

Subject: IFSS

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MBPC3007 INDIAN FINANCIAL SYSTEM AND SERVICES (IFSS) (3-0-0)

Course Objectives:

- 1.To understand the structure and functions of the Indian financial system, including banks, insurance, and regulatory bodies.
- 2.To explore the operations and instruments of money markets, capital markets, and online trading platforms.
- 3.To analyze various financial products such as mutual funds, venture capital, leasing, and insurance, including their features and regulatory aspects.
- 4.To develop skills in financial decision-making including mutual funds, stock market investments, venture capital, leasing, and hire purchase

MODULE-I:

Indian Financial System: Introduction, Components and Functions of Indian Financial System. Reforms in Indian Financial Systems. Indian Banking and Insurance Systems: Definition of Banks, Structure and Types of Banks in India. Roles & Functions of Banks in India, Banking Products – Deposit and Loan products, Recent trends of banking system in India. Definition & Principles of insurance, Types of insurance: Life and Nonlife Insurance, Re-Insurance & Micro Insurance. IRDA: Role, Functions & Powers. Different Insurance Product & their Applicability. (Pension plans, Banc-assurance, ULIPs, Endowment Plan, and Money back Plan). Microfinance: Overview of Microfinance, Self Help Group Approach, Models of Microfinance

MODULE- II:

Money Market and Capital Market: Features of Money Market, Composition of Money Market: Players, Instruments and Institutions in Money Market. Primary Market: Functions of Primary market, IPO, SEBI guidelines for IPO, Methods of issuing IPO. Secondary Market: Functions of Secondary Market, Instruments Traded in Secondary Market: Trading Mechanism in Secondary Market. Online Trading, De-Materialization Account. Brokers, Kinds of brokers,

MODULE-III:

Mutual funds: Introduction, Classification of funds, Organization Structure of Mutual fund company (Powers& Functions), Mutual fund investment vs Stock market investment. Venture Capital: Meaning, Types of venture capital, Stages of venture capital financing, exit routes, Leasing: Concept and classification, Hire Purchase: Conceptual framework, Leasing vs hire purchase.

Course Outcomes:

- CO-1: Analyze the structure, functions, and recent trends in the Indian banking system and describe the role of different types of banks in providing various banking services and products, including deposit and loan products.
- CO-2: Analyze the principles and types of insurance, and explain the applicability of different insurance products in the Indian market.
- CO-3: Outline the functioning of money market and capital market, including the role and functions of various players, instruments, and institutions, as well as the trading mechanisms and regulations in place for primary and secondary markets.
- CO-4: Illustrate and differentiate between different investment options available in the financial market, including mutual funds, stock market investments, venture capital, leasing, and hire purchase, and evaluate their suitability for different types of investors.

Books:

- Financial Markets and Services, Gordon & Natarajan
- Financial Services, Gupta, Agrawal, Kalyani
- Financial Services, Khan, MH
- Financial Markets and Financial Services, Clifford, Gourang, PHI

MODULE-1

INTRODUCTION OF INDIAN FINANCIAL SYSTEM

Meaning of Indian financial system

The financial system enables lenders and borrowers to exchange funds. India has a financial system that is controlled by independent regulators in the sectors of insurance, banking, capital markets and various services sectors.

Thus, a financial system can be said to play a significant role in the economic growth of a country by mobilizing the surplus funds and utilizing them effectively for productive purposes.

FEATURES OF INDIAN FINANCIAL SYSTEM:

- It plays a vital role in economic development of a country.
- It encourages both savings and investment.
- It links savers and investors.
- It helps in capital formation.
- It helps in allocation of risk.
- It facilitates expansion of financial markets.

COMPONENTS/ CONSTITUENTS OF INDIAN FINANCIAL SYSTEM

The following are the three major components that comprise the Indian Financial System:

1. Financial Institutions
2. Financial Markets
3. Financial Instruments/ Assets/ Securities

COMPONENT IS DISCUSSED BELOW:

FINANCIAL INSTITUTIONS

Financial institutions are the intermediaries who facilitate smooth functioning of the financial system by making investors and borrowers meet. They mobilize savings of the surplus units and allocate them in productive activities promising

a better rate of return. Financial institutions also provide services to entities (individual, business, government) seeking advice on various issues ranging from restructuring to diversification plans. They provide a whole range of services to the entities who want to raise funds from the markets or elsewhere.

Financial institutions are also termed as financial intermediaries because they act as a middle between savers by accumulating funds from them and borrowers by lending these funds.

TYPES OF FINANCIAL INSTITUTIONS

Financial institutions can be classified into two categories:

A. Banking Institutions

B. Non - Banking Financial Institutions

A. BANKING INSTITUTIONS (Reserve Bank of India)

Indian banking industry is subject to the control of the Central Bank. The RBI as the apex institution organises, runs, supervises, regulates and develops the monetary system and the financial system of the country. The main legislation governing commercial banks in India is the Banking Regulation Act, 1949.

The Indian banking institutions can be broadly classified into two categories:

1. Organised Sector

2. Unorganised Sector.

1. Organised Sector

The organised banking sector consists of commercial banks, cooperative banks and the regional rural banks.

- (a) Commercial Banks: The commercial banks may be scheduled banks or non – scheduled banks. At present only one bank is a non - scheduled bank. All other banks are scheduled banks. The commercial banks consist of 27 public sector banks, private sector banks and foreign banks. Prior to 1969, all major banks with the exception of State Bank of India in the private sector. An important step towards public sector banking was taken in July 1969, when 14 major private banks with a deposit base of 50 crores or more were nationalised. Later in 1980 another 6 were nationalised bringing up the total number of banks nationalised to twenty.

- (b) Co-operative banks: An important segment of the organized sector of Indian banking are the co-operative banking. The segment is represented by a group of societies registered under the Acts of the states relating to cooperative societies. In fact, co-operative societies may be credit societies or non-credit societies. Different types of co-operative credit societies are operating in Indian economy. These institutions can be classified into two broad categories: (a) Rural credit societies which are primary agriculture, (b) Urban credit societies which are primarily non-agriculture.
- (c) Regional Rural Banks (RRBs): Regional Rural Banks were set by the state government and sponsoring commercial banks with the objective of developing the rural economy. Regional rural banks provide banking services and credit to small farmers, small entrepreneurs in the rural areas. The regional rural banks were set up with a view to provide credit facilities to weaker sections. They constitute an important part of the rural financial architecture in India. There were 196 RRBs at the end of June 2002, as compares to 107 in 1981 and 6 in 1975.
- (d) Foreign Banks: Foreign banks have been in India from British days. Foreign banks as banks that have branches in the other countries and main Head Quarter in the Home Country. With the deregulation (Elimination of Government Authority) in 1993, a number of foreign banks are entering India. Foreign Banks are: Citi Bank. Bank of Ceylon.

2. Unorganised Sector.

In the unorganised banking sector are the Indigenous Bankers, Money Lenders.

1. Indigenous Bankers: Indigenous Bankers are private firms or individual who operate as banks and as such both receive deposits and given loans. Like bankers, they also financial intermediaries. They should be distinguished professional money lenders whose primary business is not banking and money lending. The indigenous banks are trading with the Hundies, Commercial Paper.
2. Money Lenders: Money lenders depend entirely to on their one funds. Money Lenders may be rural or urban, professional or non-professional. They include large number of farmers, merchants, traders. Their operations are entirely unregulated. They charge very high rate of interest.

B. NON – BANKING INSTITUTIONS

The non – banking institutions may be categorized broadly into two groups:

- (a) Organised Non – Banking Financial Institutions.
- (b) Unorganised Non – Banking Financial Institutions.

(a) Organised Non – Banking Financial Institutions

The organised non - banking financial institutions include:

1. Development Finance Institutions:

The institutions like IDBT, ICICI, IFCI, IIBI, IRDC at all India level. The State Finance Corporations (SFCs), State Industrial Development Corporations (SIDCs) at the state level. Agriculture Development Finance Institutions as NABARD, LDBS etc. Development banks provide medium- and long-term finance to the corporate and industrial sector and also take up promotional activities for economic development

2. Investment Institutions:

These include those financial institutions which mobilise savings at the public at large through various schemes and invest these funds in corporate and government securities. These include LIC, GIC, LTT, and mutual funds. The non - banking financial institutions in the organised sector) have been discussed at length in detail in separate chapters of this book.

(b) Unorganised Non - Banking Financial Institutions

The unorganised non - banking financial institutions include number of non - banking financial companies (NBFCs) providing whole range of financial services. These include hire - purchase 300 consumer finance companies, leasing companies, housing finance companies, factoring companies, Credit rating agencies, merchant banking companies etc. NBFCs mobilise public funds and provide loanable funds.

Functions of Banks in India

Banks in India perform various functions, which can be broadly categorized into primary and secondary functions.

Primary Functions of Banks

The primary functions of banks in India include:

1. **Accepting Deposits:** Banks accept deposits from the public in various forms, such as savings accounts, current accounts, and fixed deposits. These deposits serve as a source of funds for the bank, which it can then lend out to borrowers.
2. **Lending Loans and Advances:** Banks lend money to individuals, businesses, and other entities in the form of loans and advances. This is the primary way in which banks generate income.

Secondary Functions of Banks

In addition to their primary functions, banks in India also perform a number of secondary functions, including:

1. **Transfer of Funds:** Banks facilitate the transfer of funds between individuals and businesses, both domestically and internationally.
2. **Issue of Notes/Drafts:** Banks issue notes and drafts, which can be used to make payments.
3. **Credit Deposits:** Banks credit deposits into the accounts of their customers.
4. **Foreign Exchange Services:** Banks provide foreign exchange services, such as currency exchange and remittances.

These are just some of the many functions that banks in India perform. By understanding these functions, you can gain a better understanding of how banks work and how they can help you manage your finances.

Banking Functions

1. Accepting Deposits

- Banks accept deposits from customers, who can withdraw their funds at any time.
- Customers can deposit money in various types of bank accounts, such as savings accounts, current accounts, or fixed deposit accounts.
- Savings banks pay interest to customers on their deposits and are popular with small savers.

- Current accounts are running accounts that can be operated multiple times during a working day.
- Fixed deposit accounts hold deposits for a fixed period and offer higher interest rates.

2. Lending Loans & Advances

- Banks lend funds to individuals and businesses at a certain interest rate.
- Loans are primarily provided to agriculturists, industrialists, and businessmen for investment and economic development.

3. Issuance of Notes and Drafts

- Banks issue notes and create other inexpensive modes of exchange, such as drafts and checks.
- In India, the Reserve Bank of India (RBI) is responsible for issuing notes and coins.
- Banks create and enable the transfer of credit instruments like bank notes, bank drafts, letters of credit, and checks.
- These instruments reduce the need for metallic money and facilitate convenient and cost-effective fund transfers.

4. Credit Deposits

- Banks can create deposits by providing loans to customers.
- Borrowers are credited with a withdrawable deposit amount when needed.
- Customers often deposit borrowed funds back into the same bank, either due to bank requirements or to benefit from current deposit account features.
- These deposits are known as Credit Deposits.

Other Functions of Banks Include:

1. Collecting checks drawn on other banks
2. Accepting and collecting bills of exchange
3. Dealing in foreign exchange to assist in settling overseas debts

4. Providing safe deposit facilities
5. Acting as stock exchange trustees
6. Assisting the RBI in maintaining the safety and condition of banknotes

Indian Banking Structure

The Indian Banking Structure can be broadly categorized into two types:

- **Scheduled Banks:**
 - Defined in the Reserve Bank of India Act as banks listed in the 2nd schedule of the RBI Act of 1934.
 - Includes all RRBs, Indian and foreign commercial banks, and cooperative banks.
 - Must have a minimum paid-up capital and reserves of up to INR 25 lakh.
- **Non-Scheduled Banks:**
 - Do not follow the 2nd schedule of the RBI Act of 1934 and are not bound by RBI guidelines.
 - Required to maintain a Cash Reserve Ratio (CRR) by themselves, not with the RBI.
 - Have a paid-up capital of less than INR 5 lakhs.

Types of Banks in India

Private Sector Banks:

- Emerged after liberalization in the 1990s.
- Examples: ICICI, HDFC.
- Currently, 22 private-sector banks operate in India.

Foreign Banks:

- Must adhere to guidelines of both home and host countries.
- More effective in countries with high taxes and easy market entry for international firms.
- 46 foreign banks currently operate in India.

Regional Rural Banks (RRBs):

- Established in 1975 based on recommendations of “The Narasimhan Committee” under the RRB Act 1976.
- Regulated and supervised by **NABARD** (National Bank for Agriculture and Rural Development).
- Owned by Central Government (50%), State Government (15%), and Sponsor Banks (35%).
- 56 RRBs currently operate in India.

Cooperative Banks:

- Important forms of business conducted through mutual understanding.
- Play a crucial role in rural economy development.
- Rural cooperative credit sector's share of credit disbursed has declined from over 50% to less than 20% in recent years.

What is a Bank?

Banks are financial institutions authorized to receive deposits and provide credit. Other functions of banks may include financial services like wealth management, safe deposit boxes, and currency exchanges.

RECENT TRENDS AND DEVELOPMENTS IN BANKING AND FINANCIAL SECTOR

Today, India has got a very well-developed banking system with Reserve Bank of India (RBI) as the governing head. Its main aim is to maintain monetary stability in India. It is called the 'Reserve Bank' as it keeps the reserve of all commercial banks. In order to maintain price stability and adequate flow of credit the RBI uses monetary policy. For some time reducing inflation was one of the most important goals.

Growth and diversification were on agenda in banking sector throughout the world. In order to help the customers to avail the best of the services, government opened the door for foreign banks in 1991. It allowed them to start their operations in India and provide different facilities. It initiated the process of providing licenses to new banks. RBI also introduced important policy measures of introduction of Credit Default Swap (CDS) for corporate bonds and deregulation of saving bank deposit rate which will further sharpen the prudential norms and strengthen its supervisor mechanism.

Insurance

Insurance is a vital concept in commerce and daily life, providing a structured way to manage financial risks. It involves an agreement where an individual or a business pays regular sums, called premiums, to an insurance company. In return, the insurer promises to cover specific financial losses due to unforeseen events such as accidents, illnesses, or damage to property. Insurance is based on the principle of pooling risk, making protection affordable and accessible.

Meaning and Core Components of Insurance

In essence, insurance is a financial tool designed to provide security against sudden losses. Three essential components define most insurance policies:

- **Premium:** The amount paid, monthly or yearly, to keep the policy active.
- **Policy Limit:** The maximum sums the insurer will pay for a covered loss.
- **Deductible:** The amount the policyholder pays out-of-pocket before insurance coverage starts.

For example, in auto insurance, you might pay a premium to cover damages up to a certain limit. If a covered incident occurs, you first pay your deductible, and then the insurer covers the remaining expenses up to the policy limit.

Types of Insurance

There are several types of insurance, each designed for different risks and needs. The main categories include:

- **Health Insurance:** Pays for medical treatments, surgeries, and sometimes vision or dental care. Policies may include deductibles, copays, and coinsurance.
- **Homeowners Insurance:** Provides financial protection against damage or loss to a home, including theft, fire, and certain natural disasters.
- **Auto Insurance:** Covers damages from car accidents, natural disasters, theft, or vandalism. Often mandatory by law for drivers.
- **Life Insurance:** Pays a lump sum to beneficiaries if the insured person passes away. Can be term-based (for a set period) or permanent (for life with premiums).

- **Travel Insurance:** Covers travel-related issues like trip cancellations, medical emergencies, lost baggage, or rental car accidents.

Principles of insurance

- **Utmost Good Faith:** Both the insurer and the insured must be completely honest and disclose all material facts related to the risk.
- **Insurable Interest:** The policyholder must have a financial stake in the insured asset or person. They must suffer a financial loss if something happens to it.
- **Proximate Cause:** This principle states that the loss must be a direct result of a covered peril (the proximate cause) and not an indirect one.
- **Indemnity:** This principle ensures that the insured is not put in a better position after a loss than they were before. The insurer will compensate for the actual loss suffered, up to the policy limit.
- **Subrogation:** After paying a claim, the insurer has the right to "step into the shoes" of the insured and pursue any legal right of the insured to recover the loss from a third party.
- **Contribution:** If a loss is covered by more than one insurance policy, the insured can claim from any of the insurers, but the total payout will not exceed the actual loss. The insurers will then contribute to the claim proportionally.
- **Loss Minimization:** The insured has a duty to take all reasonable steps to minimize the loss after it occurs.

IRDAI

The **IRDAI** (Insurance Regulatory and Development Authority of India) is a statutory body that regulates and promotes the growth of the insurance sector in India. Its main role is to protect the interests of policyholders and to ensure the orderly development of the insurance market. Its functions include registering and licensing insurance companies and intermediaries, setting norms for them, and overseeing aspects like premium rates, financial reporting, and investments to ensure the industry is stable and transparent. The IRDAI has powers to conduct inspections, impose penalties, and investigate, which helps it

ensure fair treatment of policyholders, promote competition, and prevent fraud.

Role and objectives

- **Policyholder protection:** Safeguards the interests of insurance policyholders and ensures they receive fair treatment.
- **Market development:** Fosters the systematic growth of the insurance industry to benefit the public and contribute to economic growth.
- **Promoting integrity:** Promotes and monitors high standards of integrity, fair dealing, transparency, and financial soundness within the industry.
- **Ensuring claims settlement:** Ensures genuine claims are settled promptly and prevents fraud and other malpractices.

Functions

- **Registration and licensing:** Registers insurance companies, issues licenses to intermediaries (like agents and brokers), and sets the required qualifications and code of conduct.
- **Regulation:** Regulates premium rates, terms, and conditions for non-life insurance, specifies financial reporting norms, and regulates the investment of policyholders' funds.
- **Financial oversight:** Ensures that insurance companies maintain adequate solvency margins.
- **Promoting efficiency and competition:** Promotes professional organizations, encourages competition to enhance consumer choice, and spreads insurance awareness to increase its penetration.
- **Policyholder support:** Investigates and addresses policyholder grievances and ensures that policyholders are provided with accurate information about products and services.
- **Rural and social sector coverage:** Works to ensure insurance coverage reaches rural areas and vulnerable sections of society.

Powers

- **Inspection and investigation:** Conducts inspections, inquiries, and investigations into insurers, intermediaries, and other connected organizations.
- **Adjudication:** Adjudicates disputes between insurers and intermediaries or between intermediaries themselves.
- **Enforcement:** Cancels licenses, imposes penalties, and takes necessary action against entities that fail to meet standards or violate provisions.
- **Information gathering:** Can call for information and records from the entities it regulates.
- **Rule-making:** Has the power to create new rules and regulations under the Insurance Act, 1938, and to make amendments to them as market conditions evolve.

Life insurance products

Life insurance provides a financial safety net for an individual's dependents in the event of their death. It is a critical component of both personal and business financial planning.

Types of life insurance

- **Term insurance:** Provides a death benefit for a specified period (e.g., 10, 20, or 30 years) at an affordable premium.
 - **Applicability for individuals:** Ideal for young families with high debt (mortgage, education loans) and low income, protecting against the premature loss of a primary wage earner.
 - **Applicability for businesses:** Used to protect a business against the loss of a "key person," such as a founder or critical employee, whose death would severely impact operations.
- **Whole life insurance:** A permanent policy that covers the insured for their entire life. It includes a savings component, called a "cash value," which grows over time on a tax-deferred basis.

- **Applicability for individuals:** Suited for long-term financial goals like estate planning, building cash value, or providing lifetime coverage for dependents.
 - **Applicability for businesses:** Can fund buy-sell agreements to ensure a smooth ownership transition if a partner passes away. The cash value can also be a source of liquidity for business needs.
- **Unit-linked insurance plans (ULIPs):** A hybrid product that combines life insurance with investment. A portion of the premium is used for life cover, while the rest is invested in market-linked funds.
 - **Applicability for individuals:** For those who want the dual benefit of insurance and wealth creation for long-term goals, such as a child's education or retirement.
 - **Applicability for businesses:** Entrepreneurs can use ULIPs as an investment tool for wealth creation while also maintaining a death benefit.
- **Endowment plans:** Combine life insurance and savings, offering a lump-sum payout on maturity or upon the policyholder's death.
 - **Applicability for individuals:** Suited for disciplined savings toward a specific long-term financial goal while simultaneously providing a life cover.
- **Retirement plans (Annuities):** Designed to provide a regular income stream after retirement. Accumulates funds during the working years and pays a pension post-retirement.
 - **Applicability for individuals:** An essential tool for retirement planning, especially in an era of declining pension benefits.
- **Group life insurance:** A single policy that covers a group of people, typically employees of a company.
 - **Applicability for businesses:** A cost-effective way to offer life insurance as an employee benefit to attract and retain talent. Coverage typically ends when an employee leaves the company.

General (non-life) insurance products

General insurance covers losses and damages to assets and provides protection against liability claims. Unlike life insurance, these policies are usually for a short term, often a year.

Property insurance

- **Home insurance:** Covers the structure and contents of a residential property against damage from fire, natural calamities, and theft.
 - **Applicability:** Essential for homeowners to protect their largest asset. Renters can also get coverage for their contents.
- **Motor insurance:** A mandatory policy that covers vehicles (cars, bikes) against damage from accidents, theft, fire, and natural disasters.
 - **Applicability:** Required by law for all vehicle owners. Commercial vehicle insurance protects businesses that rely on a fleet.
- **Fire insurance:** Provides coverage specifically for damages caused by accidental fire, lightning, and explosions.
 - **Applicability:** Crucial for businesses with large inventories or commercial properties at risk of fire.
- **Marine cargo insurance:** Covers goods and vessels during transit via land, air, or water.
 - **Applicability:** Critical for businesses involved in import, export, and other logistics operations.

Casualty (liability) insurance

- **Commercial general liability (CGL):** Protects a business against third-party claims for bodily injury or property damage caused by the business's operations.
 - **Applicability:** A necessity for all businesses to protect against expensive lawsuits and legal fees from customers or vendors.
- **Workmen's compensation insurance:** Covers the employer's statutory liability to provide medical benefits and wage replacement for employees injured on the job.

- **Applicability:** Mandatory for all employers in most places to protect both the business and its employees.
- **Professional liability (E&O):** Protects professionals (e.g., consultants, lawyers, IT firms) against claims of negligence or errors in their professional services.
 - **Applicability:** Important for any service-based business to protect against financial harm caused by professional mistakes.
- **Directors and officers (D&O) insurance:** Covers the legal expenses and damages for directors and officers of a company if they are sued for their managerial decisions.
 - **Applicability:** Essential for protecting the personal assets of a company's leadership and mitigating legal risks.
- **Cyber liability insurance:** Covers losses resulting from cyberattacks, data breaches, and other technology-related risks.
 - **Applicability:** Critical for businesses that store sensitive customer data, such as e-commerce, healthcare, and financial services firms.
- **Product liability insurance:** Offers coverage for damages or injuries caused by a company's products.
 - **Applicability:** Vital for manufacturing and retail businesses that produce and sell physical goods.

Health insurance products

Health insurance offers financial coverage for medical expenses arising from illness, injury, or hospitalization.

- **Individual health insurance:** Covers the medical expenses of a single person, with a premium based on individual factors like age and health history.
 - **Applicability:** Suitable for individuals who want personalized and comprehensive coverage, and for businesses where employees need a specific, customizable plan.
- **Family floater plan:** Covers an entire family (usually spouse and children) under a single policy, with the sum insured shared among the members.

- **Applicability:** A cost-effective way for families to get health coverage. Businesses can offer this as an option alongside standard group insurance.
- **Group health insurance:** Offered by an employer or organization to a group of people.
 - **Applicability:** Often provided as an employee benefit by businesses of all sizes to attract and retain talent. It's also an attractive, and often cheaper, benefit for employees compared to individual plans.
- **Critical illness insurance:** A fixed-benefit plan that provides a lump-sum payout upon the diagnosis of a specific life-threatening disease (e.g., cancer, stroke).
 - **Applicability:** Can be a rider or a standalone policy that provides additional financial support for major health events beyond standard medical expenses.
- **Top-up plans:** Provide an extra layer of coverage over and above an existing health policy's sum insured. A "deductible" must be paid before the top-up kicks in.
 - **Applicability:** An affordable way for individuals and businesses to increase their total coverage for potentially high-cost medical treatments without buying a completely new policy.

What Is Microfinance?

Microfinance, also called microcredit, is a type of banking service provided to low-income individuals or groups who otherwise wouldn't have access to financial services.

Key services include:

- **Microcredit:** The most well-known service, involving small loans to help the poor engage in income-generating activities.
- **Micro savings:** Allowing the poor to save small amounts without service fees or minimum balances, helping them build financial discipline and assets.

- **Microinsurance:** Providing affordable insurance policies for specific events like illness, crop failure, or death, which can be catastrophic for the poor.
- **Payment and money transfers:** Facilitating remittances and other money transfers for marginalized communities.
- **Training and education:** Often offered alongside financial services to improve financial literacy, business skills, and empowerment.

Self-help group (SHG) approach

The self-help group (SHG) is a highly effective, community-based microfinance model, especially prevalent in India. It empowers the poor by building a bottom-up approach to financial inclusion.

Key features:

- **Structure:** SHGs consist of small, homogeneous groups of 10–20 members, usually women, from similar socioeconomic backgrounds and geographical areas.
- **Functioning:** Members voluntarily come together to make regular, small savings contributions into a common fund. They then use this fund to lend to each other for various needs, setting their own terms, interest rates, and repayment schedules.
- **Peer pressure as collateral:** Instead of requiring traditional collateral, SHGs use peer pressure and group monitoring to ensure high loan repayment rates. This mutual responsibility serves as "social collateral".
- **Empowerment:** Beyond financial services, SHGs act as a platform for social empowerment, collective bargaining, and addressing broader community issues like health, education, and gender inequality.
- **SHG-Bank Linkage Programme:** In India, this model connects SHGs to formal financial institutions. Once an SHG has demonstrated financial discipline with its own funds, it can receive loans from commercial or rural banks, significantly increasing its access to capital.

Models of microfinance

Various microfinance models have evolved to serve different target populations and achieve specific objectives.

1. Grameen model:

- **Origin:** Founded by Nobel laureate Muhammad Yunus and pioneered by the Grameen Bank in Bangladesh.
- **Structure:** The bank directly lends to small groups of borrowers, often women. Loans are disbursed in stages, with eligibility for subsequent loans dependent on the group's collective repayment performance.
- **Repayment:** This model relies on peer pressure within the group to ensure disciplined repayment, replacing traditional collateral.

2. Individual lending model:

- **Structure:** Microloans are provided directly to individual borrowers rather than to a group. This is often part of a broader "credit plus" program that includes training and other services.
- **Target audience:** Better suited for more established micro-entrepreneurs who can manage finances individually and who may have outgrown the group-lending model.

3. Rural Banking/Intermediary model:

- **Structure:** This model uses an intermediary organization, such as an NGO or a microfinance institution (MFI), to connect lenders (like commercial banks or donors) with borrowers.
- **Intermediary role:** The intermediary is responsible for raising credit awareness, training borrowers, and managing the loan disbursement and repayment process, thereby de-risking the lending for the larger financial institution.

4. Cooperative model:

- **Structure:** A cooperative is a member-owned and democratically controlled financial institution. Members pool their resources to provide savings and loan services to other members at reasonable rates.

- **Governance:** The members have a say in the governance, electing directors and committees. Examples include credit unions and specific cooperatives that include member-financing.

5. Village Banking model:

- **Structure:** Similar to the SHG model, village banks are community-based credit and savings associations, often consisting of 25–50 individuals.
- **Management:** While initial funding may come from an external source, the village bank is self-managed by the members, who distribute loans and collect payments.
- **Moral collateral:** Loans are backed by "moral collateral"—the group's collective promise to stand behind each individual loan.

6. NGO model:

- **Structure:** Non-governmental organizations (NGOs) often act as the primary microfinance provider, delivering financial services and complementary support such as education and health services.
- **Motivation:** NGOs are driven by a social mission to alleviate poverty and empower the poor, though financial sustainability is also a goal.

MODULE-2

Money Market

A money market is a financial marketplace for short-term lending and borrowing of funds through highly liquid instruments with maturities of one year or less.

Features

- **High Liquidity:** Instruments can be quickly converted to cash with minimal loss of value.
- **Low Risk:** Investments are typically considered safe due to the short maturity period and the creditworthiness of the issuers (e.g., governments and large corporations).
- **Short-Term Focus:** Deals exclusively with instruments that have maturities of less than one year.
- **Need-Based:** Transactions are driven by the short-term cash flow needs of participants.

Composition

- A collection of different sub-markets for various instruments.
- Includes both organized (e.g., regulated by the RBI) and unorganized sectors.

Players

- The Reserve Bank of India (RBI)
- Commercial banks
- Non-Banking Financial Companies (NBFCs)
- Government
- Co-operative banks
- Financial institutions like LIC, GIC, and UTI
- Corporate bodies
- Money market mutual funds

Instruments

- **Treasury Bills**: Short-term debt issued by the government to meet its short-term needs.
- **Commercial Paper**: Short-term, unsecured promissory notes issued by corporations.
- **Certificates of Deposit (CDs)**: Time deposits offered by banks with a fixed interest rate.
- **Repurchase Agreements (Repos)**: Short-term borrowing for dealers in government securities.
- **Call Money**: Overnight or short-term loans between banks.
- **Banker's Acceptance**: A time draft with a bank's guarantee of payment.

Primary market definition

- **New issue market**: The primary market is where securities like stocks and bonds are created and sold to investors for the first time.
- **Capital raising**: It serves as a crucial platform for companies and governments to raise funds directly from investors to finance activities such as expansion, research and development, or debt repayment.
- **Transfer of funds**: The fundamental function is the transfer of funds from investors to the issuing entity, creating a direct link between capital and the company.

Primary market functions

- **Capital formation**: It enables companies to raise capital by issuing new shares or bonds, which is essential for growth, new projects, and operational needs.
- **Price discovery**: The initial sale of securities in the primary market helps determine their fair value based on investor demand and company fundamentals.

- **Economic growth**: By mobilizing savings and channelling them into new ventures, it stimulates economic activity, fosters entrepreneurship, and creates jobs.
- **Facilitating investment**: It allows investors, both individual and institutional, to participate in the ownership or debt of companies by purchasing newly issued securities.
- **Origination, underwriting, and distribution**: The market involves the origination and processing of new securities, the underwriting of the issues by financial institutions to guarantee the sale, and the distribution of securities to investors.

Examples of primary market transactions

- **Initial Public Offering (IPO)**: When a company sells shares to the public for the first time.
- **Follow-on Public Offering (FPO)**: When a company issues additional shares after its IPO.
- **Rights Issue**: When a company offers new shares to its existing shareholders at a discounted price.
- **Private Placement**: When securities are sold directly to a select group of investors.

IPO

An **IPO** (Initial Public Offering) is when a private company first sells its shares to the public. The process is governed by **SEBI (Securities and Exchange Board of India)** guidelines, which mandate requirements like minimum net worth, promoter contribution, and disclosures. The two main **methods of issuing shares in an IPO** are the **Fixed Price Method**, where shares are offered at a set price, and the **Book Building Method**, where the price is determined by investor bids within a price band.

SEBI guidelines for IPOs

- **Eligibility and entry norms**: Companies must meet certain financial criteria to go public, such as having a minimum net tangible asset value or average pre-tax profits over a specified period.

- **Issue size:** The issue size is limited, typically to not more than five times the company's net worth.
- **Promoter contribution:** Promoters must contribute a minimum of 20% of the post-issue capital and are subject to a lock-in period.
- **Lock-in period:** Specific lock-in periods apply to promoter holdings and other pre-issue shares to ensure stability and prevent immediate sell-offs.
- **Prospectus:** Companies must file a Draft Red Herring Prospectus (DRHP) with SEBI for review, which contains detailed information about the company and the issue.
- **Investor allocation:** Regulations specify minimum allocations for different investor categories, such as Qualified Institutional Buyers (QIBs).
- **Anchor investor lock-in:** Recent guidelines have revised the lock-in period for anchor investors to 30 days for 50% of their shares and 90 days for the remaining 50% to protect new investors.
- **Fund utilization:** SEBI tracks and monitors the use of IPO funds to ensure they are used for the purpose for which they were raised.
- **Corporate governance:** Post-listing, companies must comply with SEBI's corporate governance norms, such as the Listing Obligations and Disclosure Requirements Regulations.

Methods of issuing IPOs

- **Book Building Method:**
 - **How it works:** The company offers shares within a price band and collects bids from investors at various price levels. The final price is then discovered based on the demand generated through the bidding process.
 - **Best for:** This method is suitable for large issues and is often used by larger companies.
- **Fixed Price Method:**
 - **How it works:** The company sets a fixed price for the shares beforehand and offers them at that price to all investors.

- **Best for:** This method is simpler and is often used by smaller companies.

IPO process

- **Intermediaries:** An IPO involves a team of intermediaries, including a merchant banker (investment bank), a registrar, and a custodian, who guide the company through the entire process.
- **Due diligence:** A key responsibility is to ensure all company-related information, including financial statements, legal compliance, and business model, is transparent and accurate before marketing the issue.
- **Valuation and pricing:** Understanding different valuation methods, such as discounted cash flow (DCF) and comparable company analysis, is crucial for determining the appropriate IPO price or price band.
- **Risk assessment:** MBA students should be able to identify, assess, and communicate the risks associated with the company and the IPO in the prospectus to potential investors.

Secondary Market

- A secondary market is a financial marketplace where investors buy and sell securities from other investors, not directly from the issuing company.
- It is also known as the "aftermarket" because it is the second stage where securities are traded after their initial sale in the primary market.

Functions

- **Liquidity:** Provides investors with the ability to buy or sell securities easily, converting them into cash without significant loss of value.
- **Price Discovery:** Helps determine the price of a security based on the continuous interaction of buyers and sellers, reflecting current market supply and demand.
- **Exit Strategy:** Gives investors a way to sell their holdings to realize profits or exit a position.
- **Portfolio Adjustment:** Allows investors to adjust their holdings based on their needs, risk assessment, and liquidity requirements.

Instruments traded

- **Equity Securities:** Shares of publicly traded companies.
- **Debt Securities:** Bonds, debentures, and treasury bills that offer fixed interest payments.
- **Derivatives:** Financial contracts like options and futures whose value is derived from an underlying asset.
- **Mutual Funds:** Units of mutual funds are also bought and sold in the secondary market, notes Kuvera, though this is often for existing funds, while new fund offers are part of the primary market.

Trading mechanism in Secondary Market

- **Order Placement:** Investors place orders to buy or sell through brokers or trading platforms.
- **Exchange-Traded Market:** In this type, securities are traded through a centralized exchange (like the NYSE) with standardized procedures. The exchange acts as a guarantor to all trades, reducing counterparty risk.
- **Over-the-Counter (OTC) Market:** Trades are negotiated directly between two parties (e.g., a buyer and seller) without a central exchange.
- **Clearing and Settlement:** After a trade, clearinghouses (or clearing corporations) ensure that both parties fulfil their obligations by delivering securities and funds.
- **Regulatory Oversight:** Trading is supervised by regulatory bodies like the Securities and Exchange Board of India (SEBI) to ensure fair and orderly markets.

Online trading

Online trading is the buying and selling of financial instruments—such as stocks, bonds, mutual funds, commodities, and derivatives—over the internet through a brokerage firm's platform. It provides investors with real-time market data and analytical tools to execute trades and manage their portfolios.

Key features

- **Convenience and accessibility:** Investors can access and manage their portfolios anytime, anywhere, using a computer or mobile device.
- **Real-time data:** Platforms offer live market updates, stock quotes, and trade information, allowing for timely decision-making.
- **Lower costs:** Online brokerages often have lower transaction fees and brokerage charges compared to traditional brokers.
- **Market knowledge:** Trading platforms provide access to a wealth of charts, research reports, and analytical tools.
- **Flexibility:** The system offers flexibility in executing different types of orders, such as limit orders and stop-loss orders.

Advantages

- **Increased control:** Investors can execute trades directly and immediately, giving them more control over their investments.
- **Transparency:** All trading activities are monitored and displayed by regulatory bodies, ensuring fairness and transparency.
- **Diversification:** The ability to trade a wide range of financial instruments helps in diversifying portfolios.
- **Faster execution:** The speed of online trading platforms allows investors to capitalize on market opportunities more effectively.

Disadvantages

- **Internet dependency:** The system is dependent on a stable internet connection. A slow or interrupted connection can lead to missed trades or losses.
- **Risk of over-trading:** The ease and speed of transactions can lead to excessive trading, particularly for impulsive investors.
- **Technical issues:** System outages or technical glitches on the trading platform can disrupt trading activities.
- **No personal relationships:** It removes the personal relationship and guidance that a traditional, full-service broker provides.

Dematerialization (Demat) accounts

Dematerialization is the process of converting physical securities, like share certificates, into an electronic format. A Demat account holds these shares and other financial instruments in an electronic form.

Key features

- **Electronic storage:** Eliminates the risk of damage, loss, or theft associated with physical certificates.
- **Seamless integration:** It is linked with a trading account and a bank account to enable seamless buying and selling.
- **Unified portfolio:** Investors can hold various financial instruments—including equities, bonds, and mutual fund units—in a single account.
- **Nomination facility:** Provides the option to appoint a nominee, ensuring a smooth transfer of assets to beneficiaries.
- **Automatic updates:** Corporate actions such as bonus shares, dividends, and stock splits are automatically updated in the account.

Brokers

Brokers act as intermediaries between investors and markets, executing trades and providing services like advisory and portfolio management.

Major types of brokers

1) Full-service brokers

- **What they are:** Brokers that provide a wide range of professional services beyond just trade execution.
- **Services offered:** Investment advice, market analysis, research reports, portfolio management, and financial planning.
- **Best for:** Investors who want comprehensive guidance, personalized support, and are willing to pay higher fees for these services.

2)Discount brokers

- **What they are:** Brokers that focus on executing trades at lower commission rates.
- **Services offered:** Primarily basic trading services, often through online platforms, with minimal to no investment advice or research.
- **Best for:** Self-directed investors who are comfortable making their own investment decisions and want to minimize costs.

3)Robo-advisors

- **What they are:** Automated investment platforms that use algorithms to build and manage a portfolio.
- **Services offered:** Investment advice and portfolio management based on an investor's goals and risk tolerance.
- **Best for:** Individuals seeking low-cost, hands-off investment management.

4)Specialized brokers

- **Real Estate Brokers:** Assist in buying and selling properties.
- **Commodity Brokers:** Specialize in trading commodity futures and options (e.g., oil, gold, agricultural products).
- **Forex Brokers:** Provide access to the foreign exchange currency market.
- **Business Brokers:** Help in the buying and selling of existing businesses.
- **Credit Brokers:** Connect clients with lenders for credit.
- **Insurance Brokers:** Arrange insurance policies for clients.
- **Institutional Brokers:** Cater to large institutional clients like pension funds and mutual funds.

MODULE-3

Mutual Fund

A mutual fund is an investment vehicle that pools money from many investors and invests it in a diversified portfolio of securities like stocks, bonds, and other money market instruments.

Classification of mutual funds

Mutual funds are classified based on several criteria, including their structure, the asset class they invest in, and their investment objective.

1)By structure

- **Open-ended funds:** Offer ongoing subscription and redemption at the current Net Asset Value (NAV), providing high liquidity.
- **Closed-ended funds:** Have a fixed maturity and limited subscription during their initial offer. They are often listed on exchanges for liquidity.
- **Interval funds:** Combine features of both, allowing transactions only during specific intervals at NAV-related prices.

2)By asset class

- **Equity funds:** Invest in stocks for capital appreciation.
- **Debt funds:** Invest in fixed-income securities for regular income.
- **Hybrid funds:** Invest in a mix of equity and debt to balance risk and return.
- **Money market funds:** Invest in short-term debt for capital preservation and liquidity.
- **Gold funds:** Offer exposure to gold and related instruments.

3)By investment objective

- **Growth funds:** Aim for capital appreciation through investments in rapidly growing companies.
- **Income funds:** Seek to provide a steady income stream via fixed-income securities.
- **Index funds:** Passively track a specific market index, often with lower costs.

- **Tax-saving funds (ELSS):** Provide tax benefits but have a mandatory lock-in period.
- **Sector funds:** Focus on a specific industry, carrying higher risk due to less diversification.

Organization structure of a mutual fund

A mutual fund operates as a trust with several entities ensuring oversight and accountability to investors, particularly within the structure outlined in India. Key components include:

1. **Sponsor:** The fund's founder, who must meet regulatory criteria.
2. **Board of Trustees:** Hold the fund's assets in trust for investors and ensure compliance.
3. **Asset Management Company (AMC):** Manages the fund's assets, making investment decisions and handling operations.
4. **Custodian:** Safeguards the fund's securities and assets.
5. **Registrar and Transfer Agent (RTA):** Processes investor transactions and maintains records.
6. **Auditors:** Independently audit the fund's financial statements.
7. **Investors (Unit holders):** The individuals or institutions who are the fund's ultimate owners.

Venture capital

Venture capital is a form of risk capital that funds innovative, high-potential new businesses that are often too risky for traditional bank loans.

Types of venture capital

Venture capital can be categorized in several ways, including by the investors' characteristics or their investment stage.

1)By investor

- **Angel investors:** High-net-worth individuals who invest their own money, often at the earliest stage. They are typically less formal than VC firms and sometimes provide mentorship as a hobby.

- **Venture capital firms:** Professional firms that manage pooled funds from institutional investors and high-net-worth individuals. They are formally structured, have a defined investment process, and seek significant returns.
- **Corporate venture capital (CVC):** Investment arms of large corporations that invest in startups for strategic reasons, such as gaining access to new technology or talent. Financial returns are a secondary objective.
- **Government VC:** Funds backed by government entities to stimulate economic growth in specific regions or industries.

2) By financing format

- **Equity financing:** VCs receive ownership shares (equity) in the company in exchange for their capital. This is the most common form.
- **Debt instruments:** Some VC funding is structured as a loan with specific repayment terms.
 - **Convertible loans:** Can be converted into equity at a later stage under pre-agreed conditions.
 - **Conditional loans:** The investor is paid a royalty on the company's sales for a specified period instead of interest. The loan may be waived if the venture fails.
- **Hybrid instruments:** A combination of debt and equity, such as convertible preferred stock or debt with attached warrants.

Stages of venture capital funding

The funding process follows a company's growth, with each round injecting capital to help the business reach its next milestone.

1. **Pre-Seed stage:** Very early funding for validating an idea, creating a business plan, and building an initial team. Funding often comes from the founders themselves, friends, or family.
2. **Seed stage:** The first official equity funding round. Capital is used for initial market research, prototype development, and setting up initial operations. Investors receive equity in return.

3. **Early stage (Series A, B):** Funds are provided to companies with a developed product and early market traction.

Series A: The first major round of institutional VC funding, typically used to build out the product, marketing, and sales teams.

Series B: Follow-on funding to expand market reach, optimize operations, and scale the business.

4. **Growth/Late stage (Series C and beyond):** Later rounds of funding for established, rapidly growing companies. Capital is used for major expansion, new markets, acquisitions, or as a final step before an initial public offering (IPO).
5. **Bridge financing (Mezzanine):** Short-term financing used to "bridge" a company until its next major funding event, such as an IPO or acquisition.

Concepts of leasing

- **Separation of ownership and use:** In a lease, the lessor retains legal ownership of the asset, while the lessee enjoys the right to use it for the lease term. At the end of the term, the asset typically reverts to the lessor.
- **Parties involved:**
 - **Lessor:** The owner of the asset who leases it to another party.
 - **Lessee:** The user of the asset who pays rent to the lessor.
- **Lease payments (Rentals):** The periodic payments made by the lessee to the lessor for the use of the asset.
- **Residual value:** The estimated market value of the leased asset at the end of the lease term. This is a critical factor, particularly in finance leases.
- **Obsolescence risk:** The risk that an asset will become outdated or less efficient due to technological advancements. In different lease types, this risk is allocated between the lessor and lessee.

Classification of leases

Leases can be classified in several ways, with the most important distinction being between financial leases and operating leases.

1. Based on the degree of risk and reward transfer

This is the primary classification used for accounting and financial analysis.

A. Finance lease (or Capital lease)

- **Concept:** This is a long-term, non-cancellable lease where the lessee assumes substantially all the risks and rewards of ownership. From an economic perspective, it is a form of financing, similar to a loan.
- **Key features:**
 - The lease term covers most of the asset's economic life.
 - The lessor recovers their full investment in the asset plus a profit through the lease rentals.
 - Maintenance, insurance, and other operating expenses are typically borne by the lessee.
 - The lessee often has the option to purchase the asset at a nominal price at the end of the lease period.
- **Accounting treatment (based on IFRS 16):** Under modern accounting standards (IFRS 16), most leases are treated as finance leases, requiring the lessee to recognize a "right-of-use" asset and a corresponding lease liability on their balance sheet.

B. Operating lease

- **Concept:** This is a short-term, cancellable lease where the lessor retains the risks and rewards of ownership. It is treated like a true rental agreement.
- **Key features:**
 - The lease term is significantly shorter than the asset's economic life.
 - The lessor is responsible for maintenance, insurance, and other services.
 - The lessor does not recover their full investment in the initial lease term; they depend on leasing the asset to multiple lessees over its lifetime.

- The lessee has no right to purchase the asset at the end of the lease.

2. Based on the source of asset

A. Direct lease

- **Concept:** A simple leasing arrangement where a lessor buys an asset directly from a manufacturer or vendor and leases it to the lessee.
- **Types:**
 - **Bipartite lease:** A two-party arrangement where the lessor purchases and leases the asset.
 - **Tripartite lease:** A three-party arrangement involving the vendor, lessor, and lessee.

B. Sale and leaseback

- **Concept:** An arrangement where a firm sells an asset it owns to a leasing company and immediately leases it back.
- **Purpose:** This is a financing strategy to unlock cash tied up in a fixed asset while still retaining its use.

3. Based on the number of parties

A. Single investor lease

- **Concept:** A straightforward transaction involving only a lessor and a lessee, where the lessor provides all the financing required to acquire the asset.

B. Leveraged lease

- **Concept:** A three-party arrangement for very expensive assets (like aircraft or ships).
- **Parties:** It involves the lessee, a lessor (who only provides a portion of the financing—the equity), and a lender (who provides the majority of the financing). The lender receives a mortgage on the asset and an assignment of the lease payments.

4. Based on geographical location

A. Domestic lease

- **Concept:** All parties to the lease—the lessor, lessee, and equipment supplier—are in the same country.

B. International lease

- **Concept:** Parties involved in the lease are domiciled in different countries. This introduces additional risks like currency fluctuation and country risk.
- **Types:**
 - **Import lease:** The lessor and lessee are in the same country, but the equipment is imported from a different country.
 - **Cross-border lease:** The lessor and lessee are in different countries.

Define hire purchase

Hire purchase (HP) is a financing method where a buyer (the hirer) acquires an asset by paying in installments over a specified period. The buyer receives possession and can use the asset immediately, but the ownership remains with the seller (the hire vendor) until the final installment is paid.

Key features:

- **Parties involved:** A hire purchase agreement involves a hire vendor (the seller) and a hire purchaser (the buyer). A third-party financier may also be involved, buying the goods from the dealer and hiring them to the customer.
- **Down payment:** The purchaser typically pays an initial, non-refundable deposit at the start of the agreement.
- **Installment payments:** The remaining balance, including interest, is paid in regular, fixed installments over the agreed-upon period.
- **Ownership transfer:** The ownership of the asset is transferred to the hirer only after the last installment is paid.

Leasing v/s Hire Purchase

Feature	Hire Purchase	Leasing
Ownership	Transferred to the hirer at the end of the payment period.	Remains with the lessor throughout the lease term.
End of Term	The hirer becomes the owner of the asset.	The lessee typically returns the asset, though some agreements may offer an option to buy.
Maintenance	The hirer is responsible for all maintenance costs.	Responsibility varies; the lessor may cover maintenance in an operating lease, while the lessee covers it in a finance lease.
Tax Benefits	The hirer can claim depreciation and tax deductions on the interest paid.	The lessee can typically deduct lease payments as an operating expense.
Payment Structure	Installments include both the principal and interest on the asset.	Lease payments are for the use of the asset, not for ownership.
Asset Use	The hirer has the right to use the asset throughout the payment period.	The lessee has the right to use the asset for the duration of the lease agreement.
Risk	The risk of ownership (including depreciation) is assumed by the hirer.	The lessor retains the risk of ownership.