Chapter 13

Financial System

INTRODUCTION

Finance plays a key role in the part of economic and business activities of the country. Systematic and efficient flow of finance is needed to efficient and effective management of the business concern. Arrangement of finance to required business concern, should be properly maintained and channelised through regulated institutions and markets. In India, with the effect of the new economic policy, emerging needs of financial institution and markets should be looked after. Indian financial system has developed constantly and successfully to infuse the new blood to the economic development of the nation. Hence, the economic growth and development is purely based on the regulated and well established financial system of the country.

FINANCIAL SYSTEM IN INDIA

Financial system is the basic concept for the industrial development of the nation. Financial system provides adequate and smooth flow of finance to the needed parts. Indian financial system consists of the four important components such as:

- Financial Institutions
- Financial Markets
- Financial Instruments
- Financial Services.

Financial system implies a set of complex and closely connected or intermixed institutions, agent practices, markets, transactions, claims and liabilities in the economy.

The financial system is concerned about the money, loan and finance. These three parts are very closely interrelated with each other and depend on each parts.

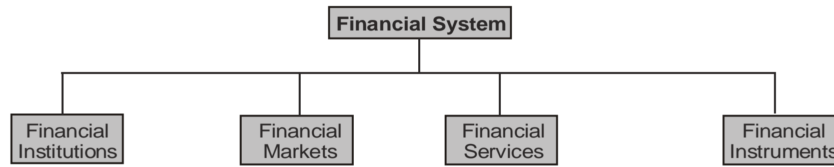

Fig. 13.1 *Financial System*

Financial Institutions

Financial institutions are the major part of the Indian financial system. Hence, it is more importance than other component of the 1FS because all the components of IFS are directly or indirectly related with the financial institutions. Financial institutions are providing various services to the economic development with the help of issuing of the financial instruments.

Financial institutions can be classified into banking and non-banking institutions. Now in India, all the financial institutions are systematically regulated and controlled by respective act.

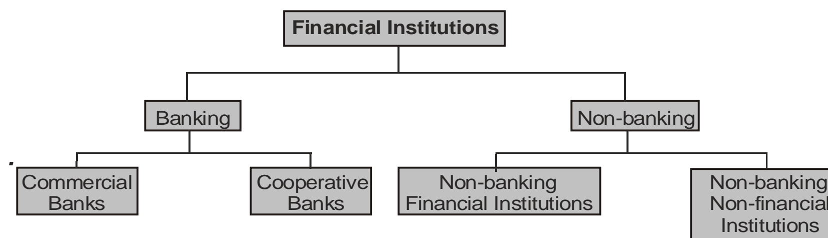

Fig. 13.2 *Financial Institutions*

Banking Institutions

Banking institutions are the key part of the economic development of the nation. Any country's financial transaction should be properly arranged from investors to the needed industrialist. Banking institutions play a major role in the field of savings and investments of money from public and lending loans to the business concern.

Indian Banking institutions may be classified into two board categories :

(1) Commercial Banks (2) Cooperative Banks

Commercial Banks

Commercial Banks are the most important deposits mobilisation and disbursers of finance. Indian commercial banks are the oldest, biggest and fastest growing financial institutions. The main function of the commercial banks are accepting deposits and rendering loans to the public. Indian commercial banks can be classified into the following categories:

Scheduled Commercial Banks

Scheduled banks are those which are included in the second scheduled of Banking Regulation

Act 1965 and others are non scheduled banks. To be included in the second scheduled of the Banking regulation act the bank full fill the following conditions:

- Must have paid up capital and reserves of not less than Rs. five lakh.
- It must also satisfy the RBI that its affairs are conducted in a manner.
- It is required to maintain a certain amount of reserves with the RBI.

Nationalised Banks

To use financial institutions as the instrument of promoting economic and social development in a more purposeful manner and to overcome the monopoly over financial resources, the government of India nationalised 20 commercial banks during the tenure of Prime Minister of Indira Gandhi.

On July 19, 1969, the first nationalisation of 14 banks took place with the following banks:

1. Bank of India
2. Union Bank of India
3. Bank of Baroda
4. Bank of Maharashtra
5. Punjab National Bank
6. Indian Bank
7. Indian Overseas Bank
8. Central Bank of India
9. Canara Bank
10. Syndicate Bank
11. United Commercial Bank
12. Allahabad Bank
13. United Bank of India
14. Dena Bank

On April 15, 1980 the second nationalisation took place with the following banks:

1. Andhra Bank
2. Corporation Bank
3. New Bank of India
4. Oriental Bank of Commerce
5. Punjab and Sind Bank
6. Vijaya Bank

In October 1993 the new bank of India was merged with Punjab National Bank, in March 2007, Bhart Overseas Bank merged with Indian Overseas Bank therefore, at present there are only 19 nationalised banks in the country besides the RBI.

State Bank of India (SBI)

The largest Public sector bank of India which was created after nationalisation of Imperial Bank of India in 1955. It is now the largest commercial banks in India and in terms of branch largest in the world.

As part from the main State Bank of India, there are seven subsidiaries:

1. State Bank of Bikaner and Jaipur
2. State Bank of Indore
3. State Bank of Patiala
4. State Bank of Travancore
5. State Bank of Hyderabad
6. State Bank of Mysore
7. State Bank of Saurashtra

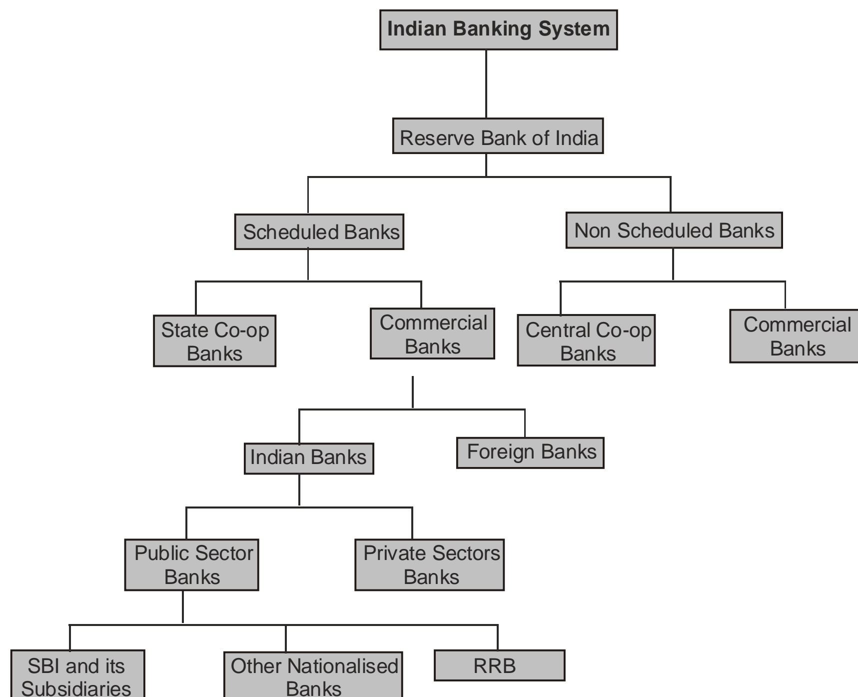

Fig. 13.3 *Indian Banking System*

Growth and Structure of Commercial Banks in India

S. No.	Particulars	1951	1986	1996	2002	2005
1.	Number of Sch. Banks	92	79	91	98	98
2.	Number of RRB	-	194	196	196	196
3.	Number of Non-Sch. Banks	474	3	3	4	4

Private Sectors Banks

These comprise of foreign and private domestic banks. The foreign banks have market share of 8.5% of total deposits into banking industry and the domestic private banks have a share of 5.8% of total deposits of the banking industry. Presently 31 private domestic banks and 33 foreign banks are functioning in India.

The following are the old generation private sector banks in India:

- Bharat Overseas Bank Ltd.
- City Union Bank Ltd.
- Development Credit Bank Ltd.
- Ing Vysya Bank Ltd.
- Karnataka Bank Ltd.
- Lord Krishna Bank Ltd.
- The Nainital Bank Ltd.
- SBI Coml. and Intl. Bank Ltd.
- Tamilnadu Mercantile Bank Ltd.
- The Bank of Rajasthan Ltd.
- The Catholic Syrian Bank Ltd.
- The Dhanalakshmi Bank Ltd.
- The Federal Bank Ltd.
- The Ganesh Bank of Kurndwad Ltd.
- The Jammu & Kashmir Bank Ltd.
- The Karur Vysys Bank Ltd.
- The Lakshmi Vilas Bank Ltd.
- The Ratnakar Bank Ltd.
- The Sangli Bank Ltd.
- The South Indian Bank Ltd.
- The United Wester Bank Ltd.

New Banks in Private Sectors

In the year 2000, the government of India related entry level for private sector by reducing the government holding in nationalised banks from 51% to 33%. The RBI in 2003 thereby issued directions for establishment of private banks in India. Some of the new banks in private sector as follows:

- UTI Bank Ltd.
- Indus Ind Bank Ltd.
- ICICI Bank Ltd.

- Global Trust Bank Ltd.
- HDFC Bank Ltd.
- Centurian Bank Ltd.
- Bank of Punjab Ltd.
- Times Bank Ltd.
- IDBI Bank Ltd.
- Development Credit Bank Ltd.
- Kotak Mahindra Bank Ltd.

Foreign Banks in India

RBI has been issuing licenses to various foreign banks to operate in India. 33 foreign and multinational banks are working in India today. The following are the major foreign banks play in Indian banking markets.

- ABN-Amro Bank N.V.
- Abu Dhabi Commercial Bank Ltd.
- American Express Bank Ltd.
- Antwerp Diamond Bank N.V.
- Arab Bangladesh Bank Ltd.
- Bank International Indonesia
- Bank of America NA
- Bank of Bahrain and Kuwait BSC
- Bank of Ceylon
- Barclays Bank PLC
- BNP Paribas
- Chinatrust Commercial Bank
- Chohund Bank
- Citibank N.A.
- Calyon Bank
- Credit Lyonnais
- Deutshe Bank AG
- Ing Bank N.V.
- JP Morgan Chase Bank
- Krung Thai Bank Public Company Ltd.
- Mashreq Bank psc
- MIZUHO Corporate Bank Ltd.

- Oman International Bank SAOG
- Societee Generale
- Sonali Bank
- Standard Chartered Bank
- State Bank of Mauritius Ltd.
- Sumitomo Mitsui Banking Corporation
- The Bank of Nova Soctia
- The Bank of Tokyo-Mitsubishi, Ltd.
- The Development Bank of Singapore Ltd.
- The Hong Kong and Shanghai Banking Corporation Ltd.
- UFJ Bank Ltd.

Non-banking Institutions

Apart from the banking institutions, Non-banking institutions are also performing their function to improve the Indian financial system. Non-banking Institutions can be classified into the following two major categories:

1. Non-banking Financial Institutions.
2. Non-banking Non-financial Institutions.

Non-banking Financial Institutions

Non-banking Financial Institutions are providing fund based services such as investment, insurance, mutual funds and lending institutions:

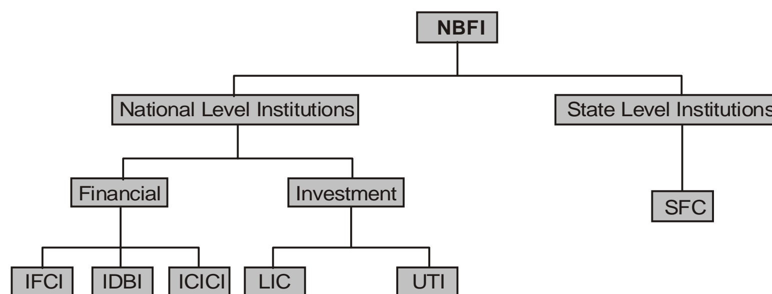

Fig. 13.4 *Non-banking Financial Institutions*

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

Origin

Industrial Finance Corporation of India, the first development bank in India was set up in July, 1, 1948 by passing a special Act as Industrial Finance Corporation of India Act 1948 in the parliament.

Capital

Industrial finance corporation of India was started with the paid up share capital of Rs. 10 crore. The share capital was contributed by Reserve Bank of India, scheduled banks. Insurance companies, investment trust and co-operative banks. Industrial finance corporation of India can raise further capital with the help of issue of bonds, debentures, accepts deposits from public and advance from RBI.

Objectives

The objective of Industrial finance corporation of India is to make medium and long-term credits more readily available to industrial concern in India particularly to the industries.

- Manufacturing, preservation or procession of goods
- The mining industry
- The shipping industries
- The hotel industries
- Generation or distribution of electricity or power

Functions

The following are the main functions of the Industrial finance corporation of India:

1. Granting loans and advances.
2. Subscribing to the shares and debentures floated by industrial concern.
3. Guaranteeing loan taken from capital market.
4. Guarantee deferred payment in respect of import of capital goods by approved concerns.
5. Involves merchant banking activities.
6. Special assistance to women, SSI and backward area.
7. Consultancy for technical, marketing and financial.

Management

Industrial finance corporation of India is managed by the board of directors which consist of 12 directors and one full time chairman. Some of the directors are nominated by IDBI, Central government, Scheduled Commercial Bank, Co-operative Banks and Insurance Companies.

Subsidies of Industrial Finance Corporation of India

Apart from the financial service to the industrial concern Industrial finance corporation of India promote some of the institutions:

- Tourism Finance Corporation of India Ltd.
- Management Development Institute.
- Risk Capital and Technology Finance Corporation Ltd.

- Technical consultancy organisation.
- Investment information and credit rating agency of India.

Working Result

In 1970–71 loan sanctioned was Rs. 32.2 crore, in 1998 it was reached to Rs. 8684 crore. The total sanctioned by Industrial finance corporation of India as at the end of March 1999 stood at Rs. 47245 crore. Now-a- days Industrial finance corporation of India providing all kind of financial assistance to medium and large scale industrial sector in India.

INDUSTRIAL CREDIT AND INVESTMENT CORPORATION OF INDIA(ICICI)

Origin

Industrial Credit and Investment Corporation of India was started in January, 5 1955 as a Public Ltd. Companies under the companies act. It is only development bank which has participation by foreign investors.

Capital

Paid up share Capital of Industrial Credit and Investment Corporation of India is Rs. 25 crore, which was contributed by commercial banks, insurance companies, foreign investors from UK, USA, Germany, France and Japan.

Objective

The following are the major objectives of Industrial Credit and Investment Corporation of India:

1. To provide following are the major objectives of Industrial Credit and Investment Corporation of India:
2. To develop underwriting facilities, to help private sector units.

Functions

The main functions of the Industrial Credit and Investment Corporation of India are as follows:

- Expansion of private sector industries.
- To give loans or guarantee of loans either in rupees or foreign currency.
- To underwrite shares and debentures and subscribes directory to share issued.
- To encourage and promote private capital.
- To promote private ownership of industrial investment alongwith the expansion of investment market.

Management

Industrial Credit and Investment Corporation of India is managed by the board of directors which full time chairman. The directors are nominated by Government, Reserve Bank of India Foreign shareholders and IDBI.

Subsidies of Industrial Credit and Investment Corporation of India

Industrial Credit and Investment Corporation of India is one of the leading and wide range of financial service providers in India. The following are the subsidies of the Industrial Credit and Investment Corporation of India.

- ICICI Banking Corporation Ltd.
- ICICI Securities and Finance Company Ltd.
- ICICI Assets Management Company Ltd.
- ICICI Trust Ltd.
- ICICI Brokerage Service Ltd.
- ICICI Credit Corporation Ltd.

Working Result

Industrial Credit and Investment Corporation of India provided financial assistance to industrial concerns has increased form 145.8 corer in 1961–62 to Rs. 34,220 crore in 1998–99 of the total loan sanctioned in 1998–99, 33% went to corporate finance, 29% to infrastructure, 19.5 each to oil gas and petrochemicals industries.

INDUSTRIAL DEVELOPMENT BANK OF INDIA (IDBI)

Origin

The Industrial Development Bank of India was set up as a wholly owned subsidiary of the RBI on July 1st 1964 under an act of parliament. In February 1976, it became an independent and autonomous bank.

Capital

Industrial Development Bank of India was started with initial paid up capital of Rs. 100 crores and now it can raise further capital with the help of issue of shares, debentures and accept deposits from public.

Objectives

The main objectives of the Industrial Development Bank of India are as follows:

- To provide credit, team finance, and financial services for the establishment of new projects.
- To expansion, diversification modernization and technology upgradation of existing Industrial concern.
- To provide several diversified financial products.
- To undertake merchant banking activities.

Functions

The functions of Industrial Development Bank of India are as follows:

1. Direct finance—Project loan, soft loan, technical development loan, equipment finance etc.
2. Indirect finance—Refinancing, rediscounting of bills, seed capital to new entrepreneurs.
3. Special assistance—Promotion of development assistance funds.
4. General assistance—Non-financial promotional activities like marketing, research, consultancy etc.

Management

Industrial Development Bank of India managed by board of directors which consist of 14 directors and one full time chairman. The directors are nominated by the government, Reserve Bank of India, company law board, insurance companies and various industries.

Subsidies of Industrial Development Bank of India are as follows:

- IDBI Bank Ltd.
- IDBI Capital Market Service Ltd.
- IDBI Mutual Funds.
- SIDBI
- IDBI Intech Ltd.

Industrial Development Bank of India has helped to set up the following institutions:

- Technical Consultancy Organization.
- EXIM Bank.
- Entrepreneurship Development Institute.
- Credit Rating and information service India Ltd.

Working Result

Total assistance sanctioned by Industrial Development Bank of India in 1998–99 was Rs. 25,555 crores, of this 96.7% goes to direct assistance, 0.4% belongs to refinance. The total amount of assistance sanctioned by the Industrial Development Bank of India till the end of March 1999 from the date of its incorporation has been Rs. 1,07,264 crores.

INDUSTRIAL RECONSTRUCTION BANK OF INDIA (IRBI)

Origin

In April 1971, Industrial Reconstruction Corporation of India (IRCI) was set up by IDBI and other development and public sector banks. IRCI was reconstituted and renamed as Industrial Reconstruction Bank of India in 1985 with a special Act in the parliament.

Capital

Industrial Reconstruction Bank of India was started with initial paid up capital of Rs. 50 crore which is contributed by central government, Reserve Bank of India, SCB and various

financial institutions. Further capital can be raised with the help of issue of shares, debentures and accept deposits from public.

Objectives

Industrial Reconstruction Bank of India was established mainly for rehabilitating sick industrial units in India.

- To identify and remedial measures to sick industries.
- To provides financial assistance to reconstruction of sick industrial units.
- To promote the sick units into profitable units.

Functions

The following are the major functions of the Industrial Reconstruction Bank of India Credit and reconstruction agency for industrial revival modernization, rehabilitation, expansion, reorganization, diversification and rationalization. Empowered to grant loans and advances:

- Underwrite stocks, share and bonds.
- Guarantee loans and advances, performances and deferred payments.
- Gives assistance for capital expenditure, addition of balancing equipment etc.

Management

Industrial Reconstruction Bank of India is managed by the Board of directors with a full time chairman. Directors are nominated by central government, Reserve Bank of India, Schedule commercial Bank and financial institutions.

Subsidies of Industrial Reconstruction Bank of India

On March 27 1997, Industrial Reconstruction Bank of India was transformed into Industrial Investment Bank of India Ltd (IIBI) under the Companies Act. IIBI acts as a coordinating agency in the field of reconstruction.

Working Result

Industrial Reconstruction Bank of India sanctioned financial assistance to various sick industrial units. Industrial Reconstruction Bank of India sanctioned Rs. 92 crores in 1980–81 but it has increased to Rs. 4526 crore in 2002–03. It contributed 80% of the financial assistance at all over India.

STATE FINANCE CORPORATION (SFC)

Origin

Central government decided to promote the Small Scale Industries and Medium Scale Industries at the state level by establishment of State Finance Corporation under a special Act. It is called as State Finance Corporation Act 1951. According to this act, state government have been empowered to set up State Finance Corporation. At present these are 18 State Finance Corporation in India.

Capital

State Finance Corporations will have a paid up capital from Rs. 50 lakhs to Rs. 5 crore which will be contributed by the respective state government, Schedule Commercial Bank, Reserved Bank of India and various financial institutions.

Objectives

- To provides financial assistance to Small scale industries
- To promote tiny, village and cottage Industries
- To provides infrastructure facilities to SSI

Functions

- Long term loans to Small Scale Industries.
- Refinance from Reserve Bank of India and Industrial Development Bank of India
- Assistance from International Development Agency (IDA) and foreign currency hire of credit from the IDBI

Management

State Finance Corporation are managed by Board of directors constituted by the respective State Government, Central Government, Reserve Bank of India, Schedule Commercial Bank and Financial Institutions as nominated directors to the State Finance Corporation.

STATE FINANCE CORPORATION IN TAMIL NADU

The Madras Industrial Investment Corporation (MIIC) was started as early as 1949, under the companies act and it was renamed as Tamil Nadu Industrial Investment Corporation (TIIC). It was the first State Finance Corporation in India, after the establishment of the State Finance Corporation Act, 1951, the first State Finance Corporation was in Punjab in 1953.

EXPORT IMPORT BANK (EXIM BANK)

Origin

EXIM bank was set up in January 1982 as a wholly owned by the central government.

Capital

EXIM bank was established with the paid up capital of Rs. 50 crores. It is empowered from RBI and also from central government to further capital raise by issue of bonds and grants from government.

Objectives

EXIM bank was established mainly for the purpose of promoting export and trading in India. The objectives are as follows:

- To promote the export and import activities
- To meet the financial requirements of the exporters
- To provides guarantee and make foreign exchange facilities to exporters.

Functions

EXIM banks performs the following important functions:

1. Grants direct loans in India and outside for import and export.
2. Refinances loans and suppliers of credit.
3. Rediscounts usance export bills export bills for banks.
4. Provides overseas investment finance.
5. Bulk import finance.
6. Foreign currency preshipment credit.
7. Product equipment finance programme.
8. Business advisory and technical assistance (BATA).

Management

EXIM bank is one of the wholly owned by central government, hence, the entire management is controlled by the central government.

Working Result

EXIM banks business is exclusively devoted to India's export and import activities. The aggregate loans and outstanding reached Rs. 16.16 billion during the first decade of the its operation. During the year 1990–91, it was sanctioned Rs. 1984 crore and it has increased to Rs. 12011 crore in 2002–03. The share of EXIM bank in industrial finance is 2.11% in the year 2002–03.

NATIONAL BANK FOR AGRICULTURAL AND RURAL DEVELOPMENT

Origin

The National Bank for agricultural and rural development was set up on July 12, 1982, based on the Recommendation of the All India rural credit survey committee under an act of Parliament as a central or apex institution for financing agricultural and rural sectors. It has taken over the functions of Agricultural Refinance and Development Corporation (ARDC) and Agricultural credit department of Reserve Bank of India.

Capital

The National Bank for Agricultural and Rural Development Functioning with the paid up capital of Rs. 100 crore which is subscribed by Government and Reserve Bank of India in equal amount. Further capital can be raised from the special borrowings from the Central Government.

Objectives

The main objectives of National Bank for Agricultural and Rural Development are as follows:

- To provides refinance assistance for agriculture, Small Scale Industries and Village Industries.

- To undertakes promotional activities for integrated rural development
- To coordinates agricultural finance alongwith the state government
- To undertakes research and development in agriculture, rural industries

Functions

The National Bank for agricultural and rural development discharges are:

It provides all sorts of reference to Co-operatives, Commercial Banks, and Regional Rural Banks, in respect the above three agencies and advices the government thereon. It makes loans to state government to enable them to subscribe to the share capital of co-operative bank.

It helps in promoting research in agriculture and rural development. National bank for agricultural and rural development undertakes evaluation and monitoring projects financed by it. It is responsible for the development, operation and co-ordination relating to rural credit.

Management

National Bank for Agricultural and Rural Development is wholly owned by central government, hence it is managed by the central government constituted management board.

Working Result

National Bank for Agricultural and Rural Development operates through 28 regional offices, 336 district offices, one sub-office at Port blair and one special cell in Srinagar during the year 1986. National Bank for Agricultural and Rural Development sanctioned short-term credit to Small Scale Industries Rs. 400 crore and it has increased to Rs. 1200 crore in the year 1990-91. Nearly Rs. 400 crore have been provided as medium term loans to various activities, Rs. 200 crore have been sanctioned as long-term loans contributing to the share capital of co-operative institutions.

National Bank for Agricultural and Rural Development has refinanced banks for implementing the national programmes of mass assistance of small and marginal farmers. It also refinance development activities of the handloom sectors. It extends refinance to state co-operative banks, provide block capital to industrial Co-operative Societies and rural artisans against state government guarantee. Service area approach of commercial banks is supported by National bank for agricultural and rural development through various special assistance.

SPECIALIZED FINANCIAL INSTITUTIONS

The following are the specialized financial institutions established by government to provide financial and non–financial assistance to various industrial sectors in India.

- Shipping Credit and Investment Corporation of India (SCICI), 1986.
- Infrastructure Leasing and Financial Service Limited (IL and FS), 1988.
- Technology Development and Information Company of India Limited (TDICI), 1988.
- Risk Capital and Technology Finance Corporation Limited (RCTFC), 1988.

- Tourism Finance Corporation of India (TFCI), 1989.
- Small Industries Development Bank of India (SIDBI), 1989.
- Infrastructure Development Finance Company (IDFC), 1997.

INSURANCE SECTOR IN INDIA

Insurance is one of the fund based financial services which provides risk coverage facilities to the human beings. Realising the vast potential in Indian market, foreign insurance companies started entering into India and even banking organisations (SBI, ICICI, etc.) also showed much interest in insurance business, this is being attributed to global technology and conversions of services as a result of which Indian Insurance market registered highest growth in the Asian region even though Indian's share of global insurance premium is less 0.5% (1998) than that of US 24.2 percent and Japan 21 percent. The private players from India and abroad are well aware that only 25 percent of the insurable population have been covered by insurance by existing companies which includes that Indian insurance market has potential enough to exploit. In this process IRDA has so for granted registration for 12 private life insurance companies and 9 general insurance. If the existing public sector insurance companies are included, there are currently 14 insurance companies in the life side and 13 companies in general insurance business.

Insurance sectors in India has been classified into the following categories:

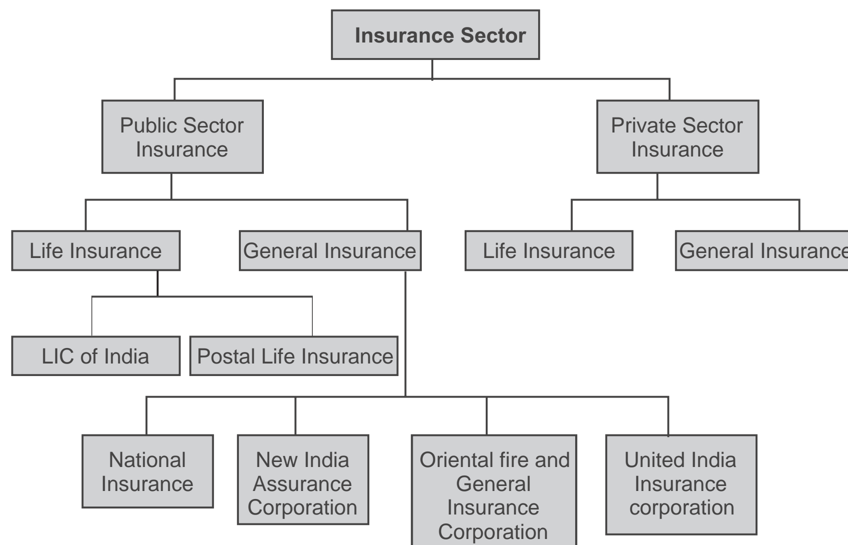

Fig. 13.5 Insurance Sector

Some of the Private Sector Life Insurance Corporation

- ICICI Prudential Life Insurance Corporation Limited.
- ING Vysya Life Insurance Corporation Limited.
- HDFC Standard Life Insurance Corporation Limited.
- Birla Sun Life Insurance Corporation Limited.
- SBI Life Insurance Corporation Limited.
- Om Kotak Life Insurance Corporation Limited.
- Met Life Insurance Corporation Limited.
- Allianz Bajaj Life Insurance Corporation Limited.
- Max New Yark Life Insurance Corporation Limited.
- Tata AIG Life Insurance Corporation Limited.
- AMP Sanmar Life Insurance Corporation Limited.

Some of the Private Sector General Insurance Corporation in India are as follows:

- CH NBH Assn General Insurance Corporation.
- ICICI Lombard General Insurance Corporation.
- Bajaj Allianz General Insurance Corporation.
- AIG General Insurance Corporation.
- IFFCO Tokio General Insurance Corporation.
- Royal Sundaram General Insurance Corporation.
- Reliance General Insurance Corporation.

LIFE INSURANCE CORPORATION OF INDIA

The Life Insurance Corporation of India (LIC) was set up in the year 1956 by nationalizing 245 insurance companies. The Primary objective of nationalization was to protect the interest of policy-holders against misuses and embezzlement of funds by private insurance companies. Secondly, the object of nationalization was to direct investment of funds in government securities, leaving a meager part for the private sector.

What marks and distinguishes the LIC from other long-term financial institutions is this that it discharges the two fold function of mobilization of long-term savings and their effective channelisation as well. The other agencies are suppliers of fund obtained from government and the Reserve Bank of India.

Role of LIC

The activities of the LIC can be broadly classified into two categories. First, it mobilizes long-term contractual savings. Its policy-holders view the LIC as a trustee of their funds, a source of emergency fund to guard against any financial misfortune and a way to accumulates funds by the time of retirement from work. As an agency it is designed to the inculcation of savings for the sake of rainy days.

During the last forty years of its operations, there has been concentration of colossal funds in hands of this monolithic state owned corporation.

The resources thus obtained by the LIC from policy-holders are invested in diverse ways for different purposes. Basically LIC is an investment institution. It is a big investor of funds in government marketable securities. Since April, 1975 the amended Section 27A of the Insurance Act, 1938 the LIC is required to invest to not less than 50% of its accruals of premium income in government marketable securities. Of this not less than 25% in central government securities. Besides it has to give loans to approved authorities like electricity boards or state government for socially oriented schemes like electricity, housing, water supply etc. These loans and investments should not exceed 87.5 percent of accretion to the controlled fund of the LIC.

The remaining 12.5 percent can be made to the private sector directly in the form of purchase of shares and debentures. Besides it grants loans to the private corporate sector and finances projects by subscribing shares and debentures of private industries. Its contribution to financing of industries in the private corporate sector is also indirect. The investment in the share capital and bonds of IFCI, SFCs, UTI and IDBI flow back to private sector in the form of direct loans. The LIC is also engaged in underwriting new issues.

The LIC plays an important role in the securities market in India. It purchases even when the market is dull (bearish) and prices are low in order to reap the benefit of future price appreciation. Nor does it usually sell shares from its stock when the market is spturn at higher prices.

Although Income Tax concessions provide incentive to higher income groups through LIC policies, the insuring public does not get the real value of its long-term savings because of chronic inflation. Barring risk coverage, the rate of return offered by LIC is much lower compared to other savings media. It is true LIC has grown at a fast speed yet it can grow at a faster rate if it can make the message of life insurance more attractive by its operational efficiency and innovative attitude.

GENERAL INSURANCE COMPANIES

The General Insurance Corporation of India(GIC) was formed as a government company in 1972 under the General Insurance Business (Nationalization) Act 1972. Before nationalization a few big companies and about 100 small companies were in this business.

All these units were merged together and reorganized into four subsidies of GIC. They are:

- National Insurance Company
- New India Assurance Company
- Oriental Fire and General Insurance Company
- United India Fire and General Insurance Company.

On January 1, 1973 of all the Indian insurance companies were transferred to the GIC. The feature of the GIC is this that it sell insurance service against some forms of risk like

loss of physical assets of various kinds from fire or accident and against personal sickness and accident. The insurer just purchases a service and not any financial asset. They draw vast resources in the other approved securities.

As a financial intermediary, the GIC invests funds in a prudent way looking after national priorities and meeting unforeseen claims under their policies. The GIC is required by law to hold central government securities to the tune of 25 percent of new accrual and at least 10% in other approved securities.

The companies can invest in the shares and debentures of the corporate sector. But shall not exceed 5% of the subscribed capital of a single company. It also participates in the underwriting of new issues and in granting term loans to industries.

UNIT TRUST OF INDIA

Origin

Unit trust was set up in 1964 by a special act passed in the parliament under the name of Unit Trust of India Act 1963, for the purpose to promote and regulate the mutual fund activities in India.

Capital

The initial capital of Unit Trust of India was Rs. 5 crores which was contributed by Reserve Bank of India, Life Insurance Corporation, State Bank of India, Schedule Commercial Banks and foreign banks. Unit Trust of India can raise further capital through issue of bonds, accepting deposits and borrowings from Reserve Bank of India and Life Insurance Corporation.

Objectives

Unit Trust of India functioning with the following major objectives:

- To promote the saving habits of small and medium investors.
- To provide stock exchange benefits to the small and medium investors.
- To reduce the risk of investors through diversified investment.
- To invest the funds on commercial purpose.

Functions

Unit Trust of India performs the following important functions:

- Mobilisation of funds through mutual funds.
- Grant term loans.
- Rediscount Bills.
- Undertake equipment leasing and hire purchasing.
- Housing and construction finance .
- Merchant banking services.
- Portfolio management services.

Management

Unit Trust of India is managed with an independent board of Trustees and a full time chairman, which is appointed by the government. The trustees are nominated by the Reserve Bank of India, Life Insurance Corporation, State Bank of India and other commercial banks.

Subsidiaries of Unit Trust of India

Unit Trust of India also established some of the associates and group of institutions apart from their regular services:

- UTI Securities Exchange Limited –1994
- UTI Bank Ltd.–1994
- UTI Investment Advisory Service Limited–1988
- UTI Investors Services Limited–1993
- UTI Institute of Capital Market–1989
- UTI contributed to the establishments of the following institutions or organisations:
- Credit Rating Information Service of India Limited (CRISIL)
- Investment Information and Credit Rating Agency of India Limited (ICRA)
- Credit Analysis and Research Limited (CARE)
- Discount Finance House of India (DFHI)
- Stock Holding Corporation of India Limited (SHCIL)
- Over the Counter Exchange of India Limited (OTCEI)

Schemes of Unit Trust of India

Unit Trust of India introduced various scheme in the different periods. The major Unit Trust of India schemes are under:

- Unit Scheme–64
- Monthly Income Scheme
- Children College and Career Fund Scheme
- Grihalakshmi Unit Plan
- UTI Bond Fund
- UTI Money Market Fund
- UTI Growth Sector Fund
- UTI Master Share.

Working Result of Unit Trust of India

Up to 1987 UTI enjoys the Monopoly power in the field of merchant banking activities. In terms of cumulative indicators it accounted for 34% of the total schemes, 83% of the resource mobilized, 82% the investment and 81% of the unit holding accounts at

4th end of 1995-96. The gross net resources mobilized by Unit Trust of India through open ended schemes were Rs 7092 crore and closed ended schemes were Rs 3.85 crore in the year 2002-03. The Growth performance of the Unit Trust of India has been explained in the below table.

Year	Sales	Repurchase	Investable	Repurchase as % of Sales
1964–65	19	0.4	25	2.06
1985–86	892	63	3218	7.06
1995–96	6373	7643	56620	119.92
2000–01	7910	10491	69346	132.63
2002–03	5767	11194	51990	194.10

Source: UTI reports

NON-BANKING NON-FINANCIAL INSTITUTIONS

Non-banking non–financial institutions are providing fee based services to the public, such as merchant banking, underwriting, counseling, etc. These institutions will not lending any financial assistance to public but they will provide financial services.

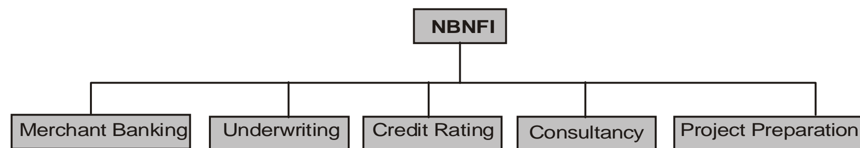

Fig. 13.6 *Non-banking Non-financial Institutions*

FINANCIAL MARKETS

Financial market deals in financial securities or instruments and financial services. It may be variously classified as primary and secondary, money markets and capital markets, organised and unorganised markets official and parallel markets, and foreign and domestic markets. Financial market provides money and capital supply to the industrial concern as well as promote the savings and investments habits of the public. In simple censes financial market is a market which deals with various financial instruments (share, debenture, bonds, treasury bills, commercial bills etc.) and financial services (merchant banking, underwriting etc).

Financial markets may be divided into two major classifications:

A. Capital market B. Money market

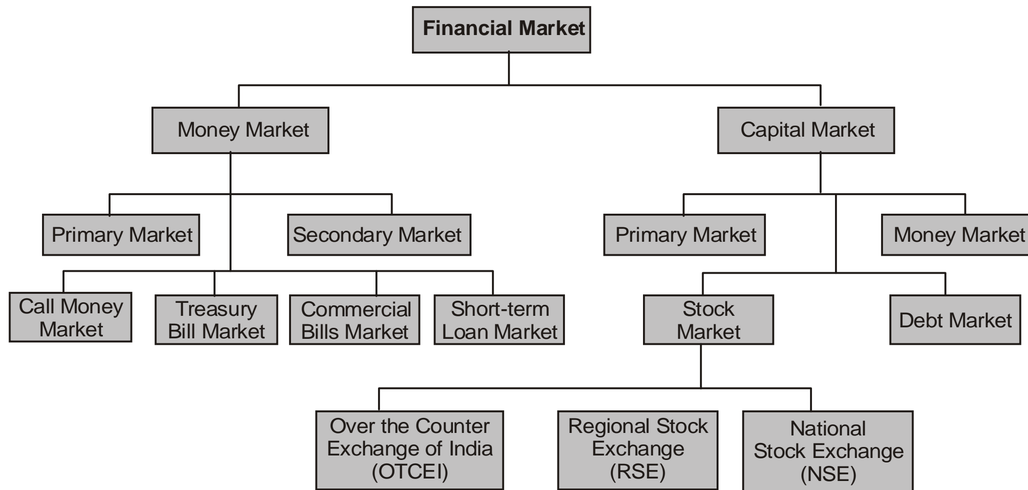

Fig. 13.7 *Financial Market*

Capital Market

Capital market may be defined as on organised mechanism for effective and efficient transfer of money-capital or financial recourses from the individuals or institutional savers to industrialist. The development of a effective capital market depends upon the availability of savings, well organised financial system and the entrepreneurship quantities of its people.

Capital market is a market for long-term funds, just as the money market is the market for short-term funds. It refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium-term and long-term funds). It does not deal in capital for purpose of investment.

The demand for long-term money capital comes predominantly from private sector manufacturing industries and agriculture and from the government largely for the purpose of economic development. As the central and state governments investment are not only on economic overheads as transport, irrigation and power development but also on basic industries and some times, even consumer goods industries, they require substantial sums from the capital market. The supply of funds for the capital market comes largely from individual savers, corporate savings, banks, insurance companies, specialized financing agencies and government.

Among institutions, we may refer to the following:

1. Commercial banks are important investors, but are largely interested in government securities and, to a small extent, debentures of companies.
2. LIC and GIC are growing importance in the Indian capital market, though their major interest is still in government securities.
3. Provident funds constitute a major medium of savings but their investments are mostly in government securities.

4. Special institutions set up since Independence, viz. the IFCI, ICICI, IDBI, UTI etc., all these aim at providing long-term capital to the private sector.

The capital market in India can be classified into

- Gilt-edged Market on Government and Semi-government Securities;
- Industrial Securities Market;
- Development Financial Institutions (DFI), and
- Non-banking Financial Companies (NBFC)

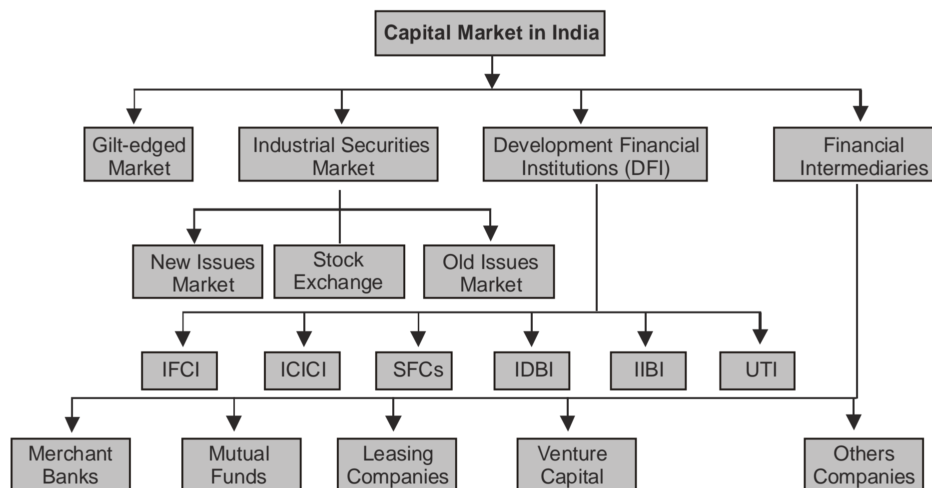

Fig. 13.8 *Capital Market in India*

The **Gilt-edged market** is the market for Government and semi-government securities, which carry fixed interest rates and backed by RBI . The securities traded in this market are stable in value and are much sought after by banks and other institutions.

The **industrial securities market** is the market for equities and debentures of companies of the corporate sector. This market further classified into (a) New Issues Markets; for raising fresh capital in the form of shares and debentures, and (b) Old Issues Market; for buying and selling shares and debentures of existing companies–this market is commonly known as the stock market or stock exchange.

Both markets are equally important, but often the new issues market will be facilitated only when there are abundant facilities for transfer of existing securities. The capital market is also classified into Primary Capital Market and Secondary Capital Market.

The **primary capital market** refers to the new issues market, which relates to the issue of shares, preference shares and debentures of non-government public limited companies, and also to the raising of fresh capital by Government companies, and also to the raising of fresh capital by Government companies and the issue of public sector bonds.

The **secondary capital market,** on the other hand, is the market for old or already issued securities. It is composed of Industry Security Market or the stock exchange in where industrial securities are bought and sold, and the Gilt-edged Market where the government and semi-government, securities are traded.

MIBOR and MIBID

On June 15, 1998 National Stock Exchange launched two new Reference Rates for the loans of Inter-Bank Call Money Market. These rates are Mumbai Inter-Bank Offer Rate (MIBOR) and Mumbai Inter-Bank Bid Rate (MIBID).

MIBOR will be the indicator of Landing Rate for loans which MIBID will be the landing rate of receipts.

Share Market

India has a well developed share market system, which is one of the best in the developing world. It has one of the oldest stock markets in Asia. The first stock exchange was established in 1875 in Bombay (Mumbai), when the stock brokers against at their plight following the severe depression in securities, decided to form an association to protect the character and interest of native share and stock brokers.

India has the second largest share holding population with around 1.5 crore shareholders; next only to the United States of America which has about 5 crore shareholders. India is significantly ahead of countries like Japan, United Kingdom and France in this regard, the Indian figure may look impressive, but it constitutes only 1.5 percent of the total population.

The country also has a large number of debenture holders, whose figure stands at around 50 lakhs (5 million). Here, it is important to note that most of the debenture holders are prospective shareholders as they are waiting for the conversion of their debentures into equity shares. The enhanced interest in capital market is a result of increasing industrialization, growing awareness among people and globalization of the capital market. Indian capital market can be divided into primary market (new issues market) and secondary market.

Primary Market

The primary market refers to the set up by which the industry raises funds by issuing different types of securities. These securities are issued directly to the investors, both individual and institutions. The primary market discharges the important function of transfer of savings, especially of the individual, Government and public sector undertakings.

In the primary market, the new issues of securities are presented in the form of Public issues, Right issues and Private Placements. Its efficient operation is made possible by the financial intermediaries and financial institutions, who arrange long-term financial transactions for the clients. Issues of the securities in the primary market may be made through (i) Prospectus, (ii) Offer for sale, and (iii) Private placement. The securities offered

to the public through prospectus are directly subscribed by the investor. The issuing companies widely publicise the offer through various media. The Securities Exchange Board of India (SEBI) has classified various issues in three groups *i.e.*, New issues, Right issues and Preferential issues.

The SEBI has issued various guidelines regarding proper disclosure for investor's protection. These guidelines are required to be duly observed by the companies making issue of capital. The guidelines issued by the SEBI broadly cover the requirements regarding issue of capital by the companies. The guidelines are applicable to all the companies after the repeal of Controller of Capital Issues (CCI) Act 1947.

The boom in the primary capital market, that started in the mid-eighties and accelerated thereafter, started slowing down by 1995. There are several reasons for this slowing down of resource mobilization in the primary market. In particular, the low return on new issues, some resulting in stock market fiasco, seems to have shattered the confidence of the investors.

Secondary Market

The secondary market refers to the network system for the subsequent sale and purchase of securities. An investor can apply and get allotted, a specified number of securities by the issuing company in the primary market. However, once allotted, the securities can thereafter be sold and purchased in the secondary market only.

A security emerges in the primary market, but its subsequent movement takes place in the secondary market. Secondary market is represented by stock exchanges in the capital market. Stock exchanges provide an organized market place for investors to trade in securities. A stock exchange permits the prices of the securities to be determined by the market forces. The bidding process flows from demand and supply, underlying each security. This means that the specific price of a security is determined, more or less, in the manner of an auction.

Stock exchange provides a market in which the members (share brokers) and investors participate to ensure liquidity to the latter. At present, there are 22 stock exchanges operating in India. Approved Stock Exchanges in India as follows:

1. Meerut Stock Exchange, Meerut (UP)
2. UP Stock Exchange, Kanpur (UP)
3. Mumbai Stock Exchange, Mumbai (Maharashtra)
4. Over the Counter Exchange of India, Mumbai (Maharashtra)
5. National Stock Exchange, Mumbai (Maharashtra)
6. Pune Stock Exchange, Pune (Maharashtra)
7. Ahmedabad Stock Exchange, Ahmedabad (Gujarat)
8. Sourashtra Stock Exchange, Rajkot (Gujarat)
9. Vadodara Stock Exchange, Vadodara (Gujarat)
10. Bangalore Stock Exchange, Bangalore(Karnataka)
11. Canara Stock Exchange, Mangalore (Karnataka)

12. Bhubaneshwar Stock Exchange, Bhubaneshwar (Orissa)
13. Calcutta Stock Exchange, Calcutta (West Bengal)
14. Delhi Stock Exchange, Delhi.
15. Guwahati Stock Exchange, Guwahati (Assam)
16. Hyderabad Stock Exchange, Hyderabad (Andhra Pradesh)
17. Jaipur Stock Exchange, Jaipur (Rajasthan)
18. Ludhiana Stock Exchange, Ludhiana (Punjab)
19. Chennai Stock Exchange, Chennai (Tamil Nadu)
20. Coimbatore Stock Exchange, Coimbatore (Tamil Nadu)
21. MP Stock Exchange, Indore (Madhya Pradesh)
22. Magadh Stock Exchange, Patna (Bihar)
23. Capital Stock Exchange, Kerala Ltd. Tiruvananthapuram (Kerala)
24. Cochin Stock Exchange, Cochin (Kerala)

Secondary market in India got a boost when Over The Counter Exchange of India (OTCEI) and National Stock Exchange (NSE) were established. It may be noted that NSE and OTCEI have been established by the all India Financial Institution, while other stock exchanges are in the form of associations.

Methods of Raising Capital

Shares**:** Otherwise known as 'ordinary shares' these are shares in the issued capital of company which are held on terms that make the holder a 'member' of the company, entitled to vote at annual meetings and elect directors, and to participate through dividends in the profits of the company. The holders of the ordinary shares carry the residual risk of the business: they rank after debenture holders and preference shareholders for the payment of dividends and they are liable for losses, although this liability is limited to the value of the share and to the limit of guarantee given by them.

Debentures**:** Fixed-interest securities issued by limited companies in return for long-term loans. The term is sometimes also used to refer to any title on a secured interest–bearing loan. Debentures are dated for redemption (*i.e.* repayment of their nominal value by the borrower to the holder), debentures are usually secured. Debenture interest must be paid whether the company makes a profit or not. In the event of non-payment debenture holders can force liquidation and rank ahead of all shareholders in their claims on the company's assets. The interest which debentures bear depends partly on long-term rates of interest prevailing at the time and partly on the type of debenture, but will in any case, because of the lower risk involved is less than borne by preference shares. Debenture shares are most appropriate for financing companies whose profits are stable and which have substantial fixed assets, such property companies.

***Convertible debentures*:** These carry an option at a fixed future date to convert the stock into ordinary shares at a fixed price. This option is compensated for by a lower rate of interest than an ordinary debenture, but convertible debentures are attractive since they offer the investor, without sacrificing his security, the prospect of purchasing equity shares cheaply in the future. For this reason, convertible debentures are issued at a time when it is difficult to raise capital either by equity or fixed interest securities. There are three ways in which a company may raise capital in the primary market.

PUBLIC ISSUE

By far the most important mode of issuing securities, a public issue involves sale of securities to the public at large. A company making a public issue informs the public about it through statutory announcements in the newspapers, makes application forms available through stock brokers and others and keeps the subscription open for a period of three to seven days. If the issue is over-subscribed, the pattern of allotment is decided in consultation with the stock exchange where the issue is proposed to be listed.

After the allotment pattern is finalized the company mails the allotment advice/letter alongwith refund order, if any. This is supposed to be done within 10 weeks of the closure of subscription. If the full amount is not asked for at the time of allotment, the balance is called in one or two calls later. The letter of allotment is exchangeable for share certificates (or debenture certificates, as the case may be), after it is duly stamped by the bank where the balance payment is made.

Of course, if the allottee wants he can sell the letter of allotment itself by transmitting it alongwith a transfer deed. If the allottee fails to pay to call money as and when called by the company, the shares are liable to be forfeited. In such a case, the allottee is not eligible for any refund of the amounts already paid. While a new company set up by promoters without a track record is required to issue its shares at par, other companies are allowed to make a public issue at a premium.

Right Issue

A right issue involves selling securities in the primary market by issuing rights to the existing shareholders. When a company issues additional equity capital, it has to be offered in the first instance to the existing shareholders on a pro rata (proportional) basis. This is required under Section 81 of the Companies Act 1956. The shareholders however, may by a special resolution forfeit this right, partially or fully, to enable a company to issue additional capital to the public.

Private Placement

In a private placement, funds are raised in the primary market by issuing securities privately to some investors without resorting to underwriting (insurance against risk by a guarantor). The investors in this case may by financial institutions, commercial banks, other companies, shareholders of promoting companies, and friends and associates of the promoters.

Group A and Group B Shares

The listed shares are divided into two categories: Group A shares (also referred to as cleared securities or specified shares) and Group B shares (also referred to as non-cleared securities or non-specified shares).

For Group A shares, the facility for carrying forward a transaction from one account period to another is available; for Group B shares, it is not. Group A shares basically represent large, well-established companies that have a broad investor base and are very actively traded. Since transactions in these shares can be carried forward, these shares attract a lot of speculative trading.

This seems to be the reason why these shares, other things being equal, tend to command higher price-earning multiples. This is clear from the fact that whenever a share is moved from Group B to Group A, its market price rises; likewise, when a share is shifted from group A to Group B market price declines.

The Mumbai Stock Exchange employs several criteria for shifting stocks from the non-specified list to the specified list. The key ones are that the company must have an equity base of Rs. 10 crore, a market capitalization of Rs. 25–30 crore, a public holding of 35 to 40 percent, a shareholding population of 15,000 to 20,000 a dividend paying status and a good growth potential.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

In 1988, SEBI was created by an administrative feat of the Ministry of Finance. Since then SEBI has gradually been granted more and more powers. With the repeal of the Capital Issues Control Act and the enactment of the SEBI Act in 1992, the regulation of the primary market has become the preserve of SEBI. Further, the Ministry of Finance has transferred a number of powers under the Securities Contracts (Regulation) Act 1956 also to SEBI. Before the establishment of the SEBI, the principal legislations governing the securities markets in India were the Capital Issues Control Act 1956 (governing the primary market) and the Securities Contract (Regulation) Act 1956 (governing the secondary market). The regulatory powers were vested with the Controller of Capital Issues (for the primary market) and the Stock Exchange Division (for the secondary market) in the Ministry of Finance, Government of India.

Functions

1. The SEBI Act armed SEBI with statutory powers.
2. It has entrusted SEBI with the responsibility of dealing with various matters relating to the capital market.

SEBI's principle tasks are to:

1. regulate the business in stock exchanges and any other securities market.
2. register and regulate the working of capital market intermediaries (brokers, merchant bankers, portfolio mangers and so on).

3. register and regulate the working of mutual funds.
4. promote and regulate self-regulatory organizations.
5. prohibit fraudulent and unfair trade practices in securities markets.
6. promote investors' education and training of intermediaries of securities markets.
7. prohibit insider trading in securities.
8. regulate substantial acquisition of shares and take-over of companies.
9. perform such other functions as may be prescribed.

Trading Procedure at Stock Exchanges

Securities can be traded at a stock exchange only if it is listed at that stock exchange or any of the other stock exchanges. Listing is a procedure by which, the issuing company has to enter into an agreement, called the listing agreement, with a stock exchange and has to abide by the clauses of the listing agreement regarding disclosure of information, payment of listing fees redressal of investor's grievance etc.

Once listed, the security can be traded at other stock exchanges too. The sale and purchase (transaction) of securities at the stock exchange can be done only through registered share brokers. An investor desiring to enter into a transaction has to place an order with one of the share brokers. In the 'outcry' system where the brokers used to shout, the deals are confirmed in few hours but in the screen-based system, the deals are confirmed immediately. The investor then gives the delivery of the securities in case of sale, or makes the payment in case of purchase of security, to the stock broker.

The stock broker in turn makes the payment for the securities sold or delivers the security certificate purchased on the completion of settlement programme of the stock exchange. Generally, it takes 15 to 20 days for completion of the transaction. The National Stock Exchange and the Over The Counter Exchange of India (OTCEI) have been operating since their inception at the national level through satellite-linked computer based system. To be in tune with the NSE, the stock exchanges at Mumbai, Delhi, Ahmedebad, and Calcutta, have already converted their operations from the 'outcry' system to the computerised one. The transactions at these stock exchanges now take place through computer based online screen system.

Recent Trends in Capital Market

In recent years, Non-Banking Finance companies, variously called as "finance companies or corporations". Finance companies have mushroomed all over the country and have been making rapid progress. These finance companies or corporations, with very little capital of their own–less than Rs. 1 lakh have been raising deposits from the public by offering attractive rates of interest and other incentives.

They advance loans to wholesale and retail traders, small-scale industries and self-employed persons. Bulk of their loans is given to parties which do not either approach commercial banks or are denied credit facilities by the latter. The finance companies give loans which are generally unsecured and the rate of interest charged by the then generally range between 24 to 36 percent per annum.

The number of official stock exchanges (SEs) in India has increased from nine in 1979–80 to 23 as at the end of March 2003. In fact, the number of SEs has remained to be 23 during 1993-94 to 2000-03. India has not the largest number of organized and recognized SEs in the world. All of them are regulated by the SEBI. They are organized either as voluntary, non-profit-making associations (*viz.*, Mumbai, Ahmedabad, Indore), or public limited companies (*viz.*, Calcutta, Delhi, Bangalore), or company limited by guarantee (*viz.*, Chennai, Hyderabad).

The BSE is the premier or apex stock exchange in India. It is the biggest in size in terms of the amount of fresh capital raised, secondary market turnover and captialisation and the total listed companies and their paid-up capital. It is also the oldest market and has been recognized permanently, while the recognition for other exchanges is renewed every five years. Its business is no longer confined to Mumbai alone; at the end of 1997, there were 100 other cities in which it had set up business.

The NSEI has a fully automated, electronic, screen-based trading system. It is sponsored by the IDBI and co-sponsored by other term-lending institutions, LIC, GIC, other insurance companies, commercial banks, and other financial institutions; *viz.*, SBI Caps, SHCIL, and ILFs. Its objectives are : (a) to provide nation-wide equal access and fair, efficient, completely transparent securities trading system to investors by using suitable communication network, (b) to provide shorter settlement cycles and book entry settlement system, (c) to bring the Indian stock market in line with international markets, (d) to promote the secondary market in debt instruments such as government and corporate bonds.

It was set up in 1992 and was the first stock exchange in India to introduce screen-based automated ring less trading system. It is promoted by UTI, ICICI, IDBI, IFCI, LIF, GIC, SBI Caps, and CANBANK as a company under Section 25 of the Companies Act 1956, with headquarters at Mumbai. Its objectives are : (a) to help companies to raise capital from the market at the cheapest costs and on optimal terms; (b) to help investors to access capital market safely and conveniently; (c) to cater to the needs of the companies which cannot be listed on other official exchanges; (d) to eliminate the problems of illiquid securities, delayed settlements, and unfair prices faced by the investors. There are 20 other national and regional exchanges located in metropolitan centers and other cities in India.

Operational Performance of Stock Exchanges

	Exchange	No. of Listed Companies	Market Capitalization	Total Members	Corporate Members
		(1)	(2)	(3)	(4)
1.	Ahmedabad	551	7,681	285(323)	49(151)
2.	Bangalore	253	17,812	230(245)	51(114)
3.	Bhubaneshwar	43	887	222(233)	8(18)

Contd....

4.	Calcutta	1,962	77,131	861(987)	78(200)
5.	Cochin	90	7,244	488(464)	38(75)
6.	Coimbatore	86	1,233	192(182)	42(62)
7.	Delhi	1,579	30,465	379(374)	65(212)
8.	Gawahati	175	786	206(175)	0(5)
9.	Hyderabad	520	11,917	304(306)	23(120)
10.	Jaipur	145	4,004	587(555)	0(19)
11.	Ludhiana	227	7,198	275(302)	48(85)
12.	Madhya Pradesh	229	6,645	188(188)	11(34)
13.	Chennai	593	28,604	200(186)	49(71)
14.	Magadh	29	246	193(199)	3(20)
15.	Manglore	18	3,183	147(116)	2(11)
16.	Mumbai	3,990	5,63,748	608(665)	71(446)
17.	NSEI	422	2,17,721	873(1036)	736(918)
18.	OTCEI	88	643	785(883)	544(675)
19.	Pune	121	12,533	197(197)	23(59)
20.	Saurashtra kutch	36	1,999	437(436)	38(85)
21.	Uttar Pradesh	321	7,260	507(518)	13(103)
22.	Vadodara	372	10,633	312(319)	25(65)
23.	Total	11,750	10,19,573	8,476(9519)	1,917(3794)

Source : SEBI, Annual Report and RBI, Annual Report.

SHARE MARKET TERMINOLOGY

Ask price: The lowest price at which a seller is willing to offer a security of the time; also known as the 'offer'. If a person enters a market in order to buy a security, he will usually pay the ask price.

Bear: A person who expects prices to fall and sells securities hoping to make a profit by subsequently repurchasing at a lower price.

Bid: The price at which someone is prepared to buy shares.

Brokerage: Charges made by a broker for acting as a agent in the buying and selling of shares.

Bull: A person who buys securities in the expectation that prices will rise and so give him an opportunity to resell on a profit.

Call option: An option giving the taker the right, but not the obligation, to buy the underlying shares at a specified price on or before a specified date.

Depreciation: Amounts charged to provide for that part of the cost, or book value of a fixed asset, which is not recoverable when it is finally put out of use.

Dividend: Distribution of a part of a company's net profit to shareholders as a reward for investing in the company. Usually expressed as percentage of par value or as cents per share.

Equity: The general term for ownership in securities value over debit balance.

Growth stock: Stock with good prospects for future expansion, which promises capital gain. Immediate income prospects may be modest.

Limited liability: The liability of the shareholder in this type of company is limited to the extent of any unpaid capital on his shares.

Market order: An order to buy or sell a security at the next available price. A buy order is executed at the lowest price available and a sell order is executed at the highest price available. All market orders are day orders.

Mutual funds: Type of investment operated by an investment company that raises money from shareholders and invests it in a portfolio of stocks, bonds, or other securities. These funds offer investors the advantages of diversification and professional management. For these services they typically charge a management fee, which must be disclosed in the prospectus. Each mutual fund has its own investment objectives and strategies.

NASDAQ (National Association of Securities Dealers Automated Quotations)**:** Owned and operated by the NASD, NASDAQ is the computerized network that provides price quotations for securities traded over the counter as well as many listed securities.

Open price: The price at which a security starts in a trading day.

Portfolio: Investors holding of securities of various types.

Preference shares: Rank above ordinary shares for claims an assets, earnings and dividends but rank below creditors and debenture holders. These shares usually have a fixed dividend rate.

Premium: The amount by which a security is quoted or issued above its value. The opposite to 'discount'.

Security: An instrument that represents an ownership interest in a corporation (stock), a creditor relationship with a corporation or government body (bond), or rights to ownership through such investment vehicles as options, rights, and warrants.

Stag: A person who applies for a new issue of securities with the intention of selling immediately at a profit as opposed to one who invests for long-term holding.

Par value: The par value is stated in the memorandum and written on the share script. The par value of equity shares is generally Rs. 10 (the most popular denomination) or Rs.100. As per the SEBI guidelines any company coming with new issues from April 2000 onwards the par value of their shares should be of Rs. 10 denomination.

Book value: The book value of an equity share is

$$= \frac{\text{Paid up equity capital + Reserve and surplus}}{\text{Number of outstanding equity shares}}$$

Quite naturally, the book value of an equity share tends to increase as the ratio of reserves and surplus to the paid-up equity capital increases.

Market value: The market value of an equity share is the price at which it is traded in the market. This price can be easily established for a company that is listed on the stock market and actively traded. For a company that is listed on the stock market but traded very infrequently. It is difficult to obtain a reliable market quotation. For a company that is not listed on the stock market, one can merely conjecture as to what its market price would be if it were traded.

Insider trading: Share market dealing by persons who have 'inside' knowledge of the companies whose shares are transacted. Insiders could be directors or top-level employees or even auditors of the company. Insider trading is a punishable offence in India.

Commodity futures markets: One of the components of the Indian securities market is the commodity futures markets. This functions through the introduction of nationwide electronic trading and market access, as was done of the equity market during 1994–96. For the transactions there new exchanges have come about: National Commodity Derivative Exchange (NCDEX), Multi Commodity Exchange (MCX) and National Multi Commodity Exchange (NECE). The National Commodity Derivative Exchange has emerged as the largest commodity futures exchange.

Main Share Price Index in Famous Share Market of the World

Mumbai — DOLEX, SENSEX, S and PCNX, NIFTY FIFTY
New York — DOW JONES
Tokyo — NIKKEI
Frankfurt — MID DAX
Hong Kong — HANG SENG
Singapore — SIMEX, STRAITS TIMES

Sensex: The Stock Exchange Sensitive Index (popularly referred to as the SENSEX) reflects the weighted arithmetic average of the price relative to a group of shares included in the index of sensitive shares. For example, Bombay Stock Exchange Sensitive index is a group of 30 sensitive shares.

Name of share price indices changed

On 28 July, 1988, main share price indices have been renamed as follows:

Old Name		*New Name*
NSE – 50	—	S and PCNX Nifty
Crisil 500	—	S and PCNX–500

Money Market

Money market is one of the part of Indian financial market which provides short-term financial requirements of the industrial and business concern. Money market again subdivided into the following categories on the basis of the instruments used in the money market.

A well-organised money market is the basis for an effective monetary policy. A money market may be defined as the market for lending and borrowing of short-term funds. It is the place where the short-term surplus investable funds at the disposal of banks and other financial institutions are bid by borrowers comprising companies, individuals and the government.

The Reserve Bank occupies a pivotal position in the Indian money market as it controls the flow of currency and credit into the market. The Indian money market is classified into the following ways:

Indian money market consists of two parts: The unorganised and the organised sectors. The unorganised sector consists of indigenous bankers who pursue the banking business on traditional lines. The organised sector comprises the Reserve Bank, the State Bank of India and its associate banks, the 19 nationalised banks and other private sector banks, both Indian and foreign.

The organised money market in India has a number of sub-markets such as the *Treasury Bills Market*: the *Commercial Bills Market* and the *Inter-Bank Call Money Market.*

On the recommendations of the Sukhmoy Chakravarty Committee on the *Review of the working of the Monetary System*, the RBI has initiated a series of money market reforms.

The Narasimhan Committee report on the Working of the Financial System in India, (1991) also made important recommendations on the Indian money market.

As par of its anti-inflationary policy, the RBI has followed a strict policy of interest rate control and regulations. Deposit rates of banks, lending rates of banks and financial institutions-in fact, all kinds of interest rates were subject to strict control and regulation by the RBI. Since 1988, the RBI has removed the ceiling stipulation (of 16.5% per annum) for all bank advances and instead has fixed a minimum of 16% per annum.

Banks have been asked to ensure that the interest rates charged remain within reasonable limits. Subsequently, the ceiling on interest rates on inter-bank call and short notice money, inter short-term deposits, bills rediscounting and inter-bank participation were removed from May 1989 and the rates were permitted to be determined by market forces.

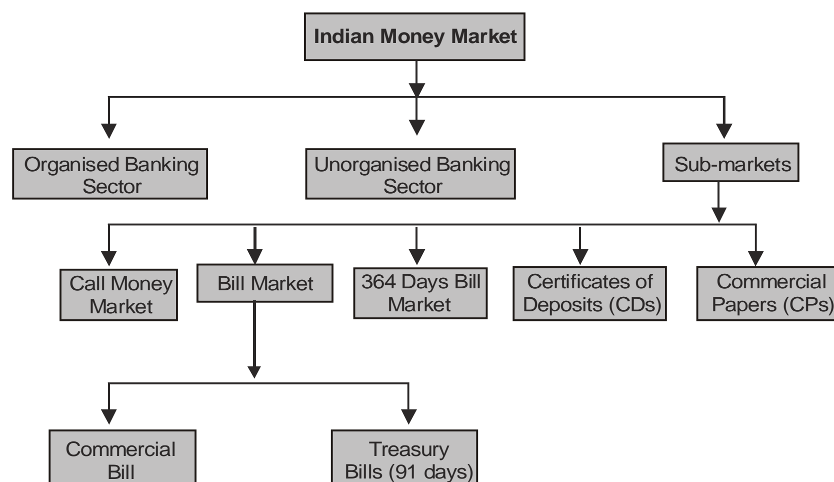

Fig. 13.9 *Indian Money Market*

1. **Call money market:** It is the market for very short-term funds repayable on demand and with the maturity period is less than 15 days. Call money market is mainly located in major industrial and commercial areas like Delhi, Mumbai, Kolkatta, Chennai and Ahmedabad.
2. **Treasury bill market:** Treasury bills are also one of the short-term financial instruments, which deal in money market. Treasury bill is a kind of finance bill or promissory note issued by the government to raise short-term funds. Treasury bills duration vary from 14 days to 364 days.

   Traditionally, the Indian money market had suffered from inadequacy of short-term credit instruments. On the recommendations of the Vaghul Working Group, the RBI has introduced many new money market instruments.

   Treasury bills: Instruments for short-term borrowing by the government. The bills are promissory notes to pay to the bearer after the maturity period. The bills are issued by tender to the Money Market and to Government Departments. Tenders are invited every week from bankers, discount houses and brokers. The Treasury Bills provide the government with a highly flexible and relatively cheap means of borrowing money to meet its fluctuating needs for cash.

   In the past there were only 91days treasury bills, which were traded in the Indian money market. The new instruments introduced by the RBI are: 182 days treasury bills, 364 days treasury bills, longer maturity treasury bills, dated Governments securities, certificates of deposits and commercial paper.

   At one time, the demand for the treasury bills by commercial banks was solely governed by Statutory Liquidity Ration (SLR) considerations. This is not true any more. Besides, the secondary market transactions in them are being increasingly driven by the felt-need for effective management of short-term liquidity by the commercial banks.

   182 days treasury bills were variable interest bills and were sold through fortnightly auctions. The yield of these long-dated papers had become attractive for a highly liquid instrument. These were replaced by 364 days treasury bills.

   364 days treasury bills there is a considerable scope for banks and financial institutions to be interested in long-dated bills, as they are far superior to their loan assets and investments which cannot be easily liquidated in times of need, without incurring heavy loses. The 364 days Treasury Bills have thus become an important instrument of Government borrowing from the market and also leading money market instrument in the sense that their yield is most reflective of market conditions. Financial institutions recongnise the yield rate on 364 days Treasury Bills–at present around 12.5 to 13 percent–as anchor rate on the basis of which interest rate instruments are floated.

   The fortnightly offerings of these bills bring in, annually, about Rs. 20,000 crores to the Government. These bills are entirely held by the market and RBI does not subscribe to them. RBI introduced two more Treasury Bills in 1997: **(i) 14 days**

Intermediate Treasury Bills from April 1997 at a discount rate equivalent to the rate of interest on ways and means advances to the Government of India–these bills cater to the needs of State Governments, foreign central banks and other specified bodies (these have surplus funds which can be invested for very short periods), **(ii) A new category of 14 days Treasury Bills,** sold through action for the first time in June 1997 to meet the cash management requirements of various sections of the economy.

Dated Government Securities: The Government of India has also decided to sell dated securities (of 5 year maturity and 10 maturity) on an auction basis. The purpose of this Government decision is:

(i) to develop dated securities as a monetary instrument with flexible yields;

(ii) to provide financial instruments to suit investors' expectations; and

(iii) to meet Government needs directly from the market.

A very interesting development is the introduction of repurchase auctions (Repos, for short), since December 1992, in respect of Central Government dated securities. Repos are now a regular feature of RBI's market operations. One purpose of Repos is to even out short-term fluctuations in liquidity of the money market.

When Government securities are repurchased from the market, RBI makes payment to commercial banks and this adds to their liquidity. Repos are developing into a useful instrument to even out sharp fluctuations in the money market.

Discount and Finance House of India Ltd. (DFHI)

DFHI has been set up as a port of the package of reform of the money market. It fills the long-standing need of a discount house in India, which will buy bills and other short-term paper from banks and financial institutions. In this way, DFHI enables banks and financial institutions to invest their idle funds for short periods in bills and short dated paper.

Banks can sell their short-term securities to DFHI and get funds, in case they need them, without disturbing their investments. The DFHI has been very active in the short-term money market and has effectively contributed to the overall stability of the money market.

3. **Commercial bills market:** Another Sub-division of money market is commercial bill market. A commercial bill or a bill of exchange is a short-term, negotiable, and self liquidating money market instrument. It may be classified into clean bills, document bills, inland bills, foreign bills, accommodation bills and supply bills etc.

Commercial Paper (CP)

The commercial paper (CP) is issued by companies with a net worth of Rs. 5 crores. The CP is issued in multiples of Rs. 25 lakhs subject to a minimum issue of Rs. 1 crore. The maturity of CP is between 3 to 6 months. The CPs are issued at a discount rate is freely determined.

The maximum amount of CP that a company can raise was limited to 20% (now raised to 30%) of the maximum permissible bank finance. The purpose of introducing CP is to

enable high-level corporate borrowers to diversify their sources of short-term borrowings on the one hand, and provide an additional instrument to the banks and financial institutions in the money market, on the other.

4. **Certificate of deposits(CDs):** The CDs are another important instrument of money market. They are issued by banks in multiples of Rs. 25 lakhs subject to a minimum amount of Rs. 1 crore. The maturity is between 3 months and one year. They are issued at a discount to the face value and the discount rate is freely determined according to market conditions. CDs are freely transferable after 45 days from the date of issue.

Money Market Mutual Funds(MMMFs)

In April 1992 the Government announced the setting up of Money Market Mutual Funds (MMMFs) with the purpose of bringing Money Market instruments within the reach of individuals. Scheduled commercial banks and public financial institutions would set up the MMMFs. The shares/units of MMMFs would be issued only to individuals. In this respect, they will differ from UTI and other mutual funds which have been mobilizing the savings of the middle classes (and also of others including companies) for investment in equities in the capital market.

Mutual funds have emerged as an important segment of financial markets in India, especially following the initiatives taken by Government in the 1999–2000. Budget to resolve problems associated with UTIs US 64 scheme and to liberalise tax treatment of incomes earned through mutual funds. The now plays a crucial role in channeling savings of millions of individuals/households form different parts of the country into investment in both equity and debt instruments.

The mutual fund industry has witnessed several innovations in the current financial year. The monetary and credit policy for 1999–2000 has permitted money market mutual funds to offer cheque writing facility to unit holders. Some of the Mutual Funds have introduced limited cheque writing facility by allowing its unit holders to issue cheques against a savings account with a designated bank.

The Mid-term Review of Monetary and Credit Policy announced the decision to permit scheduled commercial banks to offer “cheque writing” facility to Gilt Funds and those Liquid income Schemes of Mutual Funds which predominantly (not less than 80 percent of the corpus) invest in money market instruments. Another significant development related to the emergence of sector funds targeting sectors such as information technology, pharmaceuticals, fast moving consumer goods, etc. Equally important was the emergence of Dedicated Gilt Fund envisaging 100 percent investment in Government securities, which has made the Gilt Market accessible to small investors. In order to promote dematerialization, the mutual fund industry introduced an innovative product facilitating investment solely in dematerialized securities and exchange of any security in dematerialised segment for the units of the scheme.

Venture Capital Funds (VCFs)

The Union Budget for 1999–2000 stressed the need for higher investment in venture capital activity (investment in economic activities where risk is high and there is considerable innovation involved *e.g.* in the knowledge based enterprises). As it is difficult to access capital market to raise funds for technology development/demonstration, especially for small and medium industries, VCF has a major role to play in this area.

The National Venture Fund for Software and IT industry (NVFSIT) launched in the current financial year merits mention in this context. The Small Industry Development Bank of India (SIDBI) Venture Capital Ltd. (SVCL) manages NVFSIT, which is a wholly owned subsidiary of SIDBI. In the backdrop of these developments, SEBI initiated a process of interaction with industry participants and experts to identify the various issues and key areas for the development of the VCF industry in India.

Financial Services

Financial Services are the another and unavoidable component of the financial system of the country. Normally financial services are provided by the non-banking financial companies and later it is called as non-banking financial service companies. Financial services are divided into two major categories such as:

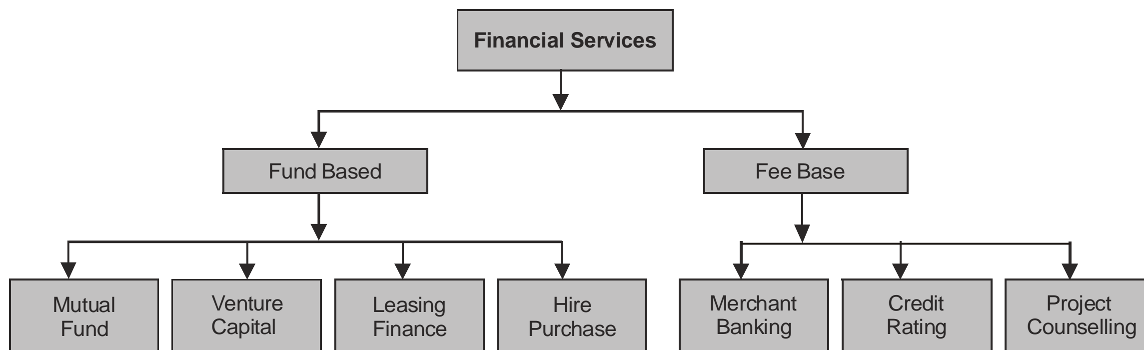

Fig. 13.10 *Financial Services*

Fund Based Financial Services

Fund based financial services such as leasing, venture capital, hire purchasing, insurance and mutual funds etc. Because, these services are related to the funds transfer from one place to another place and one person to another person.

Fee Based Financial Services

Fee based financial services such as merchant banking, underwriting, project counseling, credit rating etc., because, these services such as merchant banking, underwriting, project counseling, credit rating etc., because, these services are not related to any funds transfer activities.

Non-banking Finance Companies (NBFC)

The categories of NBFCs and the nature of their main activities currently being followed by the RBI, which are very similar to the ones discussed by the Shah Working Group, are as follows:

1. **Equipment leasing company (ELC)** means any company which is carrying on as its principal business, the activity of leasing of equipment or the financing of such activity.
2. **Hire-purchase finance company (HPFC)** means any company which is carrying on as its principal business, hire-purchase transactions or the financing of such transactions.
3. **Housing finance company (HFC)** means any company which is carrying on as its principal business, the financing of the acquisition or construction of houses including the acquisition or development of plots of land in connection therewith.
4. **Investment company (IC)** means any company which is carrying on as its principal business, the acquisition of securities.
5. **Loan company (LC)** means any company which is carrying on as its principal business, the providing of finance whether by making loans or advances, or otherwise for any activity other than its own. This category does not include an equipment leasing company or a hire-purchase finance company or a housing finance company.
6. **Mutual benefit financial company (MBFC)** means any company which is notified by the Central Government under Section 620A of the Companies Act 1956 (1 of 1956).
7. **Miscellaneous non-banking company (MNBC**) means a company carrying on all or any of the following types of business :
   (a) Managing, conducting or supervising as a promoter, foreman or agent of any transaction or arrangement by which the company enters into an agreement with a specified number of subscribers that every one of them shall subscribe a certain sum in installment over a definite period and that every one of such subscribers shall in his turn, as determines by lot or by auction or by tender or in such other manner as may be provided for in the agreement be entitled to the prize amount.
   (b) Conducting any other form of chit or *kuri* which is different from the type of business referred to above. Undertaking or carrying on or engaging in or executing any other business similar to the business referred to above.
8. **Residuary non-banking company (RNBC)** means a company which receives any deposit under any scheme or arrangement, by whatever name called, in one lump sum or in installments by way of contributions or subscriptions or by sale of units or certificates or other instruments, or in any other manner and which according to the definitions contained in the Non-Banking Financial Companies (Reserve Bank) Directions, 1977 or as the case may be, the Miscellaneous

Non-Banking Companies (Reserve Bank) Directions, 1977 is not an insurance company or a company belonging to one to seven at the previous page.

MODEL QUESTIONS

1. Define financial system?
2. Explain the major component of financial system?
3. Discuss various classification of banking as per the RBI Act?
4. Explain the role of NBFI in Indian economy?
5. What is financial market?
6. Explain the money market instrument?
7. What are the major stock market instruments?
8. Discuss the stock market performance in India.
9. What is financial services?
10. Explain the different categories of financial services provided by the NBFC.
11. Discuss the role of Life Insurance Corporation of India.