal provisions of CRR applicable on bank on this addition amount of Rs. 5 Crore.

1. Calculate addition amount of CRR to be remitted to RBI as per latest rates.
2. Which options are available for raising money from money market to comply CRR provisions?
3. Which option of raising money you would select and why?
4. If RBI imposes penalty and such order of penalty is placed on the notice board of the bank, what would be its impact on the working of bank?

Case study
On Financial Services

You have just passed MBA with specialization in finance and you have been appointed as a consultant in a financing institution. This institution is having a surplus of Rs. 10 crores which is available for investment in capital market. This institution is interested in diversified investment portfolio to minimize risk and optimize return. As a consultant, you are required to give your opinion on the following.

1. What various options are available for investment in capital market?
2. Which option/options you would suggest to this financial institution and why?

Chapter 3

Merchant Banking

Q.1 What do you understand by the term Merchant Banking? What important services are provided by Merchant Bankers?

Ans. Merchant banks are issue houses which manage new issues of companies in the capital market. Merchant banks are also known as "accepting and issuing houses" in U.K. and "investment banks" in USA. The Notification of Ministry of Finance defines Merchant banker as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as Manager, Consultant, Advisor or rendering corporate advisory services in relation to such issue management" as per SEBI Act 1992. Hence, merchant banks are issue houses rendering such services to industrial projects or corporate units as floatation of new ventures and new companies. Preparation, planning, and execution of new projects, consultancy and advise in technical, financial, managerial and organizational fields. A number of other functions such as restructuring, revaluation of assets, merger, takeovers, acquisitions etc are also undertaken by them.

Merchant banking originated in London but in India, Merchant banking started in 1972 when State Bank of India set up its merchant banking division.

The merchant banks and commercial banks differ from each other in respect of approach, attitude and area of operation. Commercial banks basically deal in debt and debt related finance while the area of activity of merchant banks is equity and equity related finance. They deal with money raised through money market and capital market. Further, for doing merchant banking related activities, registration of a bank with SEBI is essential. Commercial banks perform routine banking functions while Merchant bankers services are related to new issue management and other related activities regarding new issues. Commercial banks are primarily financers while merchant bankers are providing various other services like consultancy/advisory services, project preparation, counseling etc.

Need for Merchant Banking Services

In India, need for merchant banking services became important due to following factors.

- Growth of industries during nineteen eightees and nineteen nintees in India.
- Expensive consultancy services in private sector.
- Many mega issues came in market e.g. Reliance, ICICI bank, DLF etc.
- Need for greater number of project reports for getting finances.
- Merger, takeover, and joint ventures in industrial sector.

Services provided by Merchant Bankers.

Besides issue management i.e. pre-issue, post issue management, marketing and pricing of issues, following other services are provided by merchant bankers.

1. **Corporate counseling** – Corporate counseling covers entire field of merchant banking viz project counseling, capital restructuring, project management, loan syndication, working capital, lease financing, portfolio management, underwriting etc. Such counseling is provided to corporate and client units to solve their problems.

2. **Project Counseling** – which includes
- preparing project reports
- finance for cost of project
- appraising projects from the angle of technical, commercial and financial viability.
- Getting approval of project from bank/Govt and other agencies &
- Planning for public issue.

3. **Loan Syndication** – Arranging loan for big projects not only from one bank or financial institution but from more than one bank or financial institution as amount of loan is very large.

4. **Underwriting of public issue** – Underwriting is a guarantee given by the underwriter that in the event of under subscription, the amount would be provided by him to the extent of under subscription. All public issues are to be underwritten fully. Merchant banks provide such service of underwriting pubic issue subject to some limitations.

5. **Managers, Consultants or advisors to the issue** – Managers to the issue assist in drafting of prospectus, application forms and completion of formalities under companies act, appointment of Registrar for dealing with share applications, transfer and listing of shared with stock exchange. There are SEBI's .guidelines in this regard saying that all issues should be managed by at least one merchant banker.

6. **Portfolio Management** – It refers to investments in different kinds of securities such as shares, debentures, bonds issued by different companies and securities issued by the Govt. Merchant bankers advise about mix of investments a company should follow to ensure maximum return with minimum risk and for this purpose merchant makers have to make a careful study of Govt. policies, capital market as well as financial position of companies.

7. **Corporate restructuring** – Merchant bankers are also advising companies ;about corporate restructuring including merger, acquisition, take overs etc.

8. **Off-shore financing** – Merchant bankers are also arranging foreign currency, foreign loans, foreign collaborations, financing exports imports etc.

9. **Technical assistance** – Merchant bankers are also providing services on technical aspects such as technological up gradation, modernization of industries etc.

10. **Revival package for sick units** – Merchant bankers are also liaisoning with Board of Industrial and Financial Reconstruction (BIFR) and industrial Reconstruction Bank of India (IRBI) and such helping their clients in this regard also.

The key services of issue management are discussed in subsequent answers.

Q 2 What key aspects are looked into by merchant bankers in pre-issue and post-issue management?

Ans. In issue management, a merchant banker (MB) has to :

- Co-ordinate the activities relating to issue with Govt bodies/public bodies like Registrar of companies, Stock Exchange, SEBI etc.
- Get the prospectus vetted by solicitor. This prospectus should include information required by companies Act & SEBI.
- Ensure that information from the issuing company to be obtained about consent of experts, legal advisors, attorney, solicitor, bankers to the issue brokers, underwriters etc. and information on these aspects has been filed to Registrar of Companies along with prospectus.
- Send prospectus to SEBI for vetting.
- Send prospectus only vetted by SEBI to Registrar of Companies.
- Ensure appointment of brokers (from amongst members of stock exchange), Principal agent, bankers to the issue.

Issue management involves of marketing of equity shares, preference shares, debentures and bonds. This issue management can be divided into two parts i.e.

(i) Pre-issue Management – is divided in three parts i.e.

- issue through prospectus
- issue through offer for sale
- issue through private placement.

Issue through prospectus – is most common method where issue is offered to public through prospectus.

Offer for sale – are offers through the intermediary of issue houses of firms of stock brokers. The company sells the entire issue of shares or debentures to the issue house at the agreed price which is generally below the par value.

Private Placement means direct sale of securities to investors like LIC, UTI, GIC, State Financial Corpns etc.

(ii) Post Issue Management – includes steps like :

- collection of application form
- Statement of amount received from bankers
- Screening applications
- Deciding basis of allotment/procedure of allotment
- Mailing allotment letters
- Mailing of share certificates
- Mailing of refund orders

These steps are to be completed by Registrar to the issue and also to submit basis of allotment to stock exchange. Merchant bankers help the company in ensuring that processing of application and refund is completed within 70 days.

Q.3 What steps are taken by Merchant bankers in Marketing and pricing of issues..

Ans. **Marketing of Issue**

i) Merchant banker has to arrange meeting of company officials with advertising agents for –
   - deciding opening & closing date of issue.
   - Launching publicity campaign
   - Fixing date of board meeting to sign prospectus ;and passing resolution for issue
   - Publicity campaign covers preparation of publicity brochure, prospectus and material for advertisement in press, radio, T.V.
   - Date of investors conference, its venue etc.

2) Merchant bankers have to ensure that size of application form and prospectus confirms to the requirement of stock exchange.

3) Merchant bankers have to ensure that entire material appertaining to issue is delivered to stock exchange 21 days before opening of issue.

4) Merchant bankers have to ensure that underwriting arrangements in respect of issue have been made ;which is mandatory as per guidelines of SEBI and the same should be included in the prospectus.

Pricing of Issues – The pricing of issues is done by companies in consultation with Merchant bankers. An existing company with 5 years track record of profitability can freely price the issue. The premium has to be decided after taking into account net asset value, profit earning capacity and market price. The justification for price has to be stated and included in the prospectus.

Q.4 What are the important guidelines of SEBI about merchant bankers?

Ans. Merchant bankers (MBs) have been brought under the frame work of securities & Exchange Board of India (SEBI) under SEBI (Merchant Bankers) Regulation Act 1992. A few important guidelines of SEBI are as follows:

1) Each MB requires registration/authorization from SEBI for which each MB has to pay initial authorization fee, annual fee and renewal fee as prescribed by SEBI.
2) The minimum qualifications prescribed by SEBI for MB's are:

    i) Adequate infrastructure i.e. office space, equipment, manpower etc.
    ii) Professional qualifications in finance, law, business management.
    iii) Employing minimum two persons having experience in merchant banking.
    iv) Capital adequacy i.e. minimum net worth of Rs.1 crore.
    v) A MB should not have involvement in any criminal activity.
    vi) Good tract record/reputation and fairness in transactions.
    vii) Knowledge of analytical ability about industrial projects.
    viii) Knowledge of capital market.

3) For each issue, at least one MB is necessary which may go up to two. However, for an issue of over Rs.100 crores, number of MBs as lead Managers may go up to four. Specific responsibilities as assigned to each MB should be submitted to SEBI before issue.
4) A MB as lead Manager should have minimum underwriting obligation of 5% of total issue or Rs.25 lacs which ever is less.
5) Each MB will have to submit 6 monthly unaudited financial accounts to SEBI enabling SEBI to monitor capital adequacy of MB.
6) SEBI has a power to suspend or cancel authorization of a MB in case guidelines prescribed by SEBI are frequently violated by a MB

7) Each MB is required to report half yearly accounts reports to SEBI.
8) SEBI is authorized to conduct inspection of MB and it is obligatory on the part of MB to provide required information to inspecting/investigating team of SEBI.
9) As per amendments in MB Relgulations of SEBI in 1997, only corporate bodies have been permitted to act as MB.
10) Each MB has to follow code of conduct as prescribed by SEBI and SEBI has powers to monitor that guidelines prescribed by it are being followed by MBs.
11) As per SEBI's regulations, MBs are permitted commission as follows:
    - 0.5% commission on whole issue
    - As lead Manager, commission would be 0.5% upto Rs.25 crores and 0.2% beyond Rs.25 crores.

Q.5 What is the scope of Merchant Bankers in India and what problems they are facing?

Ans. There is a vast scope for MB's in domestic and international market due to their encouraging and supportive role to entrepreneurs, corporate sector and investors. Important points in this regard are given below :

(i) **Growth of new issue market** – Due to unprecedented growth in new issue market, scope of MB's is every year increasing as MB's has to play crucial role in managing issue of shares & securities.

(ii) **Entry of foreign investors** – has further improved their scope in India due to opening up Indian Capital market in 1992 for foreign investors. Increasing number of joint ventures abroad by Indian companies and further increased this scope.

(iii**) Changing policies of Financial Institutions** – From security orientation to project orientation has given a further boost to MB's as their services are required for project preparation, appraisal and getting the projects approved for getting finances.

(iv**) Innovations in financial instrument** – New instruments are coming in capital market and MB's are market makers for those new instruments.

(v) **Corporate restructuring** – Due to increased liberalization, gloablisation and privatization, competition in corporate sector is becoming intense leading to corporate restructuring in the form of merger, acquisition, take over, necessitating the services of MB's.

(vi) **Dis-investment** – Policy of disinvestment in public sector is opened up good scope for MB;s in capital market.

Problems of Merchant Bankers – A few problem faced by MB's are as follows :

1. The condition of having minimum net worth of Rs. 1 crore for MB is difficult for new and professional MB's to achieve.

2. Non cooperation from companies in completing the process of issue of shares up to refund of money within stipulated period of 70 days is a problem for MB's as MB's have to ensure compliance of this condition as per guidelines of SEBI.

Case study
On Financial Services

You have been recently appointed as Asstt. Manager in a Merchant Bank. ABC Company wants your bank to manage a new issue of shares of Rs. 100 crores. Manager of the bank as assigned this task to you to independently handle this new issue of shares. You would be handling this type of task for the first time. You are well aware that there is great scope for such work in your bank and you want to establish your credibility in the eyes of manager and clients.

1. As a Asstt. Manager, how you would proceed to manage this issue of Rs. 100 crores keeping in view the guidelines of SEBI, Registrar of companies & Stock Exchange?
2. Besides issue of shares, what other services are provided by Merchant Banks to its customers?

Chapter 4

Financial Services

Q.1 Explain in brief lease and hire purchase. Also differentiate between these two.

Ans. **Lease** : Lease is a contractual arrangement where the owner of the asset transfer the right to use the asset to user (Lessee) in return for rentals. Main aspects of lease are :

(i) **Parties to Lease** : There are two parties in lease i.e. Lesser and Lessee.
(ii) **Asset under Lease**: The subject matter of lease is a tangible asset movable or immovable.
(iii) **Term of Lease** : Period for which agreement for lease would be in operation.
(iv) **Rentals of lease** – These are periodic payments (rentals) that forms the consideration for lease transaction.
(v) **Ownership** – Ownership remains with lesser and he allows use of asset to lessee during lease tenure.

Types of Lease

(1) **Operating Lease** : Also known as short term lease and lease period is less than usual life of asset. The lessee has the option to renew the lease after the lease period and he is responsible for maintenance insurance and taxes of asset. As period of lease is short, it implies high risk to lesser and high lease rental to lessee. Operating lease is of two types.

Wet lease : Where lesser is responsible for maintenance insurance and taxes.

Dry lease: Where lessee is responsible for maintenance, insurance and taxes on asset.

(2) **Financial lease**: Also called capital lease is one which usually covers useful economic life of an asset or a period that is close to economic life of asset. It is usually a non-cancellation lease where lesser receives the lease rentals during the lease period so as to recover fully not only the cost of asset but also a reasonable return on funds used to buy asset. This lease is of following types.

(i) Direct lease : The lesser purchases the asset and handover the asset to lessee.

(ii) Leveraged Lease: Where lesser borrows a portion of purchase price from lender and loan is secured by asset and lease rentals. The loan is repaid out of lease rentals either directly by lessee or the lesser.

(iii) Sale and lease back - Under sale and lease back the lessee not only retains the use of the asset ;but also get funds from the sale of asset to lesser.

Lease, hire purchase and installment sale

Lease – In case of lease asset is handed over to lessee in return of lese rentals. The ownership and title to the asset remains with lesser.

Hire Purchase – The seller handover the asset to buyer but title of goods is not transferred. The buyer becomes the owner of goods and acquires the title to the goods only when he makes payment of all installments. In case of default, in payment, by the buyer, the seller can repossess the goods.

Installment Sale : In this case, title of goods is immediately transferred to the buyer though payment of price to be made in future. This is just like a credit sale. In case of default, the seller has no option but to claim the money in court of law. The seller can't repossess the goods as is available in Hire Purchase.

Difference between Financial Lease and Operating Lease

Basis of Difference	Finance Lease	Operating Lease
1. Life of Contract	Approximates the economic life of project	Shorter than economic life.
2. Maintenance	Provided by lessee or covered by a separate agreement.	Provided by lesser and included in lease rentals.
3. Lease payments	Return the cost of asset and allow a profit to the lesser.	Not sufficient to cover the cost of asset.
4. Cancellation	May be cancelled if both lesser and lessee agree.	May be cancelled before expiry date.

Hire Purchase : Hire purchase involves a system under which term loan for purchase of goods and services are advanced to be liquidated in stages through a contractual obligation. It is considered to be a sale of asset, the title of which rests with seller until the purchaser has paid all the installments and exercised his option ;to purchase the asset at the end of contract.

Features :
(i) At the time of hire purchase agreement, the buyer pays an agreed amount and balance amount in higher purchase installments.
(ii) Hire purchase installment cover both principal amount and interest.
(iii) Ownership passes to the buyer after payment of last installment.

Difference between Leasing & Hire Purchase :

Leasing	Hire purchase
1) Ownership rests with lesser.	1) Ownership passes to the buyer after payment of last installment.
2) Depreciation and investment	2) Can be claimed by

allowable can be claimed by lesser.	buyer/hirer
3) Lease rental is tax deductible expenditure.	3) Only interest component is tax deductible
4) Lease does not enjoy salvage value of asset.	4) Buyer/Hirer enjoys salvage value of asset.
5) Cost of maintenance is borne by lesser. In case of financial lease, it is borne by lessee.	5) Cost of maintenance is borne by buyer/hirer.

Q.2 Explain In brief consumer finance & bill financing.

Ans. Consumer Finance refers to any kind of lending to consumers. The key asset or loan product offered under consumer finance umbrella is broadly classified in two categories i.e. secured and unsecured.

Secured category includes products like home loans, auto loans, loans against securities, two wheeler finance etc.
Unsecured category includes products like credit cards, personal loans etc.

Consumer finance in India is more popular in middle class families residing in metropolitan cities and some of the specialized financial institutions popular in consumer finance are HSBC Finance, City Finance, G.E.Money, India Bulls credit services. The finance is made available to consumer durables preferred category of customers for such loans are salaried and self employed individuals and professional like doctors, engineers etc. In case of such clients risk is comparatively less.

The growth in consumer finance sector in India is good due to following factors.

i. Low/soft interest rate schemes of banks and financial institutions.
Boom in communication – through Media/TV for consumer durable products.

2. Tie up between manufacturers and banks/financial institutions for increasing the sale of such products.
3. Innovative schemes of banks and financial institutions for attracting customers.

4. Changing consumption/buying pattern of customers – changing consumer behaviour.

Documentation formalities in such loans are quite ;simple. Identity proof, proof of address, bank statement, form 16 and salary slip for last few months are required from a salaried customer and from self employed person, balance sheet and P&L for last 2-3 years are required. The interest rate in such loan is comparatively high as risk is also high.

BILL FINANCE / DISCOUNT

A trade bill arises on account of genuine credit sales. The seller/supplier of goods draws a bill on purchaser for the invoice price of goods sold on credit. The bill is drawn for a short period of 3 to 6 months. The buyer accepts the bill and there by binds himself liable to pay the amount of bill on due date. In this process, working capital of seller is blocked.

Here, the banks and financing institutions comes to the rescue of seller and helps him by discounting the trade bill. Bank deduct certain charges as discounting charges from the amount of bill and balance amount of bill is paid or credited to the customers account. Only those bills which arise out of genuine trade transactions are considered by banks and finance companies for discounting purpose.

Parties to the bill of exchange are :

(a) The drawer (seller of goods)
- who draws the bill
- who ensures that the bill is accepted by buyer and would pay the amount of maturity.

(b) The drawee (Buyer of goods)
- The person on whom the bill is drawn.
- Who has accepted the bill for payment of maturity
- The person who assumes responsibility to pay the bill

(c) The Payee – The person to whom or to whose order the bill is payable.
(d) The endorser – The payee or any endorsee who sign the bill on negotiation of the bill is not endorsed, the drawer and payee will be the same person.

Q.3 What do you understand by Term "factoring"? how it differs from forfeiting.?

Ans. Factoring can be defined as an arrangement between financial institution or banker (factor) and a business concern (seller/supplier) selling goods or providing securities to trade customers where by factor purchases book debts and administers the sales ledger of the supplier. In other words, the outright sale of accounts receivables is known as factoring.

In this mechanism, factor purchases the clients trade debts/accounts receivable either with recourse (where risk of non payment by debtor is of factoring agency). In this process, client is immediately paid around 80% of trade debt and for remaining 20% payment is done on recovery of debt by factor. Factoring agency gets commission/fee for performing the duties on behalf of client.

Main types of factoring are :

1. **Recourse or non recourse factoring** – In case of recourse, the risk of non payment by debtor is not of factor but in case of non recourse, such risk is assumed by factor.
2. **Maturity factoring** – In this, the factor does not provide immediate cash payment to the client, but he pays cash as and when amount of debt is collected from debtor.
3. **Bulk factoring or invoice factoring** – In case of bulk factoring, the factor simply collects the debt on behalf of client and the work like maintaining sales ledger or credit control is done by client. In case of invoice factoring, the factor provides finance to client by telling the client about this arrangement. Hence, this is also known as confidential invoice discounting.
4. **Agency factoring** – In this case, factor has to provide finance and assure credit risk and client has to undertake maintenance and collection work.
5. **International factoring** – Here the factor provides services to international business by providing factoring services to exporting agency.

FORFAITING

Forfaiting is another source of financing against receivables like factoring. This technique of forfaiting is mostly employed to help an exporter for financing goods exported on a medium term basis. It is a form of financing of receivables pertaining to International Trade. In this process of forfeiting, the exporter gives up his right to receive payment in future under an export bill for immediate cash payment by forfaiter. The cash payment involves 100% of the amount of bill less discount charges. It is a unique medium which can convert a credit sale into a cash sale for an exporter.

In this process of forfaiting, four parties are involved which are:

(i) The Exporter – One who immediately converts the credit into cash. He is also referred as client.
(ii) The Forfeiter – One who takes the responsibility of collection of debts.
(iii) The importer – One who has to pay the debt. Also known as debtor.
(iv) The bank – One who makes payment on maturity to the forfaiter on presentation of ;bill of exchange. Also known as guarenter of the importer.

Advantages of forfaiting
(i) Exporter gets better liquidity.
(ii) No risk to exporter for non settlement of claim.
(iii) No risk of exchange rate fluctuations.
(iv) Most simple and flexible in nature
(v) Provides specialized service in credit management

Difference between factoring and forfaitring

Factoring	Forfeit ring
1. It refers to domestic trade	It applies to international trade only
2. Done for short term financing	It is for medium term financing
3. Invoice of client is purchased	Export bill is purchased
4. It may be with or without recourse to client.	It is without recourse to client.
5. Around 80% to 85% of total	Forfeiter pays 100% of the value

invoice price is paid.	of export bill less discount.
6. Broader term which also includes maintenance of sales ledger, advisory services etc.	Mainly concentrates on collection of debt.

Q. 4 What do you understand by credit card? How it differs from Debit card.

Ans. A credit card can be viewed as a payment mechanism which enables the holder of the card to purchase good or services without paying immediate cash and make a one time payment at the end of specified period (known as the billing cycle which usually a month). In this way, card holder manages to postpone the expenditure by usage of card availing credit from the issuer of card. Hence, credit card is essentially a "pay later product" Credit card is a form of consumer loan., a revolving credit account that has a credit line of a specific amount that can be borrowed against in part or in full. As the outstanding balance is paid, the available credit line is restored for use again.

A debit card is "pay now" product where customer's account is immediately debited by value of transaction. The difference between credit and debit card is given below

Credit Card	Debit Card
1. "Pay later product"	Pay now product.
2. Can avail credit for 30-52 days	Immediately debited to customers account
3. No access to current or saving account	Direct access to saving or current account
4. Not essential to open a bank account	Essential to open a bank account.
5. Sophisticated telecommunication network is not required	Point of sale terminals to be installed at merchant establishment and hence are capital intensive

Credit card enables its holder to make purchases/avail the services at various designated merchant establishments like Dept. stores, hotels, airlines, railways etc who would use credit card in lieu of cash. A credit card is issued by a sponsor bank to the card holder after due valuation of credit worthiness and financial status of the prospective card holder.

Q.5 Explain in brief the term "Securitization" and its whole process..

Ans. Securitization (s) refers to the process of liquidating ill-liquid long term assets like loans/receivables of financial institutions like banks by issuing marketable securities against them. It is a technique by which long term, not negotiable and high valued financial assets are converted into securities of small value which will be traded in market.

Through this process of 'S' banks can remove long term assets from balance sheet by replacing them with liquid cash through issue of securities against them. In these long term assets, funds of banks are blocked unnecessarily for long term. Now this is readymade solution for them. This 'S' helps in recycling of funds at reasonable cost and with less credit risk. This process of 'S' provides liquidity through tradable financial instruments. Entire transaction of 'S' is carried out in asset side of balance sheet i.e. one asset (ill-liquid) is converted into another asset (cash).

Hence 'S' is nothing but liquidating assets comprising loans and receivables of an institution though systematic issuance of financial instruments. In the operational mechanism of 'S' following parties are there.

(i) Originator – The bank or financial institution which decides to go for 'S'
(ii) Special purpose vehicle (SPV) or a Trust – The institution which is ready to help originator by outright buying such assets.
(iii) Merchant banker or Investment Banker – They act as SPV
(iv) Credit Rating Agency – Which rates the 'S' assets.
(v) Servicing agent or receiving & paying agent – An agency which collects money from 'S' assets. Even originator can take this responsibility.
(vi) Original borrower or obligor – Principal debtor of 'S' assets.
(vii) Prospective Investor or buyers of securities issued by SPV or Trust buying 'S' assets.

Various stages involved in Securitization are :

(i) **Identification** – Originator has to identify assets to be securitized of homogeneous nature considering their maturity, interest rate, frequency of payment and marketability.

(ii) **Transfer Process** – After identification, selected pool of assets are passed through to another institution i.e. SPV or Trust through outright sale or through collaterised loan. This is known as Transfer process.

(iii) **Issue process** – In this stage, SPV issues securities to investors in the form of securities of smaller values. These securities are sold to investing public. These securities are called :
"Pay through certificates"
"Pass through certificates"

The repayment schedule of such securities is fixed in such a manner that it matches with repayment of securitized assets.

(iv) **Redemption stage** The repayment of interest and principal amount of securities issued is facilitated out of collections made by SPV from 'S' assets. For this purpose, collection agents are appointed on commission basis or originator does this work of collection.

The credit rating agencies rate such securities issued by SPV to facilitate their easy marketability.

The Merchant bankers play key role in this process of 'S' by way of acting as :

- SPV
- Underwriting issue of securities by SPV
- By undertaking issue Management of securities to be issued by SPV
- Structuring issue of securities and ensuring completion of legal formalities for such issue.

Two keys parties – Whose role is crucial in this whole process of securitization are

(i) **Original borrowers** : Who have to fulfill their commitments of paying the loan & interest back to bank.

(ii) **Investing public** : who are buying the securities issued by SPV.

The following type of assets are considerable suitable for securitization .

- Term loans to financially sound/reputed companies.
- Receivables from Govt. Deptts/Companies.
- Credit card receivables.
- Hire purchase loans like vehicle loans
- Lease finance
- Mortgage loans

Advantages of Securitization :

1. Additional sources of funds to originator
2. Greater profitability – Through recycling of funds, increase business turnover.
3. Raises/Enhances – Capital adequacy ratio (CAR)
4. Spreading Risk – Amongst institutions like SPV, Investor public, Merchant banker.
5. Helps originator to have easy access to security market.
6. Better rate of return
7. Avoids idle capital
8. Securities issued are ;better than traditi0onal securities as they are backed by securitized assets.

Due to advantages of securitization, there is a vast scope for commercial banks to go in for securitization.

Another Dimension of Securitization is to reduce mounting NDA's under SARFAESI ACT 2002 which is explained below ;

Securitization is the process of transforming the assets of a lending institution in to negotiable instrument. It means acquisition of financial assets by a securitization or reconstruction company (SCRC). This process is resorted to reduce large non-performing assets of a bank or financial institution buy SCRC. This is a process where non liquidated financial assets are converted into marketable securities which can be sold to investors. It is a process of converting receivables and other assets in to securities in security receipts that can be placed in market for trading.

On acquisition of financial assets, the SCRC becomes the owner of financial assets and steps into the shoes of lender bank or financial institution. The RBI is the regulatory authority for SCRC which is company registered under the companies Act 1956 for the purpose of securitization. It needs registration with RBI under SARFAESI ACT 2002.

Benefits of Securitization –

1. **Positive effect on balance sheet** – Securitization is an accounting arm related to removal of debts from the balance sheet of a bank/financial institution. A bank would find it easy to be in conformity with the capital adequacy norms laid down by RBI.

2. **Increase in income** – Bank can earn income in the form of service charges from selling the loan and than for servicing new loans.

3. **More loans with the same liability** – The cash flow obtained by selling the old debt in the form of securities can be used to lend funds further at a profit to bank. Hence against same amount of liabilities, lending of banks increases.

Q.6 Explain in brief the term 'Mortgage'

Ans. Section 58 of the Transfer of Property Act 1882 defines mortgage as "the transfer of an interest in specific immovable property for the purpose of securing the payment of money, advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to pecuniary liability. Four key words in this process of mortgage are:

"**Mortgagor**" – The person who transfers interest in the specific immovable property.
"**Mortgagee**" – is the person in whose favour interest is transferred.
"**Mortgage money**" – The principal amount and "interest thereon involved".
"**Mortgage Deed**" – Instrument/document by which transfer is effected.

Special features – Mortgage differs from sale of immovable property. In case of sale, the person has no right to get the property back while in case of mortgage, mortgagor has such right. Mortgage is always for a specific immovable property. Possession of property need not always transferred to mortgagee. The mortgagee has a right to recover loan amount out of sale process of property back after paying loan amount.

Rights of Mortgagee – As per transfer of property Act 1882, mortgagee has following rights :

- Right to foreclosure or sale by getting a decree of court.
- Right to sue for mortgage money
- Right of renewal of mortgage lease of property
- Right to receive money spent on mortgaged property.

Case study

On Financial Services

In most of the corporate houses, managing receivables/debtors is a great problem. Management of XYZ Company is not sure as to what extent money would come back. In some cases, amounts are overdue and in spite of due notices to debtors, no progress is there in recovery of dues. Statutory auditors of this company have made serious observations in the report and wants immediate steps to recover the due amount.

As an expert in finance area, management of this XYZ Company has sought your advise in this regard particularly about going for securitization for converting these receivables in to liquid cash.

1. How you are going to convince the management of ZYZ Company about securitization & its advantages?
2. Explain to management whole process of securitization including its various stages to the management of XYZ Company.

Multiple Choice Questions (MCQ's)

1. **Which of the following services are fee based**
   A- Underwriting B- Issue of DD,
   C- Credit Card D- Education loan.

2. **Which of the following services are fund based**
   A- locker facility B- Cash Credit,
   C- Project preparation D- Consultancy

3. **Money Market deals with borrowing & lending of funds for**
   A- Short term B- Medium term C- Long term

4. **Call money market deals with borrowing and lending of money for short period by**
   A- RBI B- Banks C- Development Banks

5. **A Treasury bill is issued by**
   A- Govt. B-RBI
   C- Commercial Bank D- Development Bank.

6. **In Indian Financial system, banks are part of**
   A- Financial Market B- Financial Inter media vies
   C- Regulatory bodies D- Others.

7. **Present rate of CRR is**
   A- 5% B- 6%
   C- 4.75% D- 5.5%

8. **Which of the following loan is highly secured**
   A- Mortgage B- Cash credit
   C- Overdraft D- Education loan

9. **For managing a new issue of shares of Rs. 100 Crores , number of Merchant Banks may go up to**
   A- 2 B-3
   C-4 D-5

10. **As per guidelines of SEBI, a merchant banker has to complete the whole process of issue of shares in**

    A- 60 days B-70 days

C- 80 days

11. **Which is the most common risk faced by a lender**
A- Market risk B- Interest risk
C- Credit risk D- liquidity risk

12. **Most common way of raising equity is through**
A- Rights issue B- Private Placements
C- Public issue

13. **What is the minimum underwriting obligation for a merchant banker as lead manager of the total issue**
A- 10% B- 5%
C- 15% D- 20%

14. **What is the minimum net worth condition for a merchant banker**
A- Rs. 10 crores B- Rs. 5 crores
C- Rs. 1 crore D- Rs. 100 crores

15. **In which case ownership is immediately transferred in favor of user/purchaser.**
A- Lease B- Higher purchases
C- Installment Sale

16. **For managing receivables of Rs. 20 lakhs and converting them in to cash, which option may be adopted**
A- Forfeiting B- Factoring C- Securitisation

17. **Combine regulatory bodies like RBI, SEBI, IRDA, NABARD with the following:**
A- RRB's B- Merchant Banker
B- C- Commercial Banks D- Mediclaim policy

18. **Highest return is available on investment in**
A- Shares, B- Debentures, C- Bonds, and C- Mutual Fund.

<u>**Answer Key:**</u>

1-B, 2-B, 3-A, 4-B, 5-B, 6-B, 7-C, 8-A, 9-C, 10-C, 11-C, 12-C 13-B, 14-C, 15-C, 16-B, 17-A- BABARD, B- SEBI, C- RBI, D-IRDA, 18-A.

Key Terms

1. **ATM Card:** Automatic Teller Machine (ATM) is a computerized telecommunication device that provides the customers of a financial institution with access to financial transactions in a public space/ place without the need of a human clerk or a bank teller. Customer is identified by inserting a plastic with a Plastic ATM Card with a magnetic strip or a plastic smart card with a chip.

2. **American Depository Receipts (ADR's):**- Depository Receipts issued by a company in USA are known as ADR's. Such receipts are issued in accordance with provisions stipulated by Securities and Exchange Commission of USA. ADR's are dollar dominated and are traded in the same way as are the securities of companies of USA.

3. **Bill Discounting:** When holder of the bill does not wait for payment by debtor, goes to bank and discounts the bill, it is known as bill discounting. Bank charges some discount and pays the balance to the holder.

4. **Bonds:** - Bonds refer to debts instruments bearing interest on maturity. Organization may borrow funds through securities named bonds having a fixed maturity period and pay a specified rate of interest (Coupon Rate) on the principal amount to the holders.

5. **Book Building: -** Is a method of issuing / offering shares to investors in which the price at which share are issued is discovered through bidding process. In this, bidder's (potential investors) have the flexibility to bid for shares at a price they are willing to pay.

6. **Capital Market:** Capital Market refers to institutional arrangements for facilitating borrowing and lending for long term securities having maturity period of above one year. Capital Market can be divided into primary market and secondary market.

7. **Call money Market: -** Is an integral part of Indian money market where day to day surplus funds mostly of banks are traded for short term loans from one day to 14 days. In case of need or meeting mandatory requirements of CRR and SLR, money is borrowed by one bank from other on interest rate agreed between them.
8. **Consumer Finance: -** Refers to any type of lending to consumer. It is a part of retail banking where small amount is advanced to consumer. This consumer finance is classified in two i.e. secured and unsecured loans. Loans are home loans auto loans, and unsecured are personal loans, credit cards etc.

9. **Credit Rating** – Is an act of assigning values by estimating worth or reputation of solvency credit rating froth or repretratuon of solvency and honesty so as to repose trust in a person's ability and intention to repay. Many credit rating agencies are operating in India a such as CRISIL, CARE, ICRA, etc.

10. **Commercial bill market:** Is a market where commercial Bills/Trade bills discounted by banks are traded and rediscounting of such bills takes place in this commercial bill market.

11. **Commercial Paper(CP) :** CP `s are negotiate short term unsecured promissory notes issued by well rated companies generally sold on a discount basis payable after a fixed period a fixed amount on the specified due date.

12. **Certificate of Deposit(CD) :** After treasury bills, the next lowest risk category instrument is CD issued by banks or financial institutions. It is issued at a discount to face value. RBI allows CD up to one year maturities, It is a negotiable promissory note.

13. **Challenge in Financial Services :** Financial service sector is facing a few challenges such as lack of investors awareness , lack of specialization, lack of efficient risk management system and lack of adequate, qualified and trained staff in innovative financial services.

14. **Credit Card:** It is a system named after small plastic card issued to the user of the system. Issuer lends money to the consumer. It is issued by a financial institution / bank to a reputed / creditworthy customer and costumer need not to have an account in the bank.

15. **Debit card:** It is a plastic card issued to a costumer having account in bank to withdraw funds from his account using ATM. A debit card draws directly in the costumer bank account. It is considered relatively safe alternative to cash.

16. **Debentures:** Are principal source of funds to meet long loan financial needs. Debenture is a document issued by a company as evidences of debt the holder usually arising out of loan and mostly secured by a charge.

17. **Derivatives:** To avoid risk in financial transaction derivatives came in to existence. Various types of derivatives products are forward contract, futures, options and swaps. Generally two simultaneous transaction of sale and purchases are done to reduce risk in future.

18. **Development Banks:** Are specialized banking institutions which provide finance to accelerate the rate of growth in a particular sector. Example of such development banks are NABARD for agriculture & rural development, National housing bank for housing , Exim Bank for Import & Exports and many national level institutions like IFCI, IDBI etc. for industries.

19. **Financial System:** -It is a complex and well integrated set of sub system of financial institutions, financial markets, financial intermediaries, services which facilitate transfer and allocation of funds effectively and efficiently. It also consists of regulations,laws and practices followed in the system.

20. **Financial Market:** - Financial market refers to those centers and arrangements which facilitate buying & selling of financial assets / instruments. Whenever a financial transaction takes place, it is deemed to have taken place in financial market. There is no specific place or location to indicate a financial market.

21. **Financial Services:** Are various services rendered by financial institutions /banks. These services are of two types i.e. fee based services where some fee is charge for services & fund based services where service is provided by involving funds such as loans etc.

22. **Financial Instruments:** - Are liability of issuer towards the holder. It is a claim against a person/institution for payment at a future date and periodic payment in the form of interest or dividend. Financial Instruments helps the financial market and the financial intermediaries to perform the important role of channelizing funds from lender to borrower.

23. **Financial Intermediaries:** Are institutions that mediate between ultimate lenders and ultimate borrowers or between those who have surplus money and those who need money to finance their deficit budget. Best examples of such intermediaries are bank, insurance companies, UTI, PF etc.

24. **Financial lease:** Is a contractual commitment that is noncancellabe on the part of the lessee (user) to make a series of payment to the lesser (The owner) for the use of an asset. In this case period of use is shorter then the life of asset.

25. **Factoring:** Is an arrangement between financial institutions or a bank and a business concern where factor purchases book debts either with or without recourse. In other words, outright purchaser of receivable is known as factoring.

26. **Forfeiting:** - It is a form of financing of receivables pertaining to international trade. The purchase is in the form of discounting the documents like trade bills, promissory notes covering the entire risk of nonpayment in collection of dues. All risk of collection problems are of purchaser (Forfeiture).

27. **Global Depository System (GDR's):** A depository receipt is basically a negotiable certificate denominated in US dollars that represent non U.S. company's publicly traded local currency (Indian rupee) equity shares .

28. **Hire purchase :** It is a converted from of credit sale and such hire purchased transaction are governed by hire purchase act 1972. It involves a system in which term loans for purchase of goods and services are advanced to be liquidated in stages through a contractual obligation.

29. **Housing finance:** Is a finance provided by financing agency to purchase, develop, maintain a house. Since house is a basic human need , separate financing institution for housing finance came into being National Housing Bank was establish by RBI to develop housing finance in India in 1988.

30. **Insurance services:** Services provided by insurance companies. Insurance is protection against loss or damage in which individual agree to transfer risk by paying specific amount of money called premium. Many insurance companies in the field of life and non life insurance are providing various services to policy holder.

31. **Intial Public Offering (IPO):** Original amount of shares issued /offered to public for subscription is known initial Public Offer.

32. **Investment Banks :** Are those which collect savings from public and mobilize these saving to put to productive purposes. On the one hand saving are mobilized for productive uses and on the other hand used for investment purposes and thereby help in capital formation. Best examples of investment banks are GIC,UTI, LIC, & etc.

33. **Insurance Regulatory and Development Authority (IRDA):-** IRDA came in to existence in 1999 under IRDA Act to protect the interest of insurance policy holder and to regulate and promote an orderly growth of insurance industry and all intermediary companies dealing with life and non-life insurance in the financial system of India.

34. **Leasing:** Refers to contractual agreement between two parties where by one (lesser) conveys to other (lessee) in return of rent , the right to use an asset for an agreed period of time.

35. **Money Market:** - It is a market for short term money and financial assets that are near substitutes of money. Here dealing are for a short period ranging from one day up to one year and financial assets can be converted into case easily with minimum cost. Examples of money market are call money market, treasury bill market, certificate of deposit etc.
36. **Merchant Banking: -** Merchant Bankers are issue houses which manage new issues of companies. As per SEBI Act' 1992 " any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager , consultant ,advisor or rendering corporate advisory services in relation to such issue" is known as merchant banker.

37. **Managers to the issue :** For mobilizing resources from public , companies go to capital market by way of public issue of shares, debentures bonds for which financial institutions or merchant bankers are appointed as " Manager to the issue". The Managers to the issue perform various advisory services to the company regarding issue.

38. **Mutual fund:** - Mutual funds are special type of institutions which act as financial intermediary in investment business. Mutual funds mobilize funds/savings of small investors and households by selling their own shares also known as units and pass on the returns there of .

39. **Nationalization of banks:** Converting private ownership of banks in to govt. ownership with a view to make use of huge deposit of bank in lending to weaker section and priority sector. Major 14 banks were nationalized in 1969 and six more bank were nationalized in 1980.

40. **National Housing Bank:** A development bank created in 1988 to develop housing sector in the economy. It performes financial, promotional and regulatory function in respect of housing finance in India. It also helps housing finance institutions in the state.

41. **Operating lease:** In contrast to financial lease, operating lease gives the lessee only a limited right to use the asset. The lessee enjoys right to terminate the lease at a short notice without a significant penalty.

42. **Plastic money:** Plastic money is plastic card used in place of currency when a transaction of buying and selling takes place by using these cards. Cards like ATM card , debit card, credit card are the example of plastic money in use.

43. **Registers to the issue:** Registrars are the public face of primary capital market and the intermediary that comes in the greatest contact with investors in new issues. They process the data contained in share application form, decide the basis of allotment, refund orders and issuing share certificates etc.

44. **Risks in financial services :** Risk is a part of corporate life. Various types of risk faced by financial institution while providing financial services are credit risk, liquidity risk , interest rate risk, market risk, technology risk, foreign exchange risk etc.

45. **Share (Ordinary & Preferences) :** Share is a part of unit by which share capital of a company is divided. Two classes of share are there i.e. ordinary and preference share. Equity share capital refers to the share capital which is not preference share capital.

46. **Securitization:** Means acquisition of financial assets by a Securitization or Reconstruction Company. This process of Securitization is resorted to reduce large non performing assets where illiquid financial assets are converted into marketable securities which can be sold to investors.

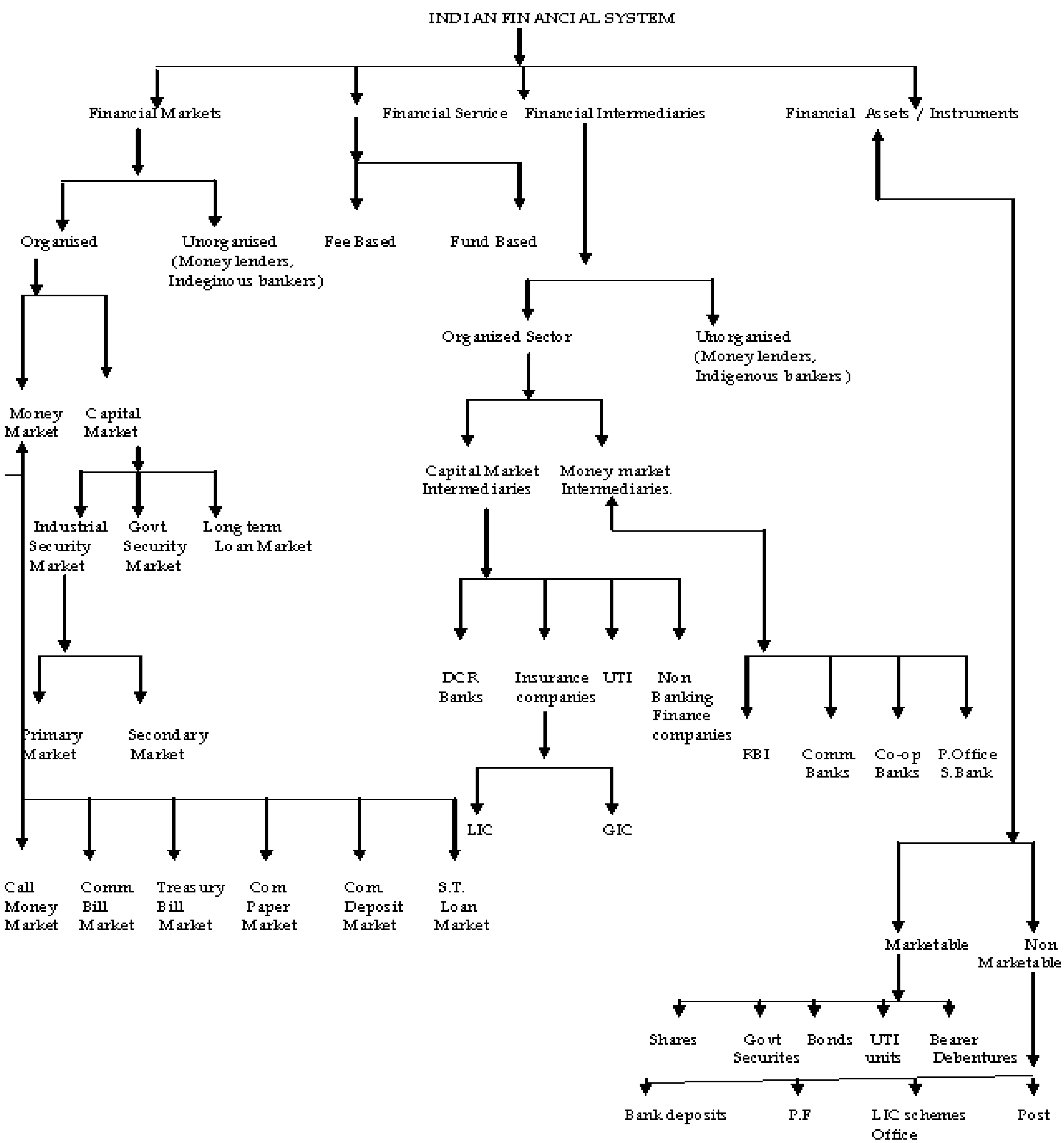
47. **Security & Exchange Board of India (SEBI):-** SEBI was made a statutory body under SEBI Act 1992 to monitor and regulate capital market activities and to promote healthy development of capital market. Its basic aim is to protect the interest of investors in securities by regulating security market.

48. **Secured Premium Note (SPN):** It Is a debenture or bond which is issued on the security of an asset of a company and matures with an assured premium. Interest is paid along with repayment of principal on redemption. It is a good source of project financing.

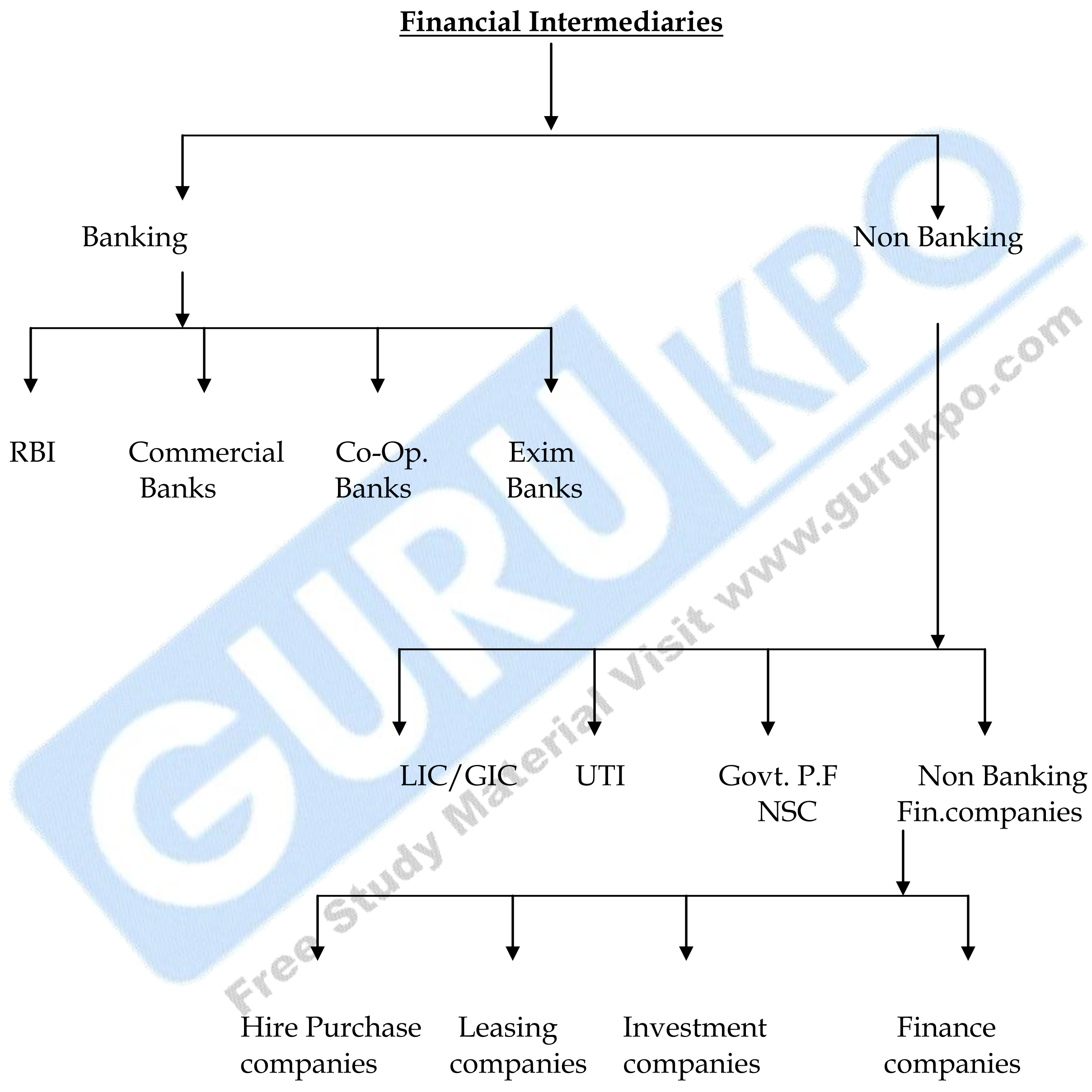
49. **Treasury bill:** In the short term, lowest risk category instrument is treasury bills issued by RBI on behalf of central government for a fixed amount . Their maturity period usually does not exceed more than a year. They are generally 91 days, 182 day and 364 day maturity.

50. **Venture capital:** Is capital invested in high risk industrial projects with high reward possibilities. Investment generally utilize new technology with higher probability of failure than success and investor makes higher capital gains if new technology process is successful.

Annexure C-I


INDIAN FINANCIAL SYSTEM
Financial Markets
Financial Service
Financial Intermediaries
Financial Assets / Instruments
Organised
Unorganised (Money lenders, Indeginous bankers)
Fee Based
Fund Based
Organized Sector
Unorganised (Money lenders, Indigenous bankers)
Money Market
Capital Market
Capital Market Intermediaries
Money market Intermediaries.
Industrial Security Market
Govt Security Market
Long term Loan Market
DCR Banks
Insurance companies
UTI
Non Banking Finance companies
RBI
Comm. Banks
Co-op Banks
P.Office S.Bank
Primary Market
Secondary Market
LIC
GIC
Call Money Market
Comm. Bill Market
Treasury Bill Market
Com Paper Market
Com. Deposit Market
S.T. Loan Market
Marketable
Non Marketable
Shares
Govt Securites
Bonds
UTI units
Bearer Debentures
Bank deposits
P.F
LIC schemes
Office
Post

Annexure C-II



Annexure C-III

Regulatory Bodies

Of

Indian Financial System

Govt. of India
Ministry of Finance
Dept. of Banking & Insurance

RBI
Reserve Bank of India

Regulates Money Market

SEBI
Securities & Exchange Board of India

Regulates Capital Market

IRDA
Insurance Regulatory & Development Authority

Regulates Insurance Companies including LIC & GIC

Annexure C-IV

BANKS IN INDIA

R.B.I. – Leader of Banks in India

COMMERCIAL BANKS

- Public Sector Banks
  - Nationalised Banks
    - 14 Banks Were Nationalized In 1969 and 6 more banks Were Nationalized In 1980
  - SBI& & its subsidiaries
    - SBI was nationalized in 1955 and six subsidiaries were created in 1959.
  - Regional Rural Banks
    - RRB's were createdunder RRB Act 1974
- Private Banks
  - There are around 20 Private sector Banks in India Such as ICICI, HDFC,INDUSIND Bank, KOTAK MAHINDRA Etc.
- Foreign Banks
  - There are 8 important banks like ABN Amro,City Bank, HSBC, American Express etc.

Total: 14+6= 20 Banks

Annexure C-V

Development Banks

R.B.I. – Leader

- NABARD For Agri.& Rural Devp. (1982)
- National Housing Bank for Housing (1988)
- EXIM Bank for export Import & Foreign Trade (1982)
- Stock Holding Corporation of India for Capital Market (SHCIL) (1987)
- For Industries
  - Industrial Fin.Corpn Of India (IFCI) (1948)
  - Industrial Investment Corporation of India (ICICI) (1955)
  - Industrial Development Bank of India (IDBI) (1965/75)
  - Industrial Investment Bank of India (IIBI) (1971/97)
  - Small Industrial Development Bank of India (SIDBI) (1998)
  - SFC's State Finance Corpns
  - SIDC State Industrial Dev Corpns

Annexure C-VI

CO-OPERATIVE BANKS

- Agriculture Credit
  - Short & Medium
    - State Co-op.Banks (At State level)
      - District Central Co-op,Banks (At District level)
        - Primary Agr.Credit Cooperatives (At Primary level) They are not banks.
  - Long Term
    - State Central Agr. & Rural Dev.Banks (SARDB;s)
      - Primary Co-0p. Agriculture. & Rural Development.. Bank. (PARDM's)
- Non-Agriculture credit
  - Urban Co-op.Banks
    - Scheduled Banks
    - Non Scheduled Banks
  - Industrial Co-op. Term Banks.

Master of Business Administration
3M6305
Management of Financial Services(Minor)

Time : 3 Hours

Total Marks : 70
Min. Passing Marks : 28

The question paper is divided in two sections. There are sections A and B. Section A contain 6 questions out of which the candidate is required to attempt any 4 questions. Section B contains short case study/application base 1 question which is compulsory. All questions are carrying equal marks.

Use of following supporting material is permitted during examination.
(Mentioned in form No.205)

1.__________Nil__________ 2.__________Nil__________

SECTION-A

1. Critically analyse the present position of the financial service sector in India and state the challenges it has to face in the years to come.

2. Inspite of suitable legislative measures, the Indian financial system remains weak". Comment and also trace out the development of the financial system in India.

3. 'Financial markets, financial services and financial intermediaries are an integral part of the financial system'. Critically examine.

4. Write short notes on : (any two)
   (a) Consumer finance
   (b) Credit cards
   (c) Factoring

5. What is debt securitization? Explain the basic process involved in debt securitisation process.

6. What is a lease? What are the types of lease? What are the basic differences between lease and hire purchase?

SECTION-B

7. ABC Ltd. is a new company intending to issue equity shares to the public. Enumerate the activities involved in a public issue with reference to:
   (a) Pre issue management; and
   (b) Post issue management.

Roll No. : ____________________

3M6305

M.B.A. (Sem. III) (Main & Back) Examination, January-2010
M-305 : Management of Financial Services (Major)

Time : 3 Hours

Total Marks : 70
Min. Passing Marks : 28

The question paper is divided in two sections. There are sections A and B. Section A contain 6 questions out of which the candidate is required to attempt any 4 questions. Section B contains short case study/application base 1 question which is compulsory. All questions are carrying equal marks.

Use of following supporting material is permitted during examination.
(Mentioned in form No.205)

1. Nil   2. Nil

SECTION-A

1. Draw an outline or a sketch of Indian Financial Institutions with respect of their Financial services.

2. Describe briefly the concept, nature, determinants and measurement of 'RISK' in the context of management of Financial Services.

3. Draw the formation of capital market in general in any economy and give your critical comments thereon with respect to Indian capital market.

4. Evaluate the significance and place of Merchant Banking in India. What do you hold about their problems and prospects in India?

5. Briefly describe the guidelines of SEBI in regard with a public issue. Make an attempt to examine these guidelines in the light of similar regulations in the developed economies.

6. PI Limited is a unit manufacturing clinical instruments. The company offers its dealers of 3% discount on cash and carry transactions. Its credit terms are 2/10 net 45. The Company has been plagued by a bad debt problem averaging 2% of the credit sales for the past several years. Dealers representing approximately 10% of the total sales opt for the cash and carry offer. On an average, 50% of the receivables are paid at the end of ten days, thus availing the 2% discount. The rest of the receivables are usually paid 50 days after sales.

   The Company has been financing 50% of its receivables from the bank at a cost of 22% p.a. The remaining half is financed through own funds whose national cost is estimated at 24% p.a. The costs associated with credit administration totals Rs. 8 lakhs.

   Imfacs a factoring Company has approached PI limited with a factoring proposal. The details are given below:

   Type of contract: Non-resourse. Advance factoring

   Interest on advance: 22.5% p.a. payable in advance.

   Factoring commission: 3.5% of the face value of factored receivables.

   Factor reserve: 20% (percentage applied on receivables net of commission payable).

   Average maturity period: 30 days

   The credit administration costs can be totally avoided when the receivables are factored. Assuming that all figures mentioned hold good for the year 2001-2002 and if projected sales for the same year is Rs. 800 lakhs, would you recommend that PI go in for a factoring arrangement? Your recommendation must be based on a cost benefit analysis assuming 360 days to a year and ignoring taxes.

SECTION-B

7. Examine the role and significance of Financial Services, in theoretical as well as empirical terms, in economic growth. Also evaluate the reforms initiated in our financial sector in view of the same.

Roll No. : ____________________

3M6305

M.B.A. (Sem. III) (Main & Back) Examination, January-2009

M-305 : Management of Financial Services (Major)

Time : 3 Hours

Total Marks : 70

Min. Passing Marks : 28

The question paper is divided in two sections. There are sections A and B. Section A contain 6 questions out of which the candidate is required to attempt any 4 questions. Section B contains short case study/application base 1 question which is compulsory. All questions are carrying equal marks.

Use of following supporting material is permitted during examination.
(Mentioned in form No.205)

1. Nil 2. Nil

SECTION-A

1. (a) How does financial development influence the economic development?
   (b) What are the different ways of classifying financial markets?

2. List the various money market instruments and state their features in brief.

3. Write short notes :
   (a) Government Securities Market

(b) Bill Financing
(c) Hire Purchase and Lease
(d) Commercial Bank and Merchant Bank

4. Write short notes on:
   (a) Securitisation
   (b) Rights issue
   (c) SEBI guidelines for new issues
   (d) Factoring

5. Discuss briefly some of the innovative financial instruments introduced in recent times in the financial services sector.

6. Explain in detail "Pre-issue management".

Section B

7. Credit cards are innovative ones in the line of financial services offered by commercial banks. The idea of a credit card was first developed by a Bavarian farmer, Franz McNamara, an American businessman who found himself without cash at a week end resort, founded Diner's card in 1950. Right from that time , the commercial banks and non-bankimg companies in USA adopted the idea of credit card to develop their business.

   Credit card culture is an old hat in western countries. In India, it has caught up fast. The present trend indicates that the coming years will witness a bargaining growth of credit cards which will lead to a cashless society.

   Keeping the above information in mind, your managing director , ABC Bank has asked you to comment on the following issues:
   (a) Types of credit cards to be launched.
   (b) Procedure to be followed for issue of credit cards
   (c) Facilities to be offered
   (d) Review of RBI norms on credit cards.

Roll No. : ____________________

3M6305

M.B.A. (Sem. III) (Main & Back) Examination, December-2009

M-305 : Management of Financial Services (Major)

Time : 3 Hours

Total Marks : 70

Min. Passing Marks : 28

The question paper is divided in two sections. There are sections A and B. Section A contain 6 questions out of which the candidate is required to attempt any 4 questions. Section B contains short case study/application base 1 question which is compulsory. All questions are carrying equal marks.

Use of following supporting material is permitted during examination.
(Mentioned in form No.205)

1.______Nil______ 2.______Nil______

SECTION-A

1. a) What do you mean by financial system? What are the primary functions of financial system.

   b) Explain types of financial services on fund and fee basis.

2. Define capital market and explain its functions.

3. Define merchant banking. Discuss the guidelines for merchant banker issued by SEBI.

4. Discuss the securitization process and explain its significance in Indian Financial system.

5. Discuss recent issues and challenges I n financial services in India.

6. Write short notes on :
   i) Treasury Bill
   ii) Factoring
   Iii)Mutual fund

Section -B

7. a) Recession is one of the major issue at world level. Critically examine the impact of this recession on Indian Financial System.
   b) Discuss the major reforms in Indian Financial sector.

Roll No. : ____________________

3M6305

M.B.A. (Sem. III) (Main & Back) Examination, December-2009

M-305 : Management of Financial Services (Minor)

Time : 3 Hours

Total Marks : 70

Min. Passing Marks : 28

The question paper is divided in two sections. There are sections A and B. Section A contain 6 questions out of which the candidate is required to attempt any 4 questions. Section B contains short case study/application base 1 question which is compulsory. All questions are carrying equal marks.

Use of following supporting material is permitted during examination.
(Mentioned in form No.205)

1. Nil

2. Nil

SECTION-A

1. What is the significance of Asset Liability Management system for NBFCs ? What are the three pillars on which effective ALM process rests ? Differentiate between interest rate risk and liquidity risk highlighting concrete examples. Critically comment on the growth of NBFC's between 2000-2007 and the specific measures taken by RBI to strengthen their operations.

2. (i) Differentiate between factoring and forfeiting .What are the service rendered bu a factor ? What are the parties involved and the mechanism for forfeiting ?
   (ii) What are the specific guidelines issued by RBI to banks on exposure to borrower and borrower group ? What are the exemptions provided and what is the rational behind those exemptions?
3. What are important pre issue and post issue obligations of merchant bankers in issue management? What are the reasons for negligible primary issues that came in the market between March 2008 to November 2008?

4. Define and differentiate between finance lease and accounting lease. Discuss the accounting treatment of finance and operating lease by lessor and their disclosure in the financial statements with the help of examples.

5. (i) What are the major functions of financial system ? Describe the structure of financial intermediaries presnet in Indian financial system and what is the rationale and purpose of financial intermediaries ?

6. (ii) What are the advantages of mutual funds investments? How would you explain the rationale for relatively very high returns given by infrastructure mutual funds investments between 2005-07?

7. What has been the philosophy of financial sector reforms in India which were introduced from 1991 onwards? Describe specific reforms introduced by highlighting them under specific categories. Evaluate critically the performance of financial sector reforms introduced with the help of facts and figures.

SECTION ---B

1. (i) Following facts relate to a leasing company XYZ :

Investment cost of equipment = Rs.96 Lakh
Primary lease period = 6 yrs
Residual values = nil
Annual required rate of return =12%

Calculate the annual rental that the company should charge under each of the following rental structures :

(a) Equated
(b) If the rental increases annually at 12%
(c) If annual rental is Rs.15 lakh for the first two years.
(d) If rentals are paid after a deferment period of 1 year.

(ii) ABC Ltd . is evaluating the acquisition of a heavy duty equipment . ABC Ltd can either purchase the equipment through the use of its normal financing mix (30% debt and 70% equity) or lease it. The equipment cost Rs.80,000,and will contribute annual before tax savings of Rs 24,000 over its useful life of 4 Years, and is expected to have a salvage value of Rs.16,000 at the end of 4 years.ABC Ltd. uses straight line depreciation in this type of analysis.

XYZ Bank has offered a 10% ,4 years loan and the equipment manufacturer has offered a four year lease with annual payments of Rs-24,000 at the beginning of each year. This lease payment would include Rs.4000 in operating expenses which ABC Ltd. would have to absorb if it purchased the equipment ABC's cost of capital is 12% and its marginal tax rate is 50%.

(a) Is the equipment acquisition justified? Why or Why not?
(b) Assuming that acquiring the equipment is absolutely necessary for day to day operation of the ABC Ltd. should it be leased or purchased?

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3.	Financial Management	I.M. Pandey\
4.	Indian Financial System	Khan
5.	Marketing of Financial Services	Jain, Rathi, & Mathur (Hand Book)
6.	Financial Services & Systems	K.Sashidhara
7.	Financial Services	R Shanughan
8.	Financial Instruments & Markets	L M Bhole
9.	Financial Services	Gupta & Aggarwal