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UNIT I

AN OVERVIEW OF FINANCIAL MARKETS

Finance is the life blood of business. It is an art and science of managing money in a business. Finance function includes the procurement of funds and their effective utilization in an organization.

Definition of Finance

Finance refers to the management of flow of money through an organization. Different experts have defined finance in their own terms:

- According to Guthmann and Dougall, business finance is defined as ―The activity concerned with the planning, raising, controlling and administering the funds used in the business.‖
- F.W.Paish defined finance as ―The position of money at the time it is wanted.‖
- According to Howard and Upton, ―Finance may be defined as that administrative area or set of administrative functions in an organization which relates with the arrangement of cash and credit so that the organization may have the means to carry out the objectives as satisfactorily as possible.‖
- According to Wheeler business finance may be defined as ―The business activity which is concerned with the acquisition and conversion of capital funds in meeting the financial needs and overall objectives of the business enterprise.‖

TYPES OF FINANCE

Business Finance:

The term _business finance‘ is very comprehensive. It implies finances of business activities. The term, ‗business' can be categorized into three groups: commerce, industry and service. It is a process of raising, providing and managing of all the money to be used in connection with business activities.

It encompasses finance of sole proprietary organizations, partnership firms and corporate organizations. No doubt, the aforesaid organizations have different characteristics, features, distinct regulations and rules. And financial problems faced by them vary depending upon the nature of business and scale of operations. However, it should be remembered that the same principles of finance are applicable to large and small organizations, proprietary and non-proprietary organizations.

The finance manager has to assume the new responsibility of managing the total funds committed to total assets and allocating funds to individual assets in consonance with the overall objectives of the business enterprise.

Direct Finance

The term ‗direct', as applied to the financial organisation, signifies that savings are affected directly from the saving-surplus units without the intervention of financial institutions such as investment companies, insurance companies, unit trusts, and so on.

Indirect Finance

The term ‗indirect finance' refers to the flow of savings from the savers to the entrepreneurs through intermediary financial institutions such as investment companies, unit trusts and insurance companies, and so on.

Finance administers economic activities. The scope of finance is vast and determined by the financial needs of the business enterprise, which have to be identified before any corporate plan is formulated. This eventually means that financial data must be obtained and scrutinised. The main purpose behind such scrutiny is to determine how to maintain financial stability.

Public Finance

It is the study of principles and practices pertaining to acquisition of funds for meeting the requirements of government bodies and administration of these funds by the government.

Private Finance

It is concerned with procuring money for private organization and management of the money by individuals, voluntary associations and corporations. It seeks to analyse the principles and practices of managing one‘s own daily affairs. The finance of non-profit organization deals with the practices, procedures and problems involved in the financial management of educational chartable and religions and the like organizations.

Corporation Finance

Corporation finance deals with the financial problems of a corporate enterprise. These problems include the financial aspects of the promotion of new enterprises and their administration during their early period; the accounting problems connected with the distinction between capital and income, the administrative problems arising out of growth and expansion, and, finally, the financial‘ adjustments which are necessary to bolster up to rehabilitate a corporation which has run into financial difficulties.

The term _corporation finance‘ includes, apart from the financial environment, the different strategies of financial planning. It includes problems of public deposits, inter-company loans and investments, organised markets such as the stock exchange, the capital market, the money market and the bill market. Corporation finance also covers capital formation and foreign capital and collaborations.

FINANCIAL MARKETS

Financial Market refers to a marketplace, where creation and trading of financial assets, such as shares, debentures, bonds, derivatives, currencies, etc. take place. It plays a crucial role in allocating limited resources, in the country‘s economy. It acts as an intermediary between the savers and investors by mobilising funds between them.

Nature of Financial Market

A financial market is as vital to the economy as blood is to the body. The nature of financial markets is mentioned below:

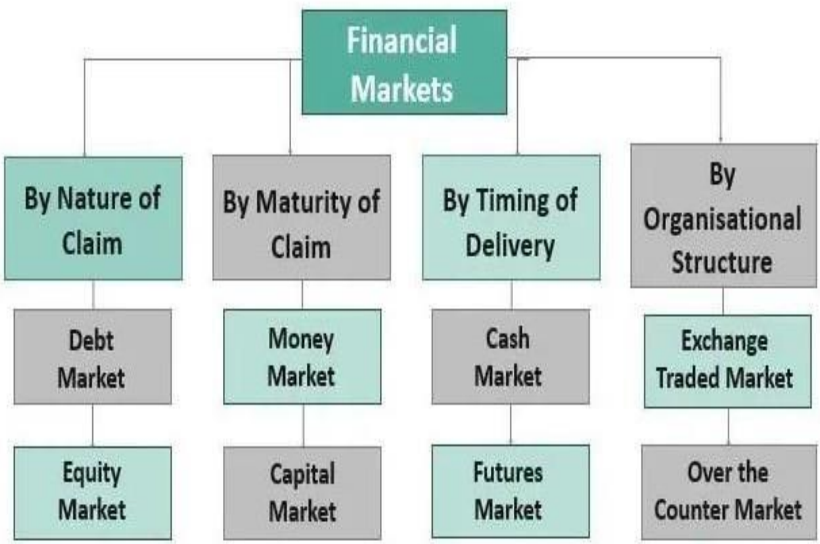
1. It acts as a link between the investors and borrowers
2. These markets are readily available at anytime for both the investors and the borrowers
3. Financial markets initiate buying and selling of marketable commodities.
4. The government controls the operations of a financial market in the country by imposing different rules and regulations.
5. These markets require financial intermediaries such as a bank, non-banking financial companies, stock exchanges, mutual fund companies, insurance companies, brokers, etc. to function.
6. Financial markets provide an opportunity of putting in their funds into various securities or schemes for short or long-term investing benefits.

Functions of Financial Market

The functions of the financial market are explained with the help of points below:

- It facilitates mobilisation of savings and puts it to the most productive uses.
- It helps in determining the price of the securities. The frequent interaction between investors helps in fixing the price of securities, on the basis of their demand and supply in the market.
- It provides liquidity to tradable assets, by facilitating the exchange, as the investors can readily sell their securities and convert assets into cash.
- It saves the time, money and efforts of the parties, as they don‘t have to waste resources to find probable buyers or sellers of securities. Further, it reduces cost by providing valuable information, regarding the securities traded in the financial market.

Classification of Financial Market



1. **By Nature of Claim**

i. Debt Market: The market where fixed claims or debt instruments, such as debentures or bonds are bought and sold between investors.

ii. Equity Market: Equity market is a market wherein the investors deal in equity instruments. It is the market for residual claims.

2. **By Maturity of Claim**

i. Money Market: The market where monetary assets such as commercial paper, certificate of deposits, treasury bills, etc. which mature within a year, are traded is called money market. It is the market for short-term funds. No such market exists physically; the transactions are performed over a virtual network, i.e. fax, internet or phone.

ii. Capital Market: The market where medium- and long-term financial assets are tradedin the capital market. It is divided into two types:

- Primary Market: A financial market, wherein the company listed on an exchange, for the first time, issues new security or already listed company brings the fresh issue.
- Secondary Market: Alternately known as the Stock market, a secondary market is an organised marketplace, wherein already issued securities are traded between investors, such as individuals, merchant bankers, stockbrokers and mutual funds.

3. **By Timing of Delivery**

i. Cash Market: The market where the transaction between buyers and sellers are settled in real-time.

ii. Futures Market: Futures market is one where the delivery or settlement of commodities takes place at a future specified date.

4. By Organizational Structure

i. Exchange-Traded Market: A financial market, which has a centralised organisation with the standardised procedure.

ii. Over-the-Counter Market: An OTC is characterised by a decentralised organisation,having customised procedures.

MONEY MARKET & CAPITAL MARKET

Money Market

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is up to one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement.

Money market does not imply to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to borrowers. Most of the money market transactions are taken place on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indianmoney market.

Money Market Instruments

Following is some of the important money market instruments or securities.

(a) **Call Money**: Call money is mainly used by the banks to meet their temporary requirement of cash. They borrow and lend money from each other normally on a daily basis. It is repayable on demand and its maturity period varies in between one day to a fortnight. The rate of interest paid on call money loan is known as call rate.

(b) **Treasury Bill**: A treasury bill is a promissory note issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments, that means, at any time the holder of treasury bills can transfer of or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference betweenthe issue price and the face value of the treasury bill represents the interest on the investment. These bills are secured instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play major role in the Treasury bill market.

(c) **Commercial Paper:** Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. The CP is an unsecured instrument issued in the form of promissory note. This instrument was introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market.

(d) **Certificate of Deposit**: Certificate of Deposit (CDs) are short-term instruments issued by Commercial Banks and Special Financial Institutions (SFIs), which are freely transferable from one party to another. The maturity period of CDs ranges from 91 days to one year. These can be issued to individuals, co-operatives and companies.

(e) **Trade Bill**: Normally the traders buy goods from the wholesalers or manufactures on credit. The sellers get payment after the end of the credit period. But if any seller does not want to wait or is in immediate need of money, he/she can draw a bill of exchange in favor of the buyer. When buyer accepts the bill, it becomes a negotiable instrument and is termed as bill of exchange or trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawee i.e., the buyer of goods. When trade bills are accepted byCommercial Banks it is known as Commercial Bills. So trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

Capital Market

Capital Market may be defined as a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc.

The market where securities are traded known as Securities market. It consists of two different segments namely primary and secondary market. The primary market deals with new or fresh issue of securities and is, therefore, also known as new issue market; whereas the secondary market provides a place for purchase and sale of existing securities and is often termed as stock market or stock exchange.

Primary Market

The Primary Market consists of arrangements, which facilitate the procurement of long-term funds by companies by making fresh issue of shares and debentures. You know that companies make fresh issue of shares and/or debentures at their formation stage and, if necessary, subsequently for the expansion of business. It is usually done through private placement to friends, relatives and financial institutions or by making public issue. In any case, the companies have to follow a well-established legal procedure and involve a number of intermediaries such asunderwriters, brokers, etc. who form an integral part of the primary market. You must have learnt about many initial public offers (IPOs) made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and the private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on. The major players in the primary market are merchant bankers, mutual funds, financial institutions, and the individual investors.

Secondary Market

The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds by providing the necessary liquidity to holdings in shares and debentures. It provides a place where these securities can be encashed without any difficulty and delay. It is an organised market where shares, and debentures are traded regularly with high degree of transparency and security. In fact, an active secondary market facilitates the growth of primary market as the investors in the primary market are assured of a continuous market for liquidity of their holdings. The major players in the secondary market include all the players in the money market and the stockbrokers who are members of the stock exchange who facilitatethe trading.

Difference between Money Market and Capital Market

S.NO.	BASIS	MONEY MARKET	CAPITAL MARKET
1.	Period of Finance	Money market is a market for short-term funds. The maturity of these instruments vary from one day to 12 months.	Capital market is a market for long-term funds. The maturity of the capital market instruments are more than a year.
2.	Type of Instruments	The instruments that are dealt in a money market are mainly T-bills, Commercial Papers (CPs), Certificate of Deposits (CDs) etc.	Capital market deals with instruments like shares, debentures, government bonds etc.
3.	Use of Funds	Funds mobilized through money market are used for financing current business operations, working capital requirement of industries, liquidity requirement of banks, short-term fund requirement of government etc.	The capital market supplies funds for financing capital requirements of corporates and long term requirement of government.
4.	Volume of funds	Money markets instruments deals in large amount. A treasury bill is of minimum one lakh. Each CD or CP is for minimum 25 Lakh.	Face value of capital market instruments are smaller. The value of one share could be Rs. 10 and value of one debenture could be Rs. 100.
5.	Presence of secondary market	Money market instruments do not have secondary market.	Capital market instruments are tradable in stock exchanges.
6.	Intermediaries	Intermediaries in money market includes banks, discount houses, acceptance houses etc.	Capital market intermediaries are stock exchanges, brokers, jobbers etc.
7.	Specific Location	There is no formal place for transaction. Most of the transactions are done over-the-phone .	Transaction takes place through stock exchange situated at a specific place.
8.	Involvement of Brokers	There is no need of brokers.	Involvement the help of brokers is common in capital market
9.	Link	Money market is a link between lenders and borrowers for a short-term needs.	Capital market is a link between investors and borrowers for long-term needs.

Difference Between Primary and Secondary Market

S.NO.	BASIS	PRIMARY MARKET (New Issue Market)	SECONDARY MARKET (Stock Exchange)
1.	Meaning	Primary market is a market where new securities are issued in the market for the first time, either by existing company or new company.	Secondary market Is a market where already issued, existing securities are traded on stock exchanges.
2.	Regulatory Authority	Activities in primary market is governed by SEBI and Companies Act.	It is regulated by bye-laws of stock exchanges and SEBI.
3.	Price determination	When securities are issued for first time in primary market, the price of securities is determined by company itself.	Prices of securities is determined by demand and supply forces in the stock exchange.
4.	Price fluctuation	Price of securities is fixed.	Price of securities keep fluctuating because of demand and supply forces.
5.	Involvement of Companies	Companies are directly involved as shares are sold by company directly to public.	There is no involvement of companies.
6.	Type of Company	All types of companies can issue new shares whether listed or unlisted.	In secondary market, shares of only listed companies are bought and sold.
7.	Geographical location	There is no fixed geographical location for new issue market. The issuing companies may have offices at different locations.	The location of a stock exchange is fixed at a specific place. E.g. NSE is situated in Mumbai.
8.	Buying and selling between	The securities are sold by companies and bought by public. So buying and selling is done between company and public.	Buying and selling is done among investors only.
9.	Intermediaries	Major intermediaries in primary market are, registrar to the issue, merchant bankers, underwriters, collection banks, debenture trusties, portfolio managers etc.	Main intermediaries in secondary market are Brokers, sub-brokers, jobbers etc.
10.	Financing to companies	Through primary market funds are raised for financing companies for their expansion and diversification.	No fund is raised for company. Only buying and selling of securities is done among investors.

MARKETS FOR DERIVATIVES

Derivatives

Derivatives are financial contracts whose value is dependent on an underlying asset or group of assets. The commonly used assets are stocks, bonds, currencies, commodities and market indices. The value of the underlying assets keeps changing according to market conditions. The basic principle behind entering into derivative contracts is to earn profits by speculating on the value of the underlying asset in future.

Advantages of Derivative contracts

- **Hedging risk exposure:** Since the value of the derivatives is linked to the value of the underlying asset, the contracts are primarily used for hedging risks. For example, an investor may purchase a derivative contract whose value moves in the opposite direction to the value of an asset the investor owns. In this way, profits in the derivative contract may offset losses in the underlying asset.
- **Arbitrage advantage**: Arbitrage trading involves buying a commodity or security at a low price in one market and selling it at a high price in the other market. In this way, one can be benefited by the differences in prices of the commodity in the two different markets.
- **Protection against market volatility**: A price fluctuation of an asset may increase the probability of losses. Investors can find products in the derivatives market which will act as a shield against a reduction in price in the stocks already owned by them.
- **Market efficiency**: It is considered that derivatives increase the efficiency of financial markets. By using derivative contracts, one can replicate the payoff of the assets. Therefore, the prices of the underlying asset and the associated derivative tend to be in equilibrium to avoid arbitrage opportunities.
- **Access to unavailable assets or markets**: Derivatives can help organizations get access to otherwise unavailable assets or markets. By employing interest rate swaps, a company may obtain a more favorable interest rate relative to interest rates available from direct borrowing.

Types of Derivatives

1. Forwards and futures

These are financial contracts that obligate the contracts‘

buyers to purchase an asset at a pre-agreed price on a specified future date. Both forwards and futures are essentially the same in their nature. However, forwards are more flexible contracts because the parties can customize the underlying commodity as well as the quantity of the commodity andthe date of the transaction. On the other hand, futures are standardized contracts that are traded on the exchanges.

2. Options

Options provide the buyer of the contracts the right, but not the obligation, to purchase or sell the underlying asset at a predetermined price. Based on the option type, the buyer can exercise the option on the maturity date (European options) or on any date before the maturity (American options).

3. Swaps

Swaps are derivative contracts that allow the exchange of cash flows between two parties. The swaps usually involve the exchange of a fixed cash flow for a floating cash flow. The most popular types of swaps are interest rate swaps, commodity swaps, and currency swaps.

Underlying assets and derivative products

While forwards, futures, options and swaps can be viewed as the mechanics of derivation, the value of these contracts are based on the prices of the underlying assets. In this section, we discuss a range of derivatives products that derive their values from the performance of five underlying asset classes: equity, fixed-income instrument, commodity, foreign currency and credit event. However, given the speed of financial innovation over the past two decades, the variety of derivatives products have grown substantially. Thus a few key examples will be discussed below.

i. Equity derivatives

Equity futures and options on broad equity indices are perhaps the most commonly cited equity derivatives securities. Way back in 1982, trading of futures based on S&P's composite index of 500 stocks began on the Chicago Mercantile Exchange (CME). Options on the S&P 500 futures began trading on the CME in the following year. Today, investors can buy futures based on benchmark stock indices in most international financial centres. It can be an extremely useful hedging tool. For example, an investor with a stock portfolio that broadly matches the composition of the Hang Seng index (HSI), he will suffer losses should the HSI record a fall in market value in the near future.Since he means to hold the portfolio as a long-term strategy, he is unwilling to liquidate the portfolio. Under such circumstances, he can protect his portfolio by selling HSI index futures contracts so as to profit from any fall in price. Of course, if his expectations turned out to be wrong and the HSI rose instead, the loss on the hedge would have been compensated by the profit made on the portfolio.

ii. Interest rate derivatives

One of the most popular interest rate derivatives is interest rate swap. In one form, it involves a bank agreeing to make payments to a counterparty based on a floating rate in exchange for receiving fixed interest rate payments. It provides an extremely useful tool for banks to manage interest rate risk. Given that banks' floating rate loans are usually tied closely to the market interest rates while their interest payments to depositors are adjusted less frequently, a decline in market interest rates would reduce their interest income but not their interest payments on deposits. By entering an interest rate swap contract and receiving fixed rate receipts from a counterparty, banks would be less exposed to the interest rate risk. Meanwhile, interest rate futures contract allows a buyer to lock in a future investment rate.

iii. Commodity derivatives

The earliest derivatives markets have been associated with commodities, driven by the problems about storage, delivery and seasonal patterns. But modern-day commodity derivatives markets only began to develop rapidly in the 1970s. During that time, the breakup of the market dominance of a few large commodity producers allowed price movements to better reflect the market supply and demand conditions. The resulting price volatility in the spot markets gave rise to demand of commodity traders forderivatives trading to hedge the associated price risks. For example, forwards contracts on Brent and other grades of crude became popular in the 1970s following the emergence of the Organisation of Petroleum Exporting Countries. Deregulations of the energy sector in the United States since the 1980s also stimulated the trading of natural gas and electrical power futures on the New York Mercantile Exchange (NYMEX) in the 1990s.

iv. Foreign exchange derivatives

The increasing financial and trade integration across countries have led to a strong rise in demand for protection against exchange rate movements over the past few decades. A very popular hedging tool is forward exchange contract. It is a binding obligation to buy or sell a certain amount of foreign currency at a pre-agreed rate of exchange on a certain future date. Consider a Korean shipbuilder who expects to receive a $1 million payment from a US cruise company for a boat in 12 months. Suppose the spot exchange rate is 1,200 won per dollar today. Should the won appreciate by 10 per cent against the dollar over the next year, the Korean shipbuilder will receive only 1,090 million of won (some 109 million of won less than he would have received today). But if the shipbuilder can hedge against the exchange risk by locking in buying dollars forwards at the rate of say 1,100 won per dollar

v. Credit derivatives

A credit derivative is a contract in which a party (the credit protection seller) promises a payment to another (the credit protection buyer) contingent upon the occurrence of a credit event with respect to a particular entity (the reference entity). A credit event in general refers to an incident that affects the cash flows of a financial instrument (the reference obligation). There is no precise definition, but in practice, it could be filing for bankruptcy, failing to pay, debt repudiation or moratorium.

The fastest growing type of credit derivatives over the past decade is credit default swap (CDS). In essence, it is an insurance policy that protects the buyer against the loss of principal on a bond in case of a default by the issuer. The buyer of CDS pays a periodic premium to the seller over the life of the contract. The premium reflects the buyer‘s assessment of the probability of default and the expected loss given default.4 In the event of a credit incident, the buyer has a right to demand compensation from the seller.

Derivatives Market

Derivatives are traded either on organised exchanges or in OTC markets. The differences between the exchange-traded and OTC derivatives are not confined to where they aretraded but also how.

In exchange-traded markets, derivatives contracts are standardised with specific delivery or settlement terms. Negotiation between traders traditionally was conducted by shouting on the trading floor (open outcry). But electronic trading system has become increasingly popular in many major exchanges. Exchange-traded derivative trades are publicly reported and cleared in a clearing house. The clearing house will be obliged to honor the trade if the seller defaults. The solvency of the clearing house was protected by marking all positions to market daily through a system of margins.

By contrast, derivative trades in OTC markets are bilateral in nature. All contract terms such as delivery quality, quantity, location, date and prices are negotiable between the two parties. Transactions can be arranged by telephone or other communication means. Prices are not reported publicly.

The different characteristics of the two types of markets mean that they complement eachother in providing a trading platform to suit various business needs. On the one hand, exchange traded derivative markets have better price transparency than OTC markets. Counterparty risks are also smaller in exchange-traded markets with all trades on exchanges being settled daily with the clearing house. On the other hand, the flexibility ofOTC markets means that they suit better for trades that do not have high order flow andor with special requirements. In this context, OTC markets perform the role as anincubator for new financial products.

Participants in the Derivatives Market

1. Hedgers

Hedging is when a person invests in financial markets to reduce the risk of price volatilityin exchange markets, i.e., eliminate the risk of future price movements. Derivatives are the most popular instruments in the sphere of hedging. It is because derivatives are effective in offsetting risk with their respective underlying assets.

2. Speculators

Speculation is the most common market activity that participants of a financial market take part in. It is a risky activity that investors engage in. It involves the purchase of any financial instrument or an asset that an investor speculates to become significantly valuable in the future. Speculation is driven by the motive of potentially earning lucrativeprofits in the future.

3. Arbitrageurs

Arbitrage is a very common profit-making activity in financial markets that comes into effect by taking advantage of or profiting from the price volatility of the market. Arbitrageurs make a profit from the price difference arising in an investment of a financial instrument such as bonds, stocks, derivatives, etc.

4. Margin traders

In the finance industry, margin is the collateral deposited by an investor investing in a financial instrument to the counterparty to cover the credit risk associated with the investment.

Stock Exchange

Stock exchange is the term commonly used for a secondary market, which provide aplace where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a regular basis. A stock exchange is generally organised as an association, a society or a company with a limited number of members. It is open only to these members who act as brokers for the buyers and sellers.

The Securities Contract (Regulation) Act has defined stock exchange as an ―association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in securities‖.

The main characteristics of a stock exchange are:

1. It is an organised market.
2. It provides a place where existing and approved

securities can be bought and soldeasily.

3. In a stock exchange, transactions take place between its members or their authorisedagents.
4. All transactions are regulated by rules and by laws of the concerned stock exchange.
5. It makes complete information available to public in regard to prices and volume of transactions taking place every day.

It may be noted that all securities are not permitted to be traded on a recognised stock exchange. It is allowed only in those securities (called listed securities) that have been duly approved for the purpose by the stock exchange authorities. The method of trading now-a-days, however, is quite simple on account of the availability of on-line trading facility with the help of computers. It is also quite fast as it takes just a few minutes to strike a deal through the brokers who may be available close by. Similarly, on account of the system of scrip-less trading and rolling settlement, the delivery of securities and the payment of amount involved also take very little time, say, 2 days.

Functions of a Stock Exchange

1. Provides ready and continuous market:

By providing a place where listed securities can be bought and sold regularly and conveniently, a stock exchange ensures a ready and continuous market for various shares, debentures, bonds and government securities. This lends a high degree of liquidity to holdings in these securities as the investor can encash their holdings as and when they want.

2. Provides information about prices and sales:

A stock exchange maintains complete record of all transactions taking place in different securities every day and supplies regular information on their prices and sales volumes to press and other media. In fact, now-a-days, you can get information about minute-to- minute movement in prices of selected shares on TV channels like CNBC, Zee News, NDTV and Headlines Today. This enables the investors in taking quick decisions on purchase and sale of securities in which they are interested. Not only that, such information helps them in ascertaining the trend in prices and the worth of their holdings. This enables them to seek bank loans, if required.

3. Provides safety to dealings and investment:

Transactions on the stock exchange are conducted only amongst its members with adequate transparency and in strict conformity to its rules and regulations which include the procedure and timings of delivery and payment to be followed. This provides a high degree of safety to dealings at the stock exchange. There is little risk of loss on account ofnon-payment or non-delivery. Securities and Exchange Board of India (SEBI) also regulates the business in stock exchanges in India and the working of the stock brokers.

Another thing is that a stock exchange allows trading only in securities that have been listed with it; and for listing any security, it satisfies itself about the genuineness and soundness of the company and provides for disclosure of certain information on regular basis. Though this may not guarantee the soundness and profitability of the company, it does provide some assurance on their genuineness and enables them to keep track of theirprogress.

4. Helps in mobilisation of savings and capital formation:

Efficient functioning of stock market creates a conducive climate for an active and growing primary market. Good performance and outlook for shares in the stock exchanges imparts buoyancy to the new issue market, which helps in mobilising savings for investment in industrial and commercial establishments. Not only that, the stock exchanges provide liquidity and profitability to dealings and investments in shares and debentures. It also educates people on where and how to invest their savings to get a fair return. This encourages the habit of saving, investment and risk-taking among the common people. Thus it helps mobilising surplus savings for investment in corporate and government securities and contributes to capital formation.

5. Barometer of economic and business conditions:

Stock exchanges reflect the changing conditions of economic health of a country, as the shares prices are highly sensitive to changing economic, social and political conditions. It is observed that during the periods of economic prosperity, the share prices tend to rise. Conversely, prices tend to fall when there is economic stagnation and the business activities slow down as a result of depressions. Thus, the intensity of trading at stock exchanges and the corresponding rise on fall in the prices of securities reflects theinvestors‘ assessment of the economic and business conditions in a country, and acts as the barometer which indicates the general conditions of the atmosphere of business.

6. Better Allocation of funds:

As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises and they avail of the greater potential for growth. Financial resources of the economy are thus better allocated.

ADVANTAGES OF STOCK EXCHANGE

(a) To the Companies

(i) The companies whose securities have been listed on a stock exchange enjoy a better goodwill and credit-standing than other companies because they are supposed to be financially sound.

(ii) The market for their securities is enlarged as the investors all over the world become aware of such securities and have an opportunity to invest

(iii) As a result of enhanced goodwill and higher demand, the value of their securities increases and their bargaining power in collective ventures, mergers, etc. is enhanced.

(iv) The companies have the convenience to decide upon the size, price and timing of the issue.

(b) To the Investors:

(i) The investors enjoy the ready availability of facility and convenience of buying and selling the securities at will and at an opportune time.

(ii) Because of the assured safety in dealings at the stock exchange the investors are free from any anxiety about the delivery and payment problems.

(iii) Availability of regular information on prices of securities traded at the stock exchanges helps them in deciding on the timing of their purchase and sale.

(iv) It becomes easier for them to raise loans from banks against their holdings in securities traded at the stock exchange because banks prefer them as collateral on accountof their liquidity and convenient valuation.

(c) To the Society

(i) The availability of lucrative avenues of investment and the liquidity thereof induces people to save and invest in long-term securities. This leads to increased capital formation in the country.

(ii) The facility for convenient purchase and sale of securities at the stock exchange provides support to new issue market. This helps in promotion and expansion of industrial activity, which in turn contributes, to increase in the rate of industrial growth.

(iii) The Stock exchanges facilitate realization of financial resources to more profitable and growing industrial units where investors can easily increase their investment substantially.

(iv) The volume of activity at the stock exchanges and the movement of share prices reflects the changing economic health.

(v) Since government securities are also traded at the stock exchanges, the government borrowing is highly facilitated. The bonds issued by governments, electricity boards, municipal corporations and public sector undertakings (PSUs) are found to be on offer quite frequently and are generally successful.

Limitations of Stock Exchange

One of the common evils associated with stock exchange operations is the excessive speculation. You know that speculation implies buying or selling securities to take advantage of price differential at different times. The speculators generally do not take or give delivery and pay or receive full payment. They settle their transactions just by paying the difference in prices. Normally, speculation is considered a healthy practice and is necessary for successful operation of stock exchange activity. But, when it becomes excessive, it leads to wide fluctuations in prices and various malpractices by the vested interests. In the process, genuine investors suffer and are driven out of the market.

Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as on account of rumors spread by interested parties. This makes it difficult to assess the movement of prices in future and build appropriate strategies for investment in securities. However, these days good amount of vigilance is exercised by stock exchange authorities and SEBI to control activities at the stock exchange and ensure their healthy functioning, about which you will study later.

Stock Exchanges in India

The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went up to 7 by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as kerb market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It isalso based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage.

Another stock exchange that needs special mention is Over the Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992 specially to cater to small and medium sized companieswith equity capital of more than Rs.30 lakh and less than Rs.25 crore. It helps entrepreneurs in raising finances for their new projects in a cost-effective manner. It provides for nationwide online ringless trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalize it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

BSE

Established in 1875, BSE (formerly known as Bombay Stock Exchange), is Asia's first & the Fastest Stock Exchange in world with the speed of 6 micro seconds and one of India's leading exchange groups. Over the past 143 years, BSE has facilitated the growth of the Indian corporate sector by providing it an efficient capital-raising platform. Popularly known as BSE, the bourse was established as ‗The Native Share & Stock Brokers' Association' in 1875. In 2017 BSE become the 1st listed stock exchange of India.

Today BSE provides an efficient and transparent market for trading in equity, currencies, debt instruments, derivatives, mutual funds. BSE SME is India's largest SME platform which has listed over 250 companies and continues to grow at a steady pace. BSE STAR MF is India's largest online mutual fund platform which process over 27 lakh transactions per month and adds almost 2 lakh new SIPs ever month. BSE Bond, the transparent and efficient electronic book mechanism process for private placement of debt securities, is the market leader with more than Rs 2.09 lakh crore of fund raising from 530 issuances.

NSE

The National Stock Exchange of India Ltd. (NSE) is the leading stock exchange in India and the second largest in the world by nos. of trades in equity shares from January to June2018, according to World Federation of Exchanges (WFE) report. NSE was incorporated in 1992. It was recognised as a stock exchange by SEBI in April 1993 and commenced operations in 1994 with the launch of the wholesale debt market, followed shortly after by the launch of the cash market segment. NSE's identity crafted in the nineties has for the last 25 years, stood for reliability, expertise, innovation and trust. In the last 25 years, the Indian economy and technology landscape has changed dramatically. And so has NSE. NSE was the first exchange in the country to provide a modern, fully automated screen-based electronic trading system that offered easy trading facilities to investors spread across the length and breadth of the country. Vikram Limaye is Managing Director & Chief Executive Officer of NSE. National Stock Exchange has a total market capitalization of more than US$3 trillion, making it the world's 9th-largest stock exchange as of May 2021.

Regulations of Stock Exchanges

The stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, as early as 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the central Government. It has also the provision of framing of proper bylaws by every stock exchange for regulation and control of their functioning subject to the approval by the Government. All stock exchanges are required submit information relating to its affairs as required by the Government from time to time. The Government was given wide powers relating to listing of securities, make or amend bylaws, withdraw recognition to, or supersede the governing bodies of stock exchange in extraordinary/abnormal situations. Under the Act, the Government promulgated the Securities Regulations (Rules) 1957, which provided inter alia for the procedures to be followed for recognition of the stock exchanges, submission of periodical returns and annual returns by recognised stock exchanges, inquiry into the affairs of recognized stock exchanges and their members, and requirements for listing of securities.

SEBI

SEBI is a regulator for the securities market in India. It was established during the year 1988 and given statutory powers on 12th April 1992 through the SEBI Act.

Objectives:

- To protect the interest of the investors.
- To regulate the securities market
- To promote efficient services by brokers, merchant bankers and other intermediaries.
- To promote orderly and healthy growth of the securities market in India.
- To create proper market environment.
- To regulate the operations of financial intermediaries.
- To provide suitable education and guidance to investors.

Role of SEBI

As part of economic reforms programme started in June 1991, the Government of India initiated several capital market reforms, which included the abolition of the office of the Controller of Capital Issues (CCI) and granting statutory recognition to Securities Exchange Board of India (SEBI) in 1992 for:

(a) protecting the interest of investors in securities;

(b) promoting the development of securities market;

(c) regulating the securities market; and

(d) matters connected there with or incidental thereto.

SEBI has been vested with necessary powers concerning various aspects of capitalmarket such as:

(i) regulating the business in stock exchanges and any other securities market;

(ii) registering and regulating the working of various intermediaries and mutual funds;

(iii) promoting and regulating self-regulatory organisations;

(iv) promoting investors education and training of intermediaries;

(v) prohibiting insider trading and unfair trade practices;

(vi) regulating substantial acquisition of shares and takeover of companies;

(vii) calling for information, undertaking inspection, conducting inquiries and audit of stock exchanges, and intermediaries and self-regulation organisations in the stock market;

(viii) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 asmay be delegated to it by the Central Government.

As part of its efforts to protect investors‘ interests, SEBI has initiated many primary market reforms, which include improved disclosure standards in public issue documents, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and risk factors associated with their projects while making public issue. All issue documents are to be vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. Merchant bankers and all mutual funds including UTI have been brought under the regulatory framework of SEBI. . A code of conduct has been issued specifying a high degree of responsibility towards investors in respect of pricing and premium fixation of issues. To reduce cost of issue, underwriting of issues has been made optional subject to the condition that the issue is not under-subscribed. In case the issue is under- subscribed i.e., it was not able to collect 90% of the amount offered to the public, the entire amount would be refunded to the investors. The practice of preferential allotment of shares to promoters at prices unrelated to the prevailing market prices has been stopped and private placements have been made more restrictive. All primary issues have now to be made through depository mode. The initial public offers (IPOs) can go for book building for which the price band and issue size have to be disclosed. Companies with dematerialized shares can alter the par value as and when they so desire.

As for measures in the secondary market, it should be noted that all statutory powers to regulate stock exchanges under the Securities Contracts (Regulation) Act have now been vested with SEBI through the passage of securities law (Amendment) Act in 1995. SEBI has duly notified rules and a code of conduct to regulate the activities of intermediaries in the securities market and then registration in the securities market and then registration with SEBI is made compulsory. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives. Corporate membership has also been introduced at the stock exchanges. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions. SEBI has constantly reviewed the traditional trading systems of Indian stock exchanges and tried to simplify the procedure, achieve transparency in transactions and reduce their costs. To prevent excessive speculations and volatility in the market, it has done away with badla system, andintroduced rolling settlement and trading in derivatives. All stock exchanges have been advised to set-up clearing corporation / settlement guarantee fund to ensure timely settlements. SEBI organises training programmes for intermediaries in the securities market and conferences for investor education all over the country from time to time.

Major International Stock Markets

1. The New York Stock Exchange (NYSE) is the 1st on the list of the largest stock exchange in the world. It was established on May 17, 1792, and consists of 2,400 listed companies. NYSE is additionally referred to as ‗The Big Board'. It has a market capitalization of US$ 30.1 trillion.
2. NASDAQ is the second largest stock exchange in the world. The NASDAQ commenced its business on February 8, 1971, and is sighted as the world's first electronically traded stock market. NASDAQ has a combined market capitalization of US$ 19.34 trillion as of Jan 2021. It consists of more than 3,000 stocks listed under it and comprises of the world's humongous tech giants such as Apple, Microsoft, Google, Facebook, Amazon, Tesla, and Intel.
3. The Shanghai Stock Exchange (SSE) is located in the city of Shanghai, China, and is one of the two stock exchanges

plying autonomously in the People's Republic of China. Although its foundation traces back to 1866, it was adjourned after the Chinese Revolution in 1949. However, The Shanghai Exchange in its contemporary outlook was laid down in 1990. Currently, Shanghai SSE is the world's 3rd largest stock exchange with a combined market capitalization of US$ 6.5 trillion as of Jan 2021.

4. The Honk Kong Stock Exchange (SEHK) is located in Hong Kong and is the world's 4th largest stock exchange on the basis of market capitalization. It consists of 2,538 listed companies with a wholesome market capitalization of US$ 6.48 trillion as of Jan 2021.Its origin can be traced back to the mid-1800s and since then it has gone through a series of mergers and agglomeration with other exchanges. Some of the gigantic and eminent companies listed under the Hong Kong Stock Exchange are China Mobile, and HSBC Holdings & Petro China.
5. The Japan Stock Exchange (JPX) is a Japanese financial services corporation that operates multiple securities exchanges including Tokyo Stock Exchange and Osaka Securities Exchange. It was formed by the merger of the two companies on January 1, 2013. JPX has close to 3,500 listed companies with a syndicated market capitalization surpassing the US$ 6.35 trillion as of Jan 2021. The TSE's metric indicator is Nikkei 225 and it is home to some of the voluminous Japanese giants with international exposure, including Toyota, Suzuki, Honda, and Mitsubishi, and Sony.
6. The London stock exchange (LSE) is based in London and is the sixth-largest stock market within the world. It was established in 1571 and is the oldest stock exchange in the world. It has more than 3,000 listed companies with a combined market capitalization of $4.59 trillion. LSE's

service was nothing but a twice-weekly paper publication of market prices back in its origin. It is also the maiden source of benchmark prices, equity- market liquidity and market data in Europe. Some of the huge companies listed under the LSE are Barclays, British Petroleum and GlaxoSmithKline.

7. The Shenzhen Stock Exchange (SZSE) is a stock exchange based in the city of Shenzhen, in the People's Republic of China. It is one of two stock exchanges operating independently in Mainland China, the other being the larger Shanghai Stock Exchange. As of January 2021, SZSE has 2,375 listed companies and has a market capitalization of US$ 4.9 trillion as of Jan 2021. Many of the companies within this market are subsidiaries of companies in which the Chinese government maintains controlling interest.
8. Tokyo Stock Exchange (TSE) which is also known as TYO and Tōshō is located in Tokyo, Japan. It is listed as the third-largest stock exchange in the world. TSE has around 3,575 listed companies which has taken its market capitalization to a whooping US$ 5.67 trillion. The TSE's benchmark index is Nikkei 225 and it is home to Japanese giants with international exposure, including Toyota, Suzuki, Honda, and Mitsubishi and Sony.
9. The Word EURONEXT is an acronym for European New Exchange Technology and has its corporate address at La Défense in Greater Paris. EURONEXT was established in 2000 by the consolidation of the exchanges in Amsterdam, Paris, and Brussels. Over the years, it amalgamated with multiple exchanges, most particularly the New York Stock Exchange. It steers financial markets in Amsterdam, London, Brussels, Lisbon, Oslo,

   Dublin, and Paris. It has around 1,500 listed companies leading to a market capitalization worth US$ 4.88 trillion as of Jan 2021. EURONEXT provided the segments which are equities, warrants, exchange-traded, bonds, commodities, funds and certificates, derivatives, indices, and foreign exchange trading platforms.

10. The Toronto Stock Exchange (TSX) is situated in Toronto, Canada. It was introduced in 1852 and is held and wielded as a subsidiary of the TMX Group. Enlistment of 2,207 companies with a combined market capitalization of $2.3 trillion makes Toronto Stock Exchange one among the top 10 biggest stock exchanges in the world. The financial instruments include equities, investment trusts, exchange-traded funds, bonds, commodities, futures, options, and other products. It is also to be noted that mining and oil and gas companies are listed in additional numbers under the Toronto stock market compared to other stock exchanges around the world. Canada's ‗Big Five' commercial banks are also listed under TSX.

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UNIT II

COMMODITY MARKETS

The term commodity refers to any material, which can be bought and sold. Commodities in a market‘s context refer to any movable property other than actionable claims, money and securities. Commodities represent the fundamental elements of utility for human beings. These commodities include gold, silver, copper, zinc, nickel, lead, aluminum, tin, energy, coffee, pepper, cashew, etc.

A commodity market is a marketplace for buying, selling, and trading raw materials or primary products. There are currently about 50 major commodity markets worldwide that facilitate trade in approximately 100 primary commodities. Commodities are often split into two broad categories: hard and soft commodities. Hard commodities include natural resources that must be mined or extracted—such as gold, rubber, and oil, whereas soft commodities are agricultural products or livestock—such as corn, wheat, coffee, sugar, soybeans, and pork.

Objectives of commodity market:

- Hedging with the objective of transferring risk related to the possession of physical assets through any adverse moments in price.
- Liquidity and price discovery to ensure minimum volume in trading of a commodity through market information and demand supply factors that facilities a regular price discovery mechanism.
- Maintaining buffer stock and better allocation of resources as it augments reduction in inventory requirement.
- Price stabilization along with balancing demand and supply position.

- Flexibility, certainty and transparency in purchasing commodities facilitate bank financing. Predictability in prices of commodity would lead to stability, which in turn would eliminate the risk associated with running the business of trading commodities.

Benefits/Role/functions of commodity market:

The primary objective of commodity exchange is authentic price discovery and an efficient price risk management. Apart from that following are the functions of commodity markets:

- **Price discovery**: Based on inputs regarding specific market information, the demand and supply equilibrium, inflation rates, Government policies, market dynamics, buyers and sellers conduct trading of future exchanges. This transforms in to continuous price discovery mechanism. The execution of trade between buyers and sellers leads to assessment of fair value of a particular commodity that is immediately disseminated on the trading terminal.

- **Price risk management**: Hedging is most common method of price risk management. It is strategy of offering price risk that is inherent in spot market by taking an equal but opposite position in the futures market. Future markets are used as a made by hedgers to protect their business from adverse price change.

- **Management of risk**: This is most important function of commodity derivatives. Risk management is not about the elimination of risk rather it is about the management of risk. Commodity derivatives provide a powerful tool for limiting risks that farmers and organizations face in the ordinary conduct of their businesses.

- **Efficiency in trading**: Commodity derivatives allow for free trading of risk components and that leads to improving market efficiency. Traders find commodity derivatives to be moreattractive instrument than the underlying security. This is mainly because of the greater amountof liquidity in the market offered by derivatives as well as the lower transaction costs associated with trading a commodity derivative as compared to the costs of trading the underlying commodity derivative as compared to the costs of trading the underlying commodity in cash market.
- **Speculation**: This is not the only use, and probably not the most important use, of commodityderivatives. Commodity derivatives are considered to be risky. If not used properly, these can lead to financial destruction in an organization.
- **Price stabilization function**: Commodity Derivatives market helps to keep a stabilizing influence on spot prices by reducing the short-term fluctuations. In other words, derivative reduces both peak and depths and leads to price stabilization effect in the cash market for underlying asset.
- **Improved product quality**: The existence of warehouses for facilitating delivery with grading facilities along with other related benefits provides a very strong reason to upgrade and enhances the quality of the commodity to grade that is acceptable by the exchange.
- **Useful to the producer:** Commodity trade is useful to the producer because he can get an idea of the price likely to prevail on a future date and therefore can decide between various competing commodities, the best that suit him.

History of Commodities Market

Commodities future trading was evolved from need of assured continuous supply of seasonal agricultural crops. The concept of organized trading in commodities evolved in Chicago, in 1848. But one can trace its roots in Japan. In 19th century Chicago in United States had merged as a major commercial hub. So that wheat producers from Mid-west attracted here to sell their produce to dealers and distributors. Due to lack of organized storage facilities, absence ofuniform weighing and grading mechanisms producers often confined to the mercy of dealers discretion. These situations lead to need of establishing a common meeting place for farmers and dealers to transact in spot grain to deliver wheat and receive cash in return. Gradually sellers and buyers started making commitments to exchange the produce for cash in future and thus contract for ―futures trading‖ evolved; Whereby the producer would agree to sell his produce to the buyer at a future delivery date at an agreed upon price. Trading of wheat in futures became very profitable which encouraged the entry of other commodities in futures market. This created a platform for establishment of a body to regulate and supervise these contracts. That‘s why Chicago Board of Trade (CBOT) was established in 1848. In 1870 and 18805 the New York Coffee, Cotton and Produce Exchanges were born. Agricultural commodities were mostly traded but as long as there are buyers and sellers, any commodity can be traded. In 1872, a group of Manhattan dairy merchants got together to bring chaotic condition in New York market to a system in terms 0f storage, pricing, and transfer of agricultural products. The largest commonly exchange in USA is Chicago Board of Trade, The Chicago Mercantile Exchange, the New York Mercantile Exchange, the New York Commodity Exchange and New York Coffee, sugar and cocoa Exchange. Worldwide there are major futures trading exchanges in over twenty countries including Canada, England, India, France, Singapore, Japan, Australia and New Zealand.

History Of Indian Commodity Market

Commodity futures markets largely remain underdeveloped in India. This is in spite of the country‗s long history of commodity derivatives trade as compared to the US and UK. A major contributor to this fact is the extensive government intervention in the agricultural sector in the post-independence era. In reality, the production and distribution of several agricultural commodities is still governed by the state and forwards as well as futures trading have only been selectively introduced with stringent regulatory controls. Free trade in many commodity items remains restricted under the Essential Commodities Act (ECA), 1955, and forwards as well as future contracts are limited to specific commodity items listed under the Forward Contracts (Regulation) Act (FCRA), 1952.

The evolution of the organized futures market in India commenced in 1875 with the setting up of the Bombay Cotton Trade Association Ltd. Following widespread discontent among leading cotton mill owners and merchants over the functioning of the Bombay Cotton Trade Association, a separate association, Bombay Cotton Exchange Ltd., was constituted in 1983. Futures trading in oilseeds originated with the setting up of the Gujarati Vyapari Mandali in 1900, which carried out futures trading in ground nuts, castor seeds and cotton. The Calcutta Hessian Exchange Ltd. and the East India Jute Association Ltd. were set up in 1919 and 1927 respectively for futures trade in raw jute. In 1921, futures in cotton were organized in Mumbai under the auspices of East India Cotton Association (EICA). Before the Second World War broke out in 1939, several futures markets in oilseeds were functioning in the states of Gujarat and Punjab. Futures markets in Bullion began in Mumbai in 1920, and later, similar markets were established in Rajkot, Jaipur, Jamnagar, Kanpur, Delhi and Calcutta. In due course, several other exchanges were established in the country, facilitating trade in diverse commodities such as pepper, turmeric, potato, Sugar and jaggery.

Post independence, the Indian constitution listed the subject of Stock Exchanges and Future Markets under the union list. As a result, the regulation and development of the commodities futures markets were defined solely as: responsibility of the central government. A bill on forward contractswas referred to an expert committee headed by Prof. A.D. Shroff and selected committees of the successive parliaments and finally, in December 1952, the Forward Contrami (Regulation) Act was enacted. The Forward Contracts (Regulation) rules were notifies by the central government in 1954. The futures trade in spices was first organized by the India Pepper and Spices Trade Association (IPSTA) in Cochin in 1957. However in order to monitor the price movements of several agricultural and essential commodities, futures trade was completely banned by the governmentin 1966. Subsequent totheban of futurestrade, many traders resorted to unofficial and informal trade in futures. However, in India_s liberalization epoch as per the JunQ 1980 Khusro committee_s recommendations, the government reintroduced futures on selected commodities, including cotton, jute, potatoes, etc.

Following the introduction of economic reforms in 1991, the Government of India appointed an expert committee on forward markets under the chairmanship of Prof. KN. Kabra in June 1993. The committee submitted its report in September 1994, championing the reintroduction of futures, which were banned in 1966, and expanding its coverage to agricultural commodities, along with silver. In order to boost the agricultural sector, the National Agricultural Policy 2000 envisaged external and domestic market reforms and dismantling of all controls and regulations in the agricultural commodity markets. It also proposed an expansion of the coverage of futures markets to minimize the wide fluctuations in commodity prices and for hedging the risk arising from extreme price volatilities.

Participants in Commodity Derivative market

The participants in commodity market can be classified as follows:

1. **Hedgers:** Hedgers are participants who use commodity derivatives instruments to hedge the price risk associated with the underlying commodity asset held them. Hedgers are those who protect themselves from the risk associated with the price of an asset by using derivatives. A person keeps a close watch upon the prices discovered in trading and when the comfortable price is reflected according to his wants, he sells futures contracts.

2. **Speculators:** Speculators are those who may not have an interest in the ready contracts, etc. but see an opportunity of price movement favorable to them. They provide depth and liquidity to the market. They provide a useful economic function and are integral part of the futures the market. It would not be wrong to say that in absence of speculators the market will not liquid and it may at times collapse.

3. **Arbitrageurs:** Arbitrage refers to the simultaneous purchase and sale in two markets so that the selling price is higher than the buying price by more than the transaction cost, resulting in risk-less profit.

4. **Investors:** investors are participants having a longer-term view as compared to speculators when they enter into trade in the commodities market. Ex. Farmers, producers, consumers etc.

Transactions in Commodity Market

There are different types of transactions traded in commodity market.

1. **Spot contracts:** Market where commodities are bought and sold in physical form by paying cash is a spot market. The price on which commodities are traded in this market is called spot price. For example, if you are a farmer or dealer of Chana and you have physical holding of 10 kg of Chana with you which you want to sell in the market. You can do so by selling your holdings in either of the three commodities exchanges in India in spot market at the existing market or spot price.
2. **Future contracts:** The market where the commodities are bought and sold by entering into contract to settle the transaction at some future date and at a specific price is called futures market. The unique feature of futures market is that you do not have to actually hold the commodities in physical form or for that matter take the delivery in physical form. Every transaction is settled on cash basis.
3. **Forward contracts:** A forward contract is a customized contract between two parties to buy or sell an asset at a specified price on a future date. A forward contract can be used for hedging or speculation, although its non-standardized nature makes it particularly apt for hedging.
4. **Options:** options are also financial instruments used for hedging and speculation. The commodity option holder has the right, but not the obligation, to buy or sell a specific quantity of a commodity at a specified price on or before a specified date. There are two types of options: calls and puts.

Calls give the buyer the right, but not the obligation, to buy the underlying asset at the strike price specified in the option contract. Investors buy calls when they believe the price of the underlying asset will increase and sell calls if they believe it will decrease. **Puts** give the buyer the right, but not the obligation, to sell the underlying asset at the strike price specified in the contract. The writer (seller) of the put option is obligated to buy the asset if the put buyer exercises their option. Investors buy puts when they believe the price of the underlying asset will decrease and sell puts if they believe it will increase.

Examples of Commodities Market

1. MCX

The Multi Commodity Exchange of India Limited (MCX) is India‘s first commodity derivatives exchange that facilitates online trading of commodity derivatives transactions, thereby providing a platform for price discovery and risk management. MCX is an independent Indian government owned commodity exchange based in India. It is India's largest commodity derivatives exchange.

MCX offers trading in commodity derivative contracts across varied segments including bullion, industrial metals, energy and agricultural commodities, as also on indices constituted from these contracts. It is India‘s first Exchange to offer commodity options contracts, bullion index futures and base metals index futures contracts. The Exchange‘s flagship index series, MCX iCOMDEX, is a series of real-time commodity futures price indices, which give information on market movements in key commodities/ segments traded on MCX. The MCX iCOMDEX series consists of a Composite index, apart from three sectoral indices: the Base Metal index, the Bullion index and the Energy index, and also nine single-commodity indices: Gold, Silver, Aluminum, Copper, Lead, Nickel, Zinc, Crude Oil and Natural Gas indices.

2. NCDEX

National Commodity & Derivatives Exchange Limited (NCDEX) (NCDEX/the Exchange) is a leading agricultural commodity exchange in India. It is privately owned. It has an independent board of directors and provides a commodity exchange platform for market participants to trade in commodity derivatives. It is a public limited company, incorporated on 23 April 2003 under the Companies Act, 1956 and obtained its Certificate for Commencement of Business on 9 May 2003. It commenced operations on 15 December 2003.

As of 31 July 2013, NCDEX has 848 registered members and client base of about 20 Lakhs and offers trading on more than 49,000 terminals across 1,000 centers in India. It facilitates deliveries of commodities through a network of over 594 accredited warehouses through eight warehouse service providers, with holding capacity of around 1.5 million tones and offers average deliveries of 1 lakh MT at every contract expiry. NCDEX has offices in Mumbai, Delhi, Ahmedabad, Indore, Hyderabad, Jaipur, and Kolkata.

3. ICEX

Indian Commodity Exchange Limited or ICEX is a SEBI regulated online Commodity Derivative Exchange, headquartered at Mumbai. ICEX provides a nationwide trading platform through its appointed brokers for commodity trading in India. The Indian Commodity Exchange Limited (ICEX) started its operation in August 2017. After a year, on August 28 2018, the exchange launched its steel long contract. In2018-2019, the National Company Law Tribunal (NCLT) sanctioned the amalgamation of the NMCE with ICEX. (National Multi Commodity Exchange of India Limited with Indian Commodity Exchange Limited).

Functions of Commodity Market

1. Providing a market place:

A commodity market provides a convenient place where the members can meet at fixed hours and transact business in a commodity according to a certain well-established rules and regulations. This type of facility is very important for trading in such commodities as are produced in abundance and cover a very wide field as far as trading therein is concerned.

2. Regulating trade:

As organised markets commodity exchanges establish and enforce rules and regulations with a view to facilitating trade on sound lines. The rules define the duties of members and lay down methods for business transaction.

3. Collecting and disseminating market information:

The buyers and sellers on the commodity exchange enter into deals for settlement in future after making an assessment the trends of price and the prospects of a rise or fall in prices of a commodity. The commodity exchange acts as an association of these traders collecting the necessary information and the relevant statistical data and publishing it for the benefit of traders all over the country.

4. Grading of commodities:

Commodities which are traded on the commodity exchanges have, to be graded according to quality. In this manner, the dealers can quickly enter into agreements for the purchase and sale of commodities by description.

5. Settling disputes:

Since its trade and there are various parties involved, there is definitely chance for disputes. The commodity exchange provides machinery for the arbitration of trade disputes.

Commodity Qualification for Trading on Exchange

Initially, in the 19th century, the exchanges were in use for trading agricultural products such as wheat, corn, cattle. Today, commodity markets have evolved and offered a wider range of products. Generally traded commodities on the exchange are:

- Natural soil produces such as cotton, jute, tea, etc.
- Manufactured products such as artificial jams, hides, gunny bags and so on.
- Mineral products such as lead, crude, mica, gold, silver, and others.

Not all the commodities are fit for trading on the commodity exchange. There are a few characteristics that a commodity should possess to qualify for trade on the exchange. These characteristics are:

- **Durability** – since the expiry of the contracts can be extended up to one year, the commodities should have a longer shelf life. Goods that can perish quickly can‘t have long term contracts, and therefore, traders can‘t trade them on the commodity exchange.
- **Homogeneity** - all units of a commodity must be the same. This ensures that the dealers meant the same commodity when they talk about it in their dealings.
- **Price Fluctuation** - the price of the product should have frequent fluctuations in order to be fit for trading. If the price remains steady for most of the time, the speculators would have only little to gain from trading it on the exchange.
- **Gradeability** - if it becomes difficult to categorize the product into well-defined grades, then trading it on the exchange becomes challenging. If there is no grading

before, then the quality of the commodity will have to be ascertained each time before trading.

- **Open Supply** - there should not be a monopolized market for the commodity, either Government or any private party. If it is so, it will only make trading impossible on the exchange.

Regulatory framework for Commodity Derivatives Market

Regulation is needed to ensure fairness and transparency in trading, clearing, settlement and management of the market institutions including stock exchanges, clearing corporations, and broking houses, and also to maintain the integrity of the marketplace, so as to protect and promote the interest of various stakeholders and investors.

Securities and Exchange Board of India (SEBI) regulates the commodity derivatives market in India since September 28, 2015. Before September 28, 2015, the Commodity derivatives market was regulated by erstwhile Forward Markets Commission (FMC). The Forward Markets Commission (FMC) was the chief regulator of commodity futures markets in India. As of July 2014, it regulated Rs 17 trillion worth of commodity trades in India. It is headquartered in Mumbai and this financial regulatory agency is overseen by the Ministry of Finance. The Commission allows commodity trading in 22 exchanges in India, of which 6 are national. On 28 September 2015 the FMC was merged with the Securities and Exchange Board of India (SEBI) to make the regulation of commodity futures market strong.

Currently the regulatory framework for commodity derivatives market comprises of Government of India, Securities and Exchange Board of India SEBI and SEBI recognised stock exchanges/ clearing corporations which also perform supervisory functions over their members. The

Commodity Derivatives Market Regulation Department is responsible for supervising the functioning and operations of Commodity Derivative Segments of Recognized Stock Exchanges/Recognized Clearing Corporations.

General Mechanism of Commodity Market

Every market transaction consists of three components- Trading, clearing and settlement. Below is given a brief overview of how transaction happen on the commodity market / commodity exchanges:

1. **Trading**: The trading system on the commodity exchanges, provides a fully automated screen-based trading for futures on commodities on a nationwide basis as well as an online monitoring and surveillance mechanism. It supports an order driver market and provides complete transparency of trading operations. The trade timings of the commodity exchanges are 10.00 am to 4.00 p.m. After hours trading has also been proposed for implementation at a later stage. The commodity exchanges system supports an order driven market, where orders match automatically. Order matching is essentially on the basis of commodity, its price, time and quantity. All quantity fields are in units and price in rupees. The exchange specifies the unit of trading and the delivery unit for futures contracts on various commodities. The exchange notifies the regular lot size and tick size for each of the contracts traded from time to time. When any order enters the trading system, it is an active order. It tries to find a match on the other side of the book. If it finds a match, a trade is generated. If it does not find a match, the order becomes passive and gets queued in the respective outstanding order book in the system. Time stamping is done for each trade and provides a possibility for a complete audit trail if required. Commodity exchanges trades commodity futures contracts having one,

month, two month and three-month expiry cycles. All contracts expire on the 20th of the expiry month. Thus a January expiration contract would expire on the 20th of January and a February expiry contract would cease trading on the 20th February. If the 20th of the expiry month is a trading holiday, the contracts shall expiry on the previous trading day. New contracts will be introduced on the trading day following the expiry of the near month contract.

2. **Clearing**: National securities clearing corporation limited (NSCCL) under takes clearing of trades executed on the commodity exchanges. The settlement guarantee fund is maintained and managed by commodity exchanges. Only clearing members including professional clearing members (PCMs) only are entitled to clear and settled contracts through the clearing house. At commodity exchanges, after the trading hours on the expiry date, based on the available information, the matching for deliveries takes place firstly, on the basis of location and then randomly keeping view the factors such as available capacity of the vault/ warehouse, commodities, already deposited and dematerialized and offered for delivery etc. matching done by this process binding on the clearing members. After completion of the matching process, clearing members are informed of the deliverable / receivable positions and unmatched positions. Unmatched positions have to be settled in cash. The cash settlement is only for the incremental gain/ loss as determined on the basis of final settlement price.

3. **Settlement**: Futures contracts have two types of settlements, the MTM settlement which happens on a continuous basis at the end of each day, and the final settlement which happens on the last trading day of the futures contracts. On the commodity exchanges, daily

MTM settlement and final MTM settlement in respect of admitted deals in futures contracts are cash settled by debiting/ crediting the clearing accounts of CMs with the respective clearing bank. All positions of a CM, either brought forward, credited during the day or closed out during the day, are market to market at the daily settlement price or final settlement price at the close of trading hours on a day. On the date of expiry, the final settlement price is the spot price on the expiry day. The responsibility of settlement is on a trading cum clearing members for all traders done on his own account and his client‘s trades. A professional clearing member is responsible for selling all the participants traders trades which he has confirmed to the exchange. On the expiry date of a futures contract‘s members submit delivery information through delivery request window on the traders‘ workstations provided by commodity exchanges for all open positions for a commodity for all constituents individually commodity exchanges on receipt of such information, matches the information and arrives at a delivery position for a member for a commodity. The seller intending to make delivery takes the commodities to the designated warehouse. These commodities have to be assayed by the exchange specified assayed. The commodities have to meet the contracts specifications with allowed variances. If the commodities meet the specifications, the warehouse accepts them. Warehouse then ensures that the receipts get updated in the depository system giving a credit in the depositors‘ electronic account. The seller then gives the invoice to his clearing member, who would courier the same to the buyer‘s clearing member. On an appointed date, the buyer goes to the warehouse and takes physical possession of the commodities.

International Commodity Market

Trading commodities goes back to the dawn of human civilization as tribal clans and newly established kingdoms would barter and trade with one another for food, supplies, and other items. Trading commodities indeed predates that of stocks and bonds by many centuries. The rise of empires such as ancient Greece and Rome can be directly linked to their ability to create complex trading systems and facilitate the exchange of commodities across vast swaths via routes like the famous Silk Road that linked Europe to the Far East. Today, commodities are still exchanged throughout the world and on a massive scale. Things have also become more sophisticated with the advent of exchanges and derivatives markets, Exchanges regulate and standardized commodity trading, allowing for liquid and efficient markets.

The major exchanges in the U.S., which trade commodities, are domiciled in Chicago and New York with several exchanges in other locations within the country.

- The Chicago Board of Trade (CBOT) was established in Chicago in 1848. Commodities traded on the CBOT include corn, gold, silver, soybeans, wheat, oats, rice, and ethanol.
- The Chicago Mercantile Exchange (CME) trades commodities such as milk, butter, feeder cattle, cattle, pork bellies, lumber, and lean hogs.
- The New York Board of Trade (NYBOT) commodities include coffee, cocoa, orange juice, sugar, and ethanol trading on its exchange. The New York Mercantile Exchange (NYMEX) trades commodities on its exchange such as oil, gold, silver, copper, aluminum, palladium, platinum, heating oil, propane, and electricity.
- The London Metal Exchange and Tokyo Commodity

Exchange are prominent international commodity exchanges.

In the U.S., the Commodity Futures Trading Commission (CFTC) regulates commodity futures and options markets. The CFTC's objective is to promote competitive, efficient, and transparent markets that help protect consumers from fraud and unscrupulous practices. The CFTC and related regulations were designed to prevent and remove obstructions on interstate commerce in commodities by regulating transactions on commodity exchanges. For example, regulations look to limit, or abolish, short selling and eliminate the possibility of market and price manipulation, such as cornering markets.

Debt Market

Debt market is a market for the issuance, trading and settlement in debt securities of various types. It is also known as the bond, credit, or fixed income market. Debt securities are one of the most innovative and dynamic instruments evolved in the financial system ever since the inception of money. Fixed Income securities personify the essence of innovation and transformation, which have fueled the explosive growth of the financial markets over the past few centuries. Fixed income securities can be issued by a wide range of organizations including the Central and State Governments, public bodies, statutory corporations, banks and institutions and corporate bodies.

The main instruments in this market are dated securities that include floating rate bonds (FRBs), zero coupon bonds (ZCBs), treasury bills (T-bills) and the state Government bonds. The corporate debt segment on the other hand includes bonds issued by private corporates, public sector units (PSUs) and development financial institutions (DFIs).

Features of Debt Market

- It is competitive in nature, as number of participants is large
- Strong and safe market, as gov. securities are traded
- Substantially low transaction cost relative to equity & money market
- Volume of transaction is huge, relative to equity market
- Heterogeneous in nature, as a result of different types of participants

Major Participants

Prominently Government, Primary dealers, Mutual Fund Firms, Provident Fund Houses, Foreign Institutional Investors, Commercial Banks, Insurance Companies and charitable Institutions are the participants of debt market.

Regulations

As debt market trade both government and corporate debt instruments, there are 2 regulating bodies: -

1. RBI - It regulates and also facilitates the government bonds and other securities on behalf of governments. RBI is also responsible for the regulations of money market segment of the debt products like commercial papers and certificate of deposits.
2. SEBI - It regulates corporate bonds, both PSU (Public sector undertaking) and private sector.

Functions or importance of Debt Market

The debt market allows government to raise money to finance the development activities of the government. It plays an important role in efficient mobilisation and allocation of resources in the economy. Since the government securities are issued to meet the short term and long-term financial needs of the government, they are not only used as instruments for raising debt, but have emerged as key instruments for internal debt management, monetary management and short-term liquidity management. The debt market also provides greater funding avenues to public-sector and private sector projects and reduce the pressure on institutional financing. It also enhances mobilization of resources by unlocking liquid retail investments like gold.

Types of Debt Market Instruments

1. Government Securities

These are the debt instruments issued by RBI. These securities have a maturity period of 1 to 30 years. G-Secs offer fixed interest rate, where interests are payable semi-annually. The yield of Government securities is mostly considered as a benchmark for return and are even considered as a risk-free rate. For shorter term, there are Treasury Bills or T-Bills, which are issued by the RBI for 91 days, 182 days and 364 days. Long term Government securities include instruments like Dated Securities or Bonds.

2. Bonds

Bonds are mainly of two types, i.e. Government Bonds and Corporate Bonds. Government Bonds holds less risk than Corporate Bonds. Mostly, Corporate Bonds pay a higher interest rate than Government Bonds. There are other Bonds like Municipal Bonds and Institutions Bonds. The Bonds have a fixed coupon rate and pay that interest to the bondholder periodically. And also repay the principal amount at the time of maturity. The interest rates of bonds are variable in the case of Floating Rate Bonds. Floating Rate Bonds provide a variable interest rate that fluctuates according to the changes in the interest rates in the economy. Fixed-Rate Bonds gives fixed interest rates, irrespective of any market changes. There are Zero-Coupon Bonds, which does not provide any interest rate periodically or at the time of redemption.

3. Debentures

Debentures are similar in nature to Bonds; the only difference is the security level. Debentures are riskier in nature. Not only this, Bonds can be issued by the Government and Companies, but

Debentures can only be issued by Companies. Debentures can be of different types, which are as follows:-

i. Registered Debentures and Bearer Debentures

The Registered Debenture is there in the company‘s records. The names of the debt holders and other details are recorded in the company and the repayment of the debenture is made to that particular name only. These debentures are transferable but need to complete the transfer process. Recording of Bearer Debentures does not take place. The issuer of the Debenture is entitled to make the repayment of the bond amount to whoever holds the debenture certificate.

ii. Secured Debentures and Unsecured Debentures

Secured Debentures are backed by collateral security. The Unsecured Debentures have no backing of any collateral security. Secured are less risky in comparison to the Unsecured ones.

iii. Redeemable Debentures and Non-Redeemable Debentures

Redeemable Debentures are repaid at the time of maturity only. Repayment of Non-Redeemable Debentures takes place at the time of liquidation only

iv. Convertible Debentures and Non-Convertible Debentures

Convertible Debentures can be converted into equity shares on a future date. Non- Convertible Debentures cannot be converted into equity shareholders on any future date.

Risk Included in the debt market

Default Risk: This can be defined as the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security or to otherwise comply with the provisions of a bond indenture and is also referred to as credit risk.

Interest Rate Risk: can be defined as the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments. A good case would be an upswing in the prevailing interest rate scenario leading to a situation where the investors‘ money is locked at lower rates whereas if he had waited and invested in the changed interest rate scenario, he would have earned more.

Reinvestment Rate Risk: can be defined as the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market. The following are the risks associated with trading in debt securities.

Counter Party Risk: is the normal risk associated with any transaction and refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale value at the time of settlement.

Price Risk: refers to the possibility of not being able to receive the expected price on any order due to an adverse movement in the prices.

Advantages of Debt Market

- The debt market capitalizes and mobilizes the funds in the economy.
- This market gives a platform to the government,

companies, and other bodies to raise funds.

- Sometimes raising equity becomes very costly for the corporate. In such a situation raising money through the debt market is the best possible option.
- This market gives fixed returns to investors with lesser risk. Government Debt Market securities are less risky than Corporate Debt securities.
- In absence of any other sources of finances, the Central/State Government takes the help of this market. It saves the Government bodies, from suffering from any cash crunch.
- Debt Market securities backed by assets get the preference as compared to other unsecured and business debts, at the time of liquidation.
- The money raised through this market helps the companies to boost its expansion and growth plans.
- The debt market helps the Government authority to boost infrastructural projects.

Disadvantages of Debt Market

- One of the biggest disadvantages of this market is that it provides fixed returns to the investors and completely ignores the inflation rate. The inflation can make the actual return falls down to a record low.
- The second disadvantage is, in the case of premature withdrawal or sell-off in the market, the investor gets the current market bond's price and not the principal amount invested. It is possible that the company might lose its credibility and the bond prices might have fallen down.
- The investors will get a fixed interest rate return only, irrespective of an increase in the interest rate in the market.

- For issuing authority, it becomes very difficult to get a good credit rating. This becomes the biggest task to meet all requirements of credit rating agencies.

Benefits of a developed corporate bond market in India

Corporate bonds would work towards de-stressing banks of the latter‘s prospective NPAs. It has been observed over time that companies have relied on opaque bank financing of big-ticket long- gestation projects. It results in the untoward build-up of huge non-performing assets (NPAs) negatively affecting banking. Another aspect which gives an edge to the companies over banks in redeeming the money lent to the borrower company lies in the fact that the level of due-diligence into the repayment capacity of the borrower, is higher in case of companies than in case of banks.

In India, given the absence of a well-functioning corporate bond market, the burden of financing infrastructure projects such as roads, ports, and airports are more on banks and the general government. This, in turn, puts lenders such as the banks under pressure as reflected in the ballooning of bad loans. For instance, in banks, such investments create an asset-liability mismatch. In other words, they are buying into long-term assets, such as a highway, with short term liabilities, that is deposits of three- to five-year maturities.

An efficient corporate bond market would help companies to raise capital in the primary market and help investors to trade in and out of risks in the secondary market. A fully functioning corporate bond market would have the following advantages:

Wider investor base: A well-developed corporate bond market allows a wider investor base to access the market, with each investor holding a smaller proportion of the total risk. The diversity of investors implies less risk of capital erosion as the number of investors/lenders are numerous unlike the present scenario where much of the corporate finance is provided for by the banks as lenders, and in case the borrowing company defaults on payment, the load of non-redemption does not fall on just one lender alone as it does in case of taking a loan from the bank to raise finances by the borrowing company.

Multiplicity of Investment Options: At present, apart from equity and several deposit schemes in banks, and other financial companies, an opportunity to invest in corporate bonds ensures widening of investment options. This option could ensure good returns especially in times where equities fail to deliver promising returns in times of economic distress. In addition, it furthers the said cause by developing the economy of the nation.

Challenges for the development of the Debt Market

- **Lack of high rated companies and transparency issues**

There are only a few corporate entities in the region which are capable of meeting investor requirements in terms of transparency and governance standards. This has resulted in a yawning gap between demand for and supply of corporate bonds in Asia causing outflow of capital in search of greener pastures for safety and higher returns. Corporate governance and disclosure standards available in these countries do not provide enough confidence to investors to go in for investments in bonds, as unlike banks, bond investors will be widely dispersed and therefore will have less bargaining power.

- **Absence of Corporate Bond Indices**

As against equity, there is no bond index which enables real time monitoring of the corporate bond market in India. Such an index/indices shall foster transparency to the rates at which bonds are issued to the lenders, thereby increasing investor/lender confidence in the genuineness of the bonds they are putting their money into. Having an index is extremely useful in the development of any security as an investment option, as can be inferred from the development that the equity market has had in India over the past few decades. From being an underdeveloped equity market until the 1980‘s, India emerged as the best performing equity market in the world, in 2020.

A large contribution to this tremendous growth shown by India has to be credited to the equity indices, which helped India to gauge its progress and rewire its strategy whenever the equity market took a beating.

- **Absence of a Dedicated Regulatory Body**

At present, the government bond market is regulated by the Reserve Bank of India (RBI) and the corporate bond market is regulated by the Securities and Exchange Board of India (SEBI). However, SEBI is already overworked in being the watchdog of the equity market In India, where an equity scam surfaces up in every few days. SEBI being the watchdog of the already developed equity market in India, cannot be expected to work with full efficiency towards the development and moreover, the regulation of the underdeveloped Corporate Bond Market in India.

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UNIT III
FINANCIAL INSTRUMENTS

A financial instrument is a lawful agreement which involves some monetary value. Financial instruments have unique characteristics and structure. In other words financial instruments are contracts for monetary assets that can be purchased, traded, created, modified, or settled for. In terms of contracts, there is a contractual obligation between involved parties during a financial instrument transaction.

Financial instruments can be classified as

A. Cash Instruments

B. Derivative Instruments

C. Foreign Exchange Instruments

A. Cash Instruments:

Cash instruments are financial instruments with values directly influenced by the condition of the markets. Within cash instruments, there are two types; securities and deposits, and loans.

i. Securities: A security is a financial instrument that has monetary value and is traded on the stock market. When purchased or traded, a security represents ownership of a part of a publicly-traded company on the stock exchange.

ii. Deposits and Loans: Both deposits and loans are considered cash instruments because they represent monetary assets that have some sort of contractual agreement between parties.

B. Derivative Instruments

Derivative instruments are financial instruments that have values determined from underlying assets, such as resources, currency, bonds, stocks, and stock indexes. The five most common examples of derivatives instruments are synthetic agreements, forwards, futures, options, and swaps. This is discussed in more detail below.

i. Synthetic Agreement for Foreign Exchange (SAFE): A SAFE occurs in the over-the-counter (OTC) market and is an agreement that guarantees a specified exchange rate during an agreed period of time.

ii. Forward: A forward is a contract between two parties that involves customizable derivatives in which the exchange occurs at the end of the contract at a specific price.

iii. Future: A future is a derivative transaction that provides the exchange of derivatives on a determined future date at a predetermined exchange rate.

iv. Options: An option is an agreement between two parties in which the seller grants the buyer the right to purchase or sell a certain number of derivatives at a predetermined price for a specific period of time.

v. Interest Rate Swap: An interest rate swap is a derivative agreement between two parties that involves the swapping of interest rates where each party agrees to pay other interest rates on their loans in different currencies.

C. Foreign Exchange Instruments

Foreign exchange instruments are financial instruments that are represented on the foreign market and primarily consist of currency agreements and derivatives. In terms of currency agreements, they can be broken into three categories-

i. Spot: A currency agreement in which the actual exchange of currency is no later than the second working day after the original date of the agreement. It is termed ―spot‖ because the currency exchange is done ―on the spot‖.

ii. Outright Forwards: A currency agreement in which the actual exchange of currency is done ―forwardly‖ and before the actual date of the agreed requirement. It is beneficial in cases of fluctuating exchange rates that change often.

iii. Currency Swap: A currency swap refers to the act of simultaneously buying and selling currencies with different specified value dates.

Primary Market

The primary market is a segment of the capital market where entities such as companies, governments and other institutions obtain funds through the sale of debt and equity-based securities.

When a company decides to go public for the first time by raising an Initial Public Offering (IPO), it is done in the primary market. Since the securities are sold for the first time here, a primary market is also known as the New Issue Market (NIM).

Functions of Primary Market

- **New Issue Offer**

This is one of the major primary market functions. It is this market that organises offering of a new issue, which has not been traded on any other exchange before. It‗s because of this reason that the primary market is also called new issue market.

There‗s a lot that goes into issuing a new offer. It involves a detailed assessment of the viability of a project and among the financial arrangement for the purpose involves taking into consideration the promoter‗s debt-equity ratio, liquidity ratio, and equity ratio, among others.

- **Underwriting Services**

One of the most important and vital aspects of offering a new issue offer is underwriting. The role of an underwriter in the primary marketplace is to buy unsold shares. Often financial institutions play the role of underwriters, earning a commission in the process. Often investors depend on underwriters to gauge whether undertaking the risk would be worth the returns. It may also happen that the underwriter buys the entire IPO issue, subsequently selling it to investors.

- **Distribution of New Issue**

This is another vital function of primary market. The distribution process is initiated with a new prospectus issue. The public is invited at large to purchase the new issue, and detailed information is given on the company and the issue along with the underwriters.

Types of Issuances in the Primary Market

Once securities are issued, investors can purchase them in various ways in the primary market. They are:

- **Public Issue**

It is one of the most common methods of issuing securities to the public at large. Done primarily through an initial public offering (IPO) whereby companies raise capital for business, the securities are then listed on the stock exchange for trading. One of the features of the primary market is that a private limited company can become a publically-traded entity through IPO. The capital raised by a company can also be deployed to improve the firm‘s existing infrastructure and repay debts, among others. It also improves a company‘s liquidity. The Securities and Exchange Board of India (SEBI) is the watchdog that monitors IPO, and before a firm goes for an IPO, proper enquiry is done to establish its authenticity.

- **Private Placement**

Private placement happens when a company offers securities to a small group of investors. These primary securities may be stocks, bonds, or any other type of security. In private placement, investors can be either institutional or individual. It‘s easy to issue private placement compared to an IPO as the regulatory norms are significantly less. Also, it incurs reduced cost and time. Private placement is more suitable for companies that have just commenced operations and are in their formative years.

- **Preferential Issues**

It is one of the quickest methods through which companies can raise capital for their business. Here, both listed and unlisted companies can issue securities to a particular select group of investors. It is essential to note that preferential issues are neither public nor rights issue. In this type of issue, preference shareholders are paid dividends before ordinary shareholders.

- **Qualified Institutional Placement**

It is another type of fundraising tool used by listed companies to raise capital by issuing primary securities to qualified institutional buyers (QIBs). Capital market regulator SEBI introduced it to make it easier for companies to raise capital in the domestic market. Note that QIBs are investors who have the requisite expertise and financial knowledge to invest in the capital markets. They are generally foreign institutional investors registered with SEBI, public financial institutions, and scheduled commercial banks, among others.

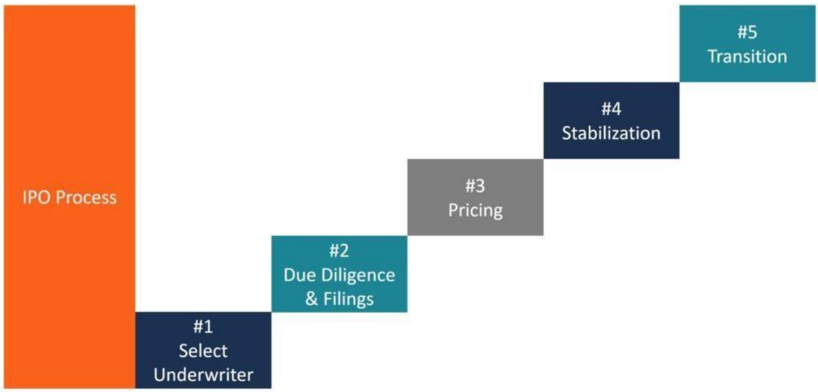
- **Rights and Bonus Issues**

This is another type of issuance in the primary market. Here the company issues securities to existing investors by allowing them to buy more securities at a pre-fixed price (in case of rights issue) and avail allotment of extra shares in the case of bonus issue. In case of rights issue, investors have the choice of purchasing stocks at a discounted price within a specific period. On the other hand, in the case of bonus issue, a firm's stocks are issued to its existing shareholders.

Initial Public Offerings

A corporate may raise capital in the primary market by way of an initial public offer, rights issue or private placement. An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is the largest source of funds with long or indefinite maturity for the company.

The IPO Process



Step 1: Select an investment bank

The first step in the IPO process is for the issuing company to choose an investment bank to advise the company on its IPO and to provide underwriting services. The investment bank is selected according to its reputation, quality of research, industry expertise, distribution reach, prior relation with the bank etc.

Step 2: Due diligence and regulatory filings

Underwriting is the process through which an investment bank (the underwriter) acts as a broker between the issuing company and the investing public to help the issuing company sell its initial set of shares. The following underwriting arrangements are available to the issuing company:

Firm Commitment: Under such an agreement, the underwriter purchases the whole offer and resells the shares to the investing public. The firm commitment underwriting arrangement guarantees the issuing company that a particular sum of money will be raised.

Best Efforts Agreement: Under such an agreement, the underwriter does not guarantee the amount that they will raise for the issuing company. It only sells the securities on behalf of the company.

All or None Agreement: Unless all of the offered shares can be sold, the offering is canceled.

Syndicate of Underwriters: Public offerings can be managed by one underwriter (sole managed) or by multiple managers. When there are multiple managers, one investment bank is selected as the lead or book-running manager. Under such an agreement, the lead investment bank forms a syndicate of underwriters by forming strategic alliances with other banks, each of which then sells a part of the IPO. Such an agreement arises when the lead investment bank wants to diversify the risk of an IPO among multiple banks.

The underwriter then drafts an engagement letter, letter of intent, underwriting agreement, the prospectus and Red Herring Document.

Step 3: Verification by SEBI

Market regulator, SEBI then verifies the disclosure of facts by the company. If the application is approved, the company can announce a date for its IPO.

Step 4: Making an Application to The Stock Exchange

The company now has to make an application to the stock exchange for floating its initial issue.

Step 5: Pricing

After the IPO is approved by the SEC, the effective date is decided. On the day before the effective date, the issuing company and the underwriter decide the offer price (i.e., the price at which the shares will be sold by the issuing company) and the precise number of shares to be sold. Deciding the offer price is important because it is the price at which the issuing company raises capital for itself.

The price can be determined by either through Fixed Price IPO or by Book Binding Offering. In the case of Fixed Price Offering, the price of the company‘s stocks is announced in advance.

Book Building Process

Book Building is a process undertaken by which a demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document. Book Building is basically a process used in Initial Public Offer (IPO) for efficient price discovery. It is a mechanism where, during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date.

The book building process comprises these steps:

1. The issuing company hires an investment bank to act as an underwriter who is tasked with determining the price range the security can be sold for and drafting a prospectus to send out to the institutional investing community.
2. The investment bank invites investors, normally large-scale buyers and fund managers, to submit bids on the number of shares that they are interested in buying and the prices that they would be willing to pay.
3. The book is 'built' by listing and evaluating the aggregated demand for the issue from the submitted bids. The underwriter analyzes the information and uses a weighted average to arrive at the final price for the security, which is termed the cutoff price.
4. The underwriter has to, for the sake of transparency, publicize the details of all the bids that were submitted.
5. Shares are allocated to the accepted bidders.

Step 6: Final Allotment of Shares

Once the IPO price is finalised, the company along with the underwriters will determine the number of shares to be allotted to each investor. In the case of over-subscription, partial allotments will be made. The IPO stocks are usually allotted to the bidders within 10 working days of the last bidding date.

Buy Back of Shares

A buyback of shares is buying back of own shares by a company that was issued earlier. It is a corporate action event wherein a company makes a public announcement for the buyback offer to acquire the shares from existing shareholders within a given timeframe. The buyback of shares is also known as a stock buyback or repurchase of shares. The company announces an offer price for the buyback that is generally higher than the current market price.

Reasons for Buyback of shares

There are several reasons associated with it that urge a company to announce a buyback:

- **Undervalued stock**

This is one of the main reasons why companies opt to buy back their shares. When the management feels that their stock is undervalued, they adopt the buyback route to rectify the stock price. The stock buyback reduces the number of shares in the market and thus gives a price boost to the remaining shares in the market.

- **Excess Cash with not many projects' opportunities**

A company with free reserves in hand but not many project opportunities would prefer to go for a buyback. The company would use the cash to reward the shareholders rather than keeping it idle in the bank account over the required amount.

- **Tax-efficient method of rewarding shareholders**

The dividends get taxed at two levels. First, at the company level and a second time in the hands of the shareholders. However, in the case of a buyback, only the company is liable to pay a buyback tax. The capital gains tax on the income from the buyback of shares is exempted for the investor. Thus, buybacks prove to be a more tax-effective way of distributing rewards to the shareholder.

- **Strengthen promoter holding in the company**

The company promoters can increase its stake in the company by forfeiting the buyback offer. This strengthens their hold over the company and acts as a defense strategy in the case of hostile takeovers.

- **To achieve optimum capital structure**

The capital structure of a company gets represented by its debt-equity ratio. Each industry has a different capital structure requirement. Some industries may not be suitable to rely on more debts, whereas some other business models may require large debts to run their business. Thus, as per the company requirement, a company may opt for buyback as a tool and repurchase its equity from the market to achieve an optimum capital structure.

Buyback of shares methods

SEBI Buyback Regulations prescribe three methods of buyback of shares in India. A company can buy back the securities through any one of the following modes:

- **Buyback of shares through tender offer**

In a tender offer, the company buys back its shares from the existing shareholders at a fixed price on a proportionate basis within a given time frame. The company issues a letter of offer and Tender Form to all the eligible shareholders on the company records as on the buyback record date. All the eligible shareholders who hold the shares either in physical form or Demat can participate in the buyback offer.

- **Buyback of shares through open market**

In the case of buyback of shares from open market, a company can do so either through the stock exchange or the book-building process. In the case of buyback from the open market through the Stock Exchange mechanism, a company can buy back the shares only on the stock exchanges having nationwide trading terminals via an order matching mechanism. The promoters are not allowed to participate in the open market offers through the stock exchange. All other shareholders holding Equity shares of the company can participate in this offer.

- **Buyback of shares from Odd-lot holders**

In the case of buyback from the odd-lot holders, the company buys directly from the odd-lot shareholders by approaching them. An odd lot holder is a shareholder with shares lesser than the marketable lots as specified by the stock exchange. This method of the buyback is less common in India.

Innovative Financial Instruments

Innovative financial instruments are a range of activities such as:-

- participation in equity (risk capital) funds
- guarantees to local banks lending to a large number of final beneficiaries, for instance small and medium-sized enterprises (SMEs)
- risk-sharing with financial institutions to boost investment in large infrastructure projects (e.g. the Europe 2020 project bonds initiative or the connecting Europe facility financial instruments).

The aim is to boost the real economy through increasing the access to finance for enterprises and industry producing goods and services.

Purpose of Innovation

- Different types of Credit Control and Macro level Liquidity Management
- Matching Cash flow requirement of the fund raiser
- Satisfying other objectives like retaining management control
- More effective catering to the needs of the investors
- Better treasury management

Some important innovative financial instruments are:-

1. **Triple Option Convertible Debentures (TOCD)**

- First Issued by Reliance Power Limited with an issue size of Rs. 2,172 Cr.
- There was no outflow of interest for first five years.
- Equity increase was in phases.
- No put option to investors and no takeover threat.
- Reduced dependence on the financial institutions. The expenses for floating the issue were just 2.62% of the issue size which was very less when compared to the 10-12% for a general public issue.

2. **Deep Discount Bonds:**

- The investor got a tax advantage and could eliminate the re-investment risk.
- From the issuer's point of view also, the issue cost was saved as it involved no immediate service cost and lower effective cost. The refinancing risk was also eliminated.

3. **Floating Rate Notes:**

- First issued by Tata Sons with a floor rate of 12.5% and a cap of 15.5% and a reference rate of 364 T-Bill yield, which was 9.85% at the time of issue.
- The investors would get a minimum return of the floor rate and the maximum return was the cap rate. They would get higher than floor rate depending upon the fluctuations in the reference rate.

4. **Perpetual Bonds**

- Perpetual bonds are fund-raising instruments that do not carry any maturity date as bonds usually do. Instead, they offer to pay their buyers a coupon or interest at a fixed date for perpetuity.

- While a variety of entities may issue perpetual bonds, the most common ones in India are issued by banks to meet their Basel III capital norms and are called Additional Tier 1 or AT-1 bonds.

5. Bonus Debentures

- A bonus debenture is a free debt instrument issued to a company‘s shareholders as a reward. When the company declares a bonus debenture, you will receive bonds from the company for a specific face value.
- Interest will be paid on these debentures every year.
- They will be redeemed after a specific period, when you will receive a lump- sum payment.

6. Zero – Coupon Bond

- A zero-coupon bond is a bond that pays no interest and trades at a discount to its face value. It is also called a pure discount bond or deep discount bond.
- The maturity dates on zero coupon bonds are usually long-term—many don‘t mature for ten, fifteen, or more years.
- Investors can purchase different kinds of zero-coupon bonds in the secondary markets that have been issued from a variety of sources.

Crypto Currency

A cryptocurrency is a digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. The word ―cryptocurrency‖ is derived from the encryption techniques which are used to secure the network. A defining feature of cryptocurrencies is that they are generally not issued by any central authority, rendering them theoretically immune to government interference or manipulation.

Many companies have issued their own currencies, often called tokens, and these can be traded specifically for the good or service that the company provides. Cryptocurrencies work using a technology called blockchain. Blockchain is a decentralized technology spread across many computers that manages and records transactions. Part of the appeal of this technology is its security.

Bitcoin

Bitcoin is a digital currency created in January 2009. Bitcoin is a type of cryptocurrency. There is no physical bitcoin, only balances kept on a public ledger that everyone has transparent access to. All bitcoin transactions are verified by a massive amount of computing power. Bitcoin is not issued or backed by any banks or governments, nor is an individual bitcoin valuable as a commodity. Despite it not being legal tender in most parts of the world, bitcoin is very popular and has triggered the launch of hundreds of other cryptocurrencies, collectively referred to as altcoins. Bitcoin is commonly abbreviated as "BTC."

Ethereum

Ethereum is a blockchain platform with its own cryptocurrency, called Ether (ETH) or Ethereum, and its own programming language, called Solidity. As a blockchain network, Ethereum is a decentralized public ledger for verifying and recording transactions. The network's users can create, publish, monetize, and use applications on the platform, and use its Ether cryptocurrency as payment. Insiders call the decentralized applications on the network "dapps." As a cryptocurrency, Ethereum is second in market value only to Bitcoin, as of May 2021.

Cardano

Cardano is a third-generation, decentralized proof-of-stake (PoS) blockchain platform designed to be a more efficient alternative to proof-of-work (PoW) networks. Scalability, interoperability, and sustainability on PoW networks like Ethereum are limited by the infrastructure burden of growing costs, energy use, and slow transaction times. Charles Hoskinson, the co-founder of the proof-of-work (PoW) blockchain Ethereum, understood the implications of these challenges to blockchain networks, and began developing Cardano and its primary cryptocurrency, ada, in 2015, launching the platform and the ada token in 2017.

Dogecoin

Dogecoin (DOGE) is a peer-to-peer, open-source cryptocurrency. It is considered an altcoin and an almost sarcastic meme coin. Launched in Dec. 2013, Dogecoin has the image of a Shiba Inu dog as its logo. While it was created seemingly as a joke, Dogecoin's blockchain still has merit. Its underlying technology is derived from Litecoin. Notable features of Dogecoin, which uses a scrypt algorithm, are its low price and unlimited supply. Dogecoin started as something of a joke, but after it was created, it gained a following. By late 2017, it was participating in the cryptocurrency bubble that sent the values of many coins up significantly

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UNIT IV

DEVELOPMENT FINANCIAL INSTITUTIONS

Introduction

Development Finance Institution (DFI) is a provider, enabler and catalyst for infrastructure financing and as the principal financial institution and development bank for building and sustaining a supportive ecosystem across the life-cycle of infrastructure projects.

Development Financial institution (DFI) is defined as ‒an institution endorsed or supported by Government of India primarily to provide development/Project finance to one or more sectors or sub-sectors of the economy. the institution differentiates itself by a thoughtful balance between commercial norms of operation, as adopted by any financial institution like commercial bank and developmental responsibilities. it emphasizes the long-term financing of a project rather than collateral-based financing apart from provision of long-term loans, equity capital, guarantees and underwriting functions, a development institution normally is also expected to upgrade the managerial and the other operational requirements of the assisted projects. its association with its clients is of an on-going nature and of being a companion in the project than that of a plain lender like banks. Hence, the basic stress of a DFI is on long-term finance and support for activities to the sectors of the economy where the risks may be higher that may not be feasible for commercial banks to finance them. so role of DFIs is not just long-term financing but more of development of significant sectors of our economy for hastening growth. these DFIs are also known as Development banks.

After independence the role of commercial banking was limited to working capital financing on short term basis so thrust of DFIs was on long term finance to industry and infrastructure sector in India. India‘s first DFI was operationalised in 1948 and it set up State Financial Corporations (SFCs) at the state level after passing of the SFCs act, 1951, succeeded by the development of industrial Finance corporation of India (IFCI).

Evolution of DFIs in India

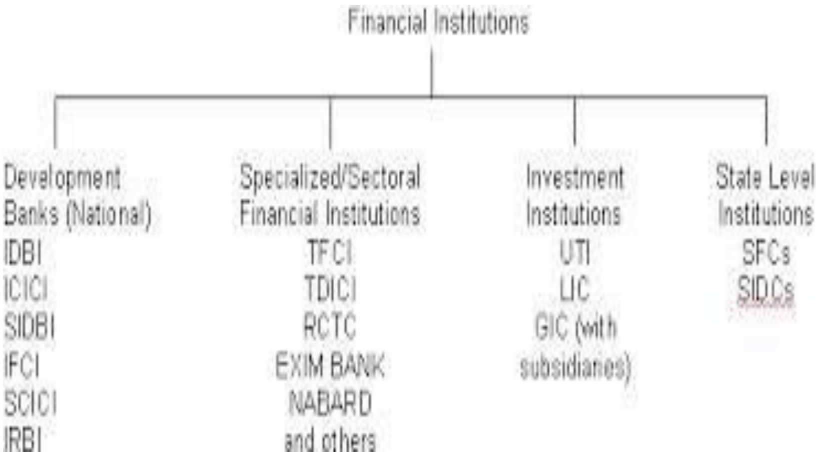
The process started instantly after Independence, with the setting up of the Industrial Finance Corporation (IFCI) in 1948 to embark on long term term-financing for industries. State Financial Corporations (SFCs) were formed under an Act that came into effect from August 1952 to endorse state-level, small and medium-sized industries with industrial finance. In January 1955, the Industrial Credit and Investment Corporation of India (ICICI), the first development finance institution in the private sector, came to be set up, with backing and funding of the World Bank. In June 1958, the Refinance Corporation for Industry was established, which was later taken over by the Industrial Development Bank of India (IDBI). Other DFIs that were launched included the Agriculture Refinance Corporation (1963), Rural Electrification Corporation Ltd. and HUDCO. Two other major steps in institution building were the setting up of IDBI as an apex term-lending institution and the Unit Trust of India (UTI) as an investment institution, both starting operations in July 1964 as subsidiaries of the Reserve Bank of India. There were new initiatives at the level of the states as well in the 1960s. State governments setup State Industrial Development Corporations (SIDCs) to inspire industrial development in their territories.

Specialized financial institutions set up after 1974 included NABARD (1981), EXIM Bank (1982), Shipping

Credit and Investment Company of India (1986), Power Finance Corporation, Indian Railway Finance Corporation (1986), Indian Renewable Energy Development Agency (1987), Technology Development and Information Company of India, a venture fund later known as IFCI Venture Capital Funds Ltd. and ICICI Venture Funds Management Ltd. (1988), National Housing Bank (1988), the Tourism Finance Corporation of India, set up by IFCI (1989), Small Industries Development Bank of India (SIDBI), with functions relating to the micro, medium and small industries sector taken out of IDBI (1989).

DFIs can be classified in four categories of institutions as per their functions:

1. National Development Banks e.g. IDBI, SIDBI, ICICI, IFCI, IRBI, IDFC
2. Sector specific financial institutions e.g. TFCI, EXIM Bank, NABARD, HDFC, NHB
3. Investment Institutions e.g. LIC, GIC and UTI
4. State level Institutions e.g. State Finance corporations and SIDCs



Some of the major DFIs are discussed below:

IFCI Ltd.

The Industrial Finance Corporation of India, now known as IFCI Ltd (IFCI) was set up as a Statutory Corporation by an Act of Parliament in 1948 for providing medium- and long-term finance to industry. In 1993, after repeal of the IFC Act, IFCI became a Public Limited Company, registered under the Companies Act, 1956.

At the time of independence in 1947, the Indian Capital Markets were relatively less developed. The demand for capital was growing rapidly, however there was a dearth of providers of capital. The commercial banks that existed were not equipped well enough to provide for long term capital needs of the country. Against this backdrop and to bridge the demand supply gap for capital needs of the economy, the Government of India established The Industrial Finance Corporation of India (IFCI).

IFCI was the first Development Financial Institution of India set up to propel economic growth through development of infrastructure and industry. Since then, IFCI has contributed significantly to the economy through its incessant support to projects in all the three spheres of growth & development – manufacturing, infrastructure & services and agriculture allied sectors.

The Liberalisation of the Indian Economy in 1991 brought in significant changes in the Indian Capital Markets & Financial System. To aid raising of funds directly through capital markets, the constitution of IFCI was changed from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the name of the company was changed to ‗IFCI Limited' with effect from October 1999.

Currently, IFCI is a Government Company with

Government of India holding 61.02% of paid-up capital of IFCI. IFCI is also registered with the Reserve Bank of India (RBI) as a Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC-ND-SI) and is also a notified Public Financial Institution under the Companies Act, 2013. IFCI‘s Registered office is in Delhi with Regional Offices in Chennai, Hyderabad, Kolkata and Mumbai. IFCI shares are listed on BSE/NSE.

IFCI‘s financing activities cover Project Finance, Corporate Finance, Structured Products and all the growth propelling areas of the country including airports, roads, telecom, power, real estate, manufacturing, services sector and such other allied industries are recipient of IFCI funding.

Government of India appointed IFCI as nodal agency for promoting specified projects, some of them are:

- To act as the Project Management Agency (PMA) under the Ministry of Electronics and Information Technology for the Scheme for Promotion of Manufacturing of Electronics Components and Semiconductors (SPECS). The Scheme has an outlay of ~INR 3,285 crore ($440 million) and shall provide incentive of 25% on capital expenditure for eligible goods on reimbursement basis. The Scheme will be open for applications initially for a period of 3 years up to 31/03/2023 and incentive will be available for investment made within 5 years from the date of acknowledgement of the application.
- To act as the Project Management Agency (PMA) under the Ministry of Electronics and Information Technology for Production Linked Incentive Scheme (PLI) for Large Scale Manufacturing. The scheme is aimed at boosting domestic manufacturing and also to attract large investment in electronic value chain including electric component and semiconductor packaging. The Scheme has

an outlay of ~INR 40,951 crores and shall extend incentive of 4% to 6% on incremental sales (over base year) of eligible goods manufactured in India.

- Since inception of the Sugar Development Fund (1986) for the purpose of disbursement, follow-up and recovery of SDF loans sanctioned to private sugar factories for modernization- cum-expansion, setting-up of bagasse-based cogeneration power projects, manufacture of ethanol from alcohol/molasses, zero liquid discharge (ZLD) distillery projects, case development schemes, etc.

  In the SDF sector, as the nodal agency of GoI, IFCI is primarily responsible for examination/execution of loan and security documents, recommendation to GOI for release of funds, undertaking site visits for verification of physical and financial progress, verification of utilization of loan monies released by SDF, maintaining loan accounts of borrowers, recovery of SDF dues, taking legal actions against defaulters, etc. In addition, IFCI also carries out financial appraisals of projects for availing SDF loans by sugar mills. The cumulative Sanction and Disbursement under SDF up to March 31, 2017 stood at Rs.6,436 crore and Rs.5,028 crore respectively. (to incorporate latest figures)

- The Department of Social Justice & Empowerment under the aegis of Ministry of Social Justice & Empowerment, Government of India, has sponsored the ―Credit Enhancement Guarantee Scheme for Scheduled Castes‖ under its social sector initiatives. The objective of the Scheme is to promote entrepreneurship amongst the Scheduled Castes, by providing Credit Enhancement Guarantee to Member Lending Institutions (MLIs), who shall be providing financial assistance to these entrepreneurs. The Government of India has initially allocated a corpus of Rs.200 crore for this and may make further contributions depending upon utilization of funds. Out of the fund, the guarantee cover is extended to the Member Lending Institutions. IFCI has been designated as the Nodal Agency under the Scheme, to issue the guarantee cover in favor of Member Lending Institutions, who shall be encouraged to finance Scheduled Caste entrepreneurs to boost entrepreneurship amongst the marginal strata of the Society. As per the scheme, the MLI (Bank) shall receive the application from the eligible SC entrepreneurs and process the same as per the terms of lending of the respective bank and sanction the loan under the scheme. The Bank shall forward the application to IFCI for issuance of registration / token No. On receipt of sanction letter IFCI shall issue the token no. to the Bank and Bank shall remit the guarantee fee to IFCI and IFCI shall sanction the guarantee cover to the Bank as per the scheme.

–Entrepreneurship‖ relates to entrepreneurs managing businesses which are oriented towards innovation and growth technologies

IFCI Group is a promoter / stake holder in Stock Holding Corporation of India Ltd, IFCI Venture Capital Fund Ltd, IFCI Factors Ltd, IFCI Infrastructure Development Ltd, IFCI Financial Services Ltd, MPCON Ltd. (a professionally managed Technical Consultancy Organization), Management Development Institute and Institute of Leadership Development.

AMFI (The Association of Mutual Funds in India)

AMFI, the association of all the Asset Management Companies of SEBI registered mutual funds in India, was incorporated on August 22, 1995, as a non-profit organisation. As of now, 44 Asset Management Companies that are registered with SEBI, are its members.

Mutual Funds in India are governed by the SEBI (Mutual Fund) Regulations 1996 as amended from time to time. SEBI (Mutual Funds) Regulation 1996 requires all Asset Management Companies to register with SEBI.

AMFI is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

The objectives of AMFI are :

- To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
- To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
- To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.
- To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry.
- To undertake nationwide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.
- To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.
- To regulate conduct of distributors including disciplinary actions (cancellation of ARN) for violations of Code of

Conduct.

- To protect the interest of investors / unit holders.

AMFI office is located in Mumbai and its day-to-day activities are managed by a Chief Executive under the guidance of Board of Directors. For monitoring its activities, AMFI has formed following committees, viz. AMFI Financial Literacy Committee, AMFI Committee on Certified Distributors (ARN Committee), AMFI ETF Committee, AMFI Operations, Compliance & Risk, AMFI Valuation Committee, with a member of each Committee as its Chairperson.

NABARD (NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT)

Agriculture plays a vital role in the Indian economy. Over 70 per cent of the rural households depend on agriculture. Agriculture is an important sector of Indian economy as it contributes about 17% to the total GDP and provides employment to over 60% of the population.

Considering the importance of the agriculture sector in Indian Economy, need was felt to sustain, encourage and promote agriculture and allied activities. To achieve this objective the Government of India recognized right from its early stages of planning the importance of institutional credit in boosting rural economy. Therefore, the Reserve Bank of India (RBI) at the insistence of the Government of India, constituted a Committee to review the arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) to look into these very critical aspects. The Committee was formed on 30 March 1979, under the Chairmanship of Shri B. Sivaraman, former member of Planning Commission, Government of India.

The Committee‘s interim report outlined the need for a new organisational device for providing undivided attention, forceful direction and pointed focus to credit related issues linked with rural development. The Committee recommended formation of a unique development financial institution which would address these aspirations and formation of National Bank for Agriculture and Rural Development (NABARD) was approved by the Parliament through Act 61 of 1981.

NABARD came into existence on 12 July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then Agricultural Refinance and Development Corporation (ARDC). It was dedicated to the service of the nation by the late Prime Minister Smt. Indira Gandhi on 05 November 1982. Set up with an initial capital of Rs.100 crore, its‘ paid-up capital stood at Rs.14,080 crore as on 31 March 2020. Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India.

NABARD‘s initiatives are aimed at building an empowered and financially inclusive rural India through specific goal-oriented departments which can be categorized broadly into three heads: Financial, Developmental and Supervision. Through these initiatives NABARD touches almost every aspect of rural economy. From providing refinance support to building rural infrastructure; from preparing district level credit plans to guiding and motivating the banking industry in achieving these targets; from supervising Cooperative Banks and Regional Rural Banks (RRBs) to helping them develop sound banking practices and onboarding them to the CBS (Core Banking Solution) platform; from designing new development schemes to the implementation of GoI‘s development schemes; from training handicraft artisans to providing them a marketing platform for selling these articles.

Over the years NABARD‘s initiatives have touched millions of rural lives across the country. To name a few, the SHG Bank Linkage Project launched by NABARD in 1992 has blossomed into the world‘s largest micro finance project. Kisan Credit Card, designed by NABARD has become source of comfort for crores of farmers. NABARD also financed one fifth of India‘s total rural infrastructure, pioneered in the field of watershed development as a tool for sustainable climate proofing, etc.

Development of food processing industry in the country is accorded top priority by the Government of India as it is one of the most critical links in the agri value chain. Taking this agenda further, the Hon‘ble Finance Ministry, in 2014, announced setting up of a Special Fund of Rs.2,000 crore in NABARD for providing direct term loans at affordable rates of interest to Designated Food Parks (DFPs) and food processing units in the DFPs. Loans are provided to eligible entities for projects involving creation of storage infrastructure with a minimum aggregate capacity of 5000 metric tons (MT) for agricultural and allied produce, including construction of:

- Warehouses
- Silos
- Cold storage, Controlled Atmosphere (CA) Stores, other Cold Chain Infrastructure Activities like Pack Houses/ Integrated Pack Houses, Reefer Vans, Bulk Coolers, Individually Quick- Frozen Units, Chilling/ Freezing Infrastructure, etc.
- Construction/ Modernisation/ Upgradation of Marketing Infrastructure Facilities of Agricultural Produce Marketing Committee (APMC).
- Modernization/ Improvement of the existing storage infrastructure projects will be considered on merit of each

proposal provided it leads to Scientific/ Additional storage capacity.

- There‘s no minimum capacity for projects of Governments/ Government owned corporations.

Another important activity of NABARD is extending Credit Facilities to Marketing Federations. Marketing federations and cooperatives are playing a very vital role in agri business and value/supply chain management of the various agricultural commodities. Major activities undertaken by these institutions are:

- Procurement of agricultural commodities including milk
- Aggregation, storage and value addition in few select commodities like milk etc.
- Marketing

Large number of farmers, producers‘ organizations, and primary societies depend upon these institutions for marketing of their produce and for value-added services like input supply, value addition and storage facilities. The marketing operations by these federations and cooperatives require seasonal and timely short-term credit facility to support their day-to-day operations.

Eligible Institutions

The following institutions, fulfilling broad eligibility criteria, will be eligible for funding under Credit Facility to Federations (CFF)

I. State/Central Govt. Agricultural Marketing Federations, Corporations

II. Dairy Co-operatives/Federations

III. Agriculture Marketing Co-operatives/Federations

IV. Registered Companies

Nature of Loan

- Procurement and marketing of agricultural commodities
- Processing and marketing of agricultural commodities
- Procurement, processing and marketing of milk
- Supply of Agricultural inputs including animal feed

Quantum of Loan and Margin/Borrower's contribution will be as per the guidelines issued by RBI from time to time.

Rate of interest: The rate of interest will be as per the rate decided by the Asset-Liability Management Committee (ALCO) of NABARD. Further, interest is dependent upon the type of borrower, type of security offered, availability of guarantee, type of project, credit rating of the entity and the prevailing market conditions. Interest will be due and paid at monthly rests for short term loans. Interest rate is linked to the risk rating.

Rural Infrastructure Development Fund (RIDF):

Government of India created the RIDF in NABARD in 1995-96, with an initial corpus of Rs.2,000 crore. With the allocation of Rs.29,848 crore for 2020-21 under RIDF XXVI, the cumulative allocation has reached Rs.3,78,348 crore, including Rs. 18,500 crores under Bharat Nirman.

Eligible Activities

At present, there are 37 eligible activities under RIDF as approved by GoI. The eligible activities are classified under three broad categories i.e.

- Agriculture and related sector
- Social sector
- Rural connectivity

Eligible Institutions

- State Governments / Union Territories
- State Owned Corporations / State Govt. Undertakings
- State Govt. Sponsored / Supported Organisations
- Panchayat Raj Institutions/Self Help Groups (SHGs)/ NGOs

Direct Refinance Assistance to Co-operative Banks

Implementation of the Government of India‘s Revival Package of Short-Term Co-operative Credit Structure (STCCS) as per Vaidyanathan Committee recommendations enabled District Central Co-operative Banks (DCCBs) to borrow funds directly from any financial institution regulated/approved by RBI. As a corollary to this enabling provision, NABARD developed a progressive product titled ‗Short Term Multipurpose Credit Product‘ (STMPCP) to provide financial assistance to Co-operative Banks (STCBs/DCCBs). The primary objective here was to expand their lendable resources and enable their diversification into a variety of business operations.

Purposes covered under STMPCP

I. Short Term Multipurpose Credit Product

- Working capital requirements
- Repair and maintenance of farm equipment and other productive assets
- Storage/grading/packaging of produce
- Marketing activities
- Crop loan (if the requirement is more than Rs.3.0 lakh)
- Redemption of old debts and other socio-economic needs
- In addition to the above, all purposes which are covered

under Section 21(1)(i) to (v) of NABARD Act, 1981 are also eligible for refinance under this product

II. Assistance to Co-operative Banks for on-lending to sugar factories

The refinance assistance would be provided to Co-operative Banks for on-lending to sugar factories (co-operative & private) for prompt payment to farmers towards procurement of sugarcane and also to meet out their internal expenditure. Terms and conditions of sanction, eligibility of the banks, interest rate and security are same as that of STMPCP.

NABARD‘s activities are visible throughout rural India as it has touched almost all areas in agriculture and rural development, listed above are a small list.

SFCS (STATE FINANCE CORPORATIONS)

By an Act ―The State Financial Corporations Act 1951‖ enacted by the Indian Parliament, formation of SFCs was enabled throughout India. It shall come into force in any State on such date as the Central Government may, by notification in the Official Gazette, appoint the SFC.

The important functions of State Finance Corporations are:

(i) Provide loans mainly for the acquisition of fixed assets like land, building, plant, and machinery.

(ii) Extend financial assistance to industrial units whose paid-up capital and reserves do not exceed Rs. 3 crores (or such higher limit up to Rs. 30 crores as may be notified by the central government).

(iii) Underwrite new stocks, shares, debentures etc., of industrial units.

(iv) Stand guarantee to loans raised in the capital market by scheduled banks, industrial concerns, and state co-operative banks to be repayable within 20 years.

The authorized Capital of a State Financial Corporation should be within the minimum and maximum limits of Rs. 50 lakhs and Rs. 5 crores which are fixed by the State government. It is divided into shares of equal value which were acquired by the respective State Governments, the Reserve Bank of India, scheduled banks, co-operative banks, other financial institutions such as insurance companies, investment trusts, and private parties. The State Government guarantees the shares of SFCs. The SFCs can augment its fund through issue and sale of bonds and debentures also, which should not exceed five times the capital and reserves at Rs. 10 Lakh.

The State Finance Corporations (SFCs) are an integral part of institutional finance structure of a country. It promotes small and medium industries of the states. Besides, SFC helps in ensuring balanced regional development, higher investment, more employment generation and broad ownership of various industries.

Special Help to Women Entrepreneurs: Various state financial corporations like Delhi SFC have started new scheme for helping women entrepreneurs who want to establish their new business in India. This is a very innovative prospect of State financial corporation for the development and empowerment of women. SFCs are highest loan provider for small scale industries in the country.

Industrial research: Since enactment of SFC Act in 1951, SFCs are working for a long period of more than 70 years in India. These financial institutions have a wide range of industrial information. A new entrepreneur can start their industrial research by contacting these institutions if he / she wants to establish a new business.

In India, at present, there are 18 state finance corporations (out of which 17 SFCs were established under the SFC Act 1951). Tamil Nadu Industrial Investment Corporation Ltd. which is established under the Company Act, is also working as state finance corporation.

Problems of State Financial Corporation

All SFCs are dependent upon the rules and regulations made by the state government. All decisions of these institutions are dependent on the political environment of the state. Due to this, sometimes the loan is not available at the right time for the right person.

UTI (UNIT TRUST OF INDIA)

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI.

UTI is a statutory public sector investment institution that has the main objective to encourage as well as mobilize the savings of the community. It then canalizes the funds into productive investments. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs. 6,700 crores of assets under management.

Unit Trust is an investment plan where the funds are pooled together and then the investment. The fund that has been pooled is later unitized. The investor is known as a unit holder and he or she holds a certain number of units. On the other hand the second party who is the manager is responsible for the daily running of the trust and for investing the funds.

The Trustee is the third party. The role of the third party is to monitor the manager‘s performance against the trust deed. The purpose of the deed is to outline the objectives and the vital information about the trust. Also the assets of the trust are held in the name of the Trustees. Then they are held ―in trust‖ for unit holders.

UTI provides the investor with a safe return on the investment and allows withdrawal of funds whenever there is a need for funds. UTI provides the daily price record and also advertises in the print / visual media. Two prices are always quoted on a daily basis, one the purchase price and the second the sale price. Prices may fluctuate on a daily basis but the fluctuation is nominal on a monthly average basis. The main objective of UTI is to cater small as well as large investors.

Primary objective of UTI

(1) Promote and pool the small savings from the lower- and middle-class income groups who cannot have direct access to the stock market and

(2) provide them with an opportunity to share the benefits of prosperity resulting out of rapid industrialization in India.

Schemes introduced, managed and operated by UTI

1) Unit Scheme introduced in 1964.
2) Children Gift Growth Fund Unit Scheme in 1986
3) Rajalakshmi Unit Scheme in 1992
4) Senior citizens unit plan introduced in the year 1993, for the senior citizens of our country.
5) Monthly Income Unit scheme
6) Master equity plan in 1995.
7) Master equity plan in 1997
8) Money market mutual fund scheme in 1997

9) UTI Growth Sector Fund in 1999

10) Growth and income unit schemes.

Main functions of UTI are as follows :

1. Mobilizes the savings of the relatively small investors.
2. Canalizes the small savings into productive investments.
3. Encourages savings of the lower- and middle-class people.
4. Sells Units to the investors in different parts of the country.
5. Converts small savings into industrial finance.
6. Gives investors an opportunity to share the benefits and fruits of industrialization in the country.
7. Provides liquidity to the Unit holders.
8. Grants loans and advances to the investors.
9. Allows buying or selling or making a deal in foreign currency.

Advantages of UTI.

a) Investments are safe

b) Distributes 90 per cent of its income, investors will get regular and reasonable return on investments.

c) High degree of liquidity, as investors can sell units back to the Trust at a specific price at any time.

d) Resources of an investor are pooled with other investors, allowing one to make investments which he cannot do as an individual investor.

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of US

64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs. 76,000 crores of assets under its management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

SIDBI (SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA)

Small Industries Development Bank of India (SIDBI) was set up on 2nd April 1990 under an Act of Indian Parliament. SIDBI is mandated to serve as the principal financial institution for executing the triple agenda of promotion, financing and development of the MSME sector and coordination of the functions of the functions of various institutions engaged in similar activities. SIDBI's objective is to facilitate and strengthen credit flow to MSMEs and address both financial and developmental gaps in the MSME sector. SIDBI is under the jurisdiction of Ministry of Finance, Government of India, headquartered at Lucknow and having its offices all over the country.

SIDBI works to emerge as a single window for meeting the financial and developmental needs of the MSME sector to make it strong, vibrant and globally competitive. It also aims to position SIDBI Brand as the preferred and customer -

friendly institution and for enhancement of shareholder wealth and highest corporate values through modern technology platform.

The Shares of SIDBI are held by the Government of India and twenty-two other institutions / public sector banks / insurance companies owned or controlled by the Central Government, including SBI, LIC, NABARD, etc.

Since its formation in 1990, SIDBI has been impacting the lives of Indian citizens across various strata of society through its integrated, innovative and inclusive approach. Be it traditional domestic industry, small, bottom-of-the-pyramid entrepreneurs, medium enterprises to high-end knowledge-based industries and export promotions, SIDBI has directly or indirectly touched the lives of more than 360 lakh people in the MSE sector, through various credit and developmental measures.

SIDBI aims to further accelerate this effort by transforming its current role to that of an All-India Financial Institution that can create an integrated credit and development support ecosystem for Indian MSEs, thus promoting their inclusive growth. The initiative is dedicated to meet both, credit and non-credit needs of MSEs, enabling them to be globally competitive businesses. SIDBI schemes are designed to bring about sustainable development of MSE sector in India, based on the Triple Ps, namely – Profit (economic), People (Social) & Planet (Environment).

The lending methods of SIDBI are:

a) Indirect Lending - based on multiplier effect / larger reach in financing the MSME sector and is undertaken through Banks, SFBs, NBFCs, MFIs and New Age Fintechs.

b) Direct Lending - aims to fill the existing credit gaps in the MSME sector and is undertaken through demonstrative and innovative lending products, which can be further scaled up by credit delivery ecosystem.

c) Fund of Funds - boosts entrepreneurship culture by supporting emerging startups through the Fund of Funds channel.

d) Promotion and Development - promoting entrepreneurship and handholding budding entrepreneurs for holistic development of MSME sector through credit-plus initiatives.

e) Facilitator - playing facilitator roles like Nodal Agency for the MSME oriented Schemes of the Government.

With the out-break of Covid 19 pandemic, the country is passing through a very difficult situation, particularly impacting economy and health-care. Both the Central and State Governments are united in fighting this pandemic. In its efforts to be a part in this work, SIDBI has introduced special schemes to support the health-care sector:

- Micro, Small & Medium Enterprises engaged in manufacturing of oxygen cylinders, oxy- generators, oxygen concentrators, liquid oxygen or providing services in transportation, storage, refilling to supply of these items.
- Micro, Small & Medium Enterprises engaged in manufacturing of products or providing services which are directly related to fighting corona virus, such as Pulse Oximeters, Permitted drugs (Remdesivir, Fabiflu, Dexamethasone, Azithromycin, etc.), Ventilators, PPEs etc.

SIDBI is active in the development of Micro Finance Institutions through SIDBI Foundation for Micro Credit, and assists in extending microfinance through the Micro Finance Institution (MFI) route. Its promotion & development program focuses on rural enterprises promotion and entrepreneurship development. SIDBI supports the Government of India in its initiatives and work as a nodal agency for some of the schemes related to development of MSMEs, such as Make in India and Startup India.

In order to increase and support money supply to the MSE sector, it operates a refinance program known as Institutional Finance program. Under this program, SIDBI extends Term Loan assistance to Banks, Small Finance Banks and Non-Banking Financial Companies. Besides the refinance operations, SIDBI also lends directly to MSMEs.

As part of non-financial intervention in the MSME sector, SIDBI had also undertaken various measures in the past. Recently, in association with credit rating agency CRISIL and Credit Information Company TransUnion CIBIL it has introduced "CriSidEx" and "MSME Pulse".

CriSidEx, India's first sentiment index for micro and small enterprises (MSEs), has been developed jointly by CRISIL & SIDBI. It is a composite index based on a diffusion index of 8 parameters and measures MSE business sentiment on a scale of 0 (extremely negative) to 200 (extremely positive). The crucial benefit of CriSidEx is that its readings will flag potential headwinds and changes in production cycles and thus help improve market efficiencies. And by capturing the sentiment of exporters and importers, it will also offer actionable indicators on foreign trade.

SIDBI in association with TransUnion CIBIL launched "MSME Pulse" and Microfinance Pulse launched by Equifax, a quarterly report on MSME credit activity, for closely tracking and monitoring the MSME segment in the country. The report is based on a study done on over five million active MSMEs who have access to formal credit, with live credit facilities in the Indian banking system.

SIDBI has launched the ‗Udyami Mitra‘ Portal to improve accessibility of credit and handholding services to MSMEs. They can select and apply for preferred banks through this portal. Under the portal entrepreneurs can apply for loan without physically visiting any bank branches and can select from over 1 lakh bank branches, track their application status and avail multiple loan benefits. It also has facility for uploading all necessary documents. Through the portal the MSMEs can also seek handholding support for getting finance. SIDBI has also entered into an arrangement with CSC e-governance Services (CSCeGS) to take Udyami Mitra portal to the unserved and the underserved MSMEs. CSCeGS is a special purpose vehicle (SPV) set up by ministry of electronics and IT (MEITY) which acts as connect point for various digitally aligned services to villages in the country.

SIDBI has floated several other entities for related activities, including:

- SIDBI Venture Capital Limited (SVCL) for providing Venture Capital (VC) assistance to MSMEs;
- Micro Units Development & Refinance Agency (MUDRA) - for ‗funding the unfunded‘ micro enterprises in the country;
- Receivable Exchange of India Ltd. (RXIL) to enable faster realisation of receivables by MSMEs;
- SMERA Ratings Limited (SMERA) - for credit rating of MSMEs, renamed as Acuite Ratings & Research Limited.
- India SME Technology Services Ltd (ISTSL) - for technology advisory and consultancy services and
- India SME Asset Reconstruction Company Ltd. (ISARC) for speedier resolution of Non- Performing Assets (NPA) in the MSME sector.

MUTUAL FUND

Mutual fund is a type of financial vehicle made up of a pool of money collected from many investors to invest in securities like stocks, bonds, money market instruments, and other assets. Mutual funds are operated by professional money managers, who allocate the fund's assets and attempt to produce capital gains or income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

Mutual funds give small or individual investors access to professionally managed portfolios of equities, bonds, and other securities. Each shareholder, therefore, participates proportionally in the gains or losses of the fund. Mutual funds invest in a vast number of securities, and performance is usually tracked as the change in the total market cap of the fund—derived by the aggregating performance of the underlying investments.

History & Growth:

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases

First Phase - 1964-1987

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs. 6,700 crores of assets under management.

Second Phase - 1987-1993 (Entry of Public Sector Funds)

1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India Mutual Fund (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. At the end of 1993, the mutual fund industry had assets under management of Rs. 47,004 crores.

Third Phase - 1993-2003 (Entry of Private Sector Funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.

The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs. 44,541 crores of assets under its management were way ahead of other mutual funds.

Fourth Phase - since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of Unit 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India, does not come under the purview of the Mutual Fund Regulations.

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Understanding Mutual Funds:

Mutual funds pool money from the investing public, both small individual investors and other entities – small and large, and use that money to buy other securities, usually stocks and bonds. The value of the mutual fund company depends on the performance of the securities it decides to buy. So, when you buy a unit or share of a mutual fund, you are buying the performance of its portfolio or, more precisely, a part of the portfolio's value. Investing in a share of a mutual fund is different from investing in shares of stock. Unlike stock, mutual fund shares do not give its holders any voting rights. A share of a mutual fund represents investments in many different stocks (or other securities) instead of just one holding.

Therefore, the price of a mutual fund share is referred to as the net asset value (NAV) per share, sometimes expressed as NAVPS. A fund's NAV is derived by dividing the total value of the securities in the portfolio by the total amount of shares outstanding. Outstanding shares are those held by all shareholders, institutional investors, and company officers or insiders. Mutual fund shares can typically be purchased or redeemed as needed at the fund's current NAV, which— unlike a stock price—doesn't fluctuate during market hours, but it is settled at the end of each trading day. The price of a mutual fund is also updated when the NAVPS is settled.

Features of Mutual Fund:

- Mutual fund is a type of investment vehicle consisting of a portfolio of stocks, bonds, or other securities.
- Mutual funds give small or individual investors access to diversified, professionally managed portfolios at a low price.
- Mutual funds are divided into several kinds of categories, representing the kinds of securities they invest in, their investment objectives, and the type of returns they seek.
- Mutual funds charge annual fees (called expense ratios) and, in some cases, commissions, which can affect their overall returns.
- The overwhelming majority of money in employer-sponsored retirement plans goes into mutual funds.

Investors typically earn a return from a mutual fund in three ways:

1. Income is earned from dividends on stocks and interest on

bonds held in the fund's portfolio. A fund pays out nearly all of the income it receives over the year to fund owners in the form of a distribution. Funds often give investors a choice either to receive a check for distributions or to reinvest the earnings and get more shares.

2. If the fund sells securities that have increased in price, the fund has a capital gain. Most funds also pass on these gains to investors in a distribution.
3. If fund holdings increase in price but are not sold by the fund manager, the fund's shares increase in price. You can then sell your mutual fund shares for a profit in the market.

Types of Mutual Funds:

Mutual funds are divided into several categories, representing the kinds of securities they have targeted for their portfolios and the type of returns they seek. There is a fund for nearly every type of investor or investment approach. Other common types of mutual funds include money market funds, sector funds, alternative funds, smart-beta funds, target-date funds, and even funds of funds, or mutual funds that buy shares of other mutual funds.

1. Equity Funds

The largest category is that of equity or stock funds. As the name implies, this sort of fund invests principally in stocks. Within this group are various subcategories. Some equity funds are named for the size of the companies they invest in: small-, mid-, or large-cap. Others are named by their investment approach: aggressive growth, income-oriented, value, and others. Equity funds are also categorized by whether they invest in domestic stocks or foreign equities. There are so many different types of equity funds because there are many different types of equities.

2. Fixed-Income Funds

Another big group is the fixed income category. A fixed-income mutual fund focuses on investments that pay a set rate of return, such as government bonds, corporate bonds, or other debt instruments. The idea is that the fund portfolio generates interest income, which it then passes on to the shareholders.

3. Index Funds

Another group, which has become extremely popular in the last few years, falls under the name "index funds." Their investment strategy is based on the belief that it is very hard, and often expensive, to try to beat the market consistently. So, the index fund manager buys stocks that correspond with a major market index such as the BSC / NSC. This strategy requires less research from analysts and advisors, so there are fewer expenses to eat up returns before they are passed on to shareholders. These funds are often designed with cost-sensitive investors in mind.

4. Balanced Funds

Balanced funds invest in a hybrid of asset classes, whether stocks, bonds, money market instruments, or alternative investments. The objective is to reduce the risk of exposure across asset classes. This kind of fund is also known as an asset allocation fund. There are two variations of such funds designed to cater to the investor‘s objectives.

5. Money Market Funds

The money market consists of safe, short-term debt instruments, mostly government Treasury bills. This is a safe place to park your money. You won't get substantial returns, but you won't have to worry about losing your principal. A typical return is a little more than the amount you would earn in a regular savings account and a little less than the average FD return.

6. Income Funds

Income funds are named for their purpose: to provide current income on a steady basis. These funds invest primarily in government and high-quality corporate debt, holding these bonds until maturity in order to provide interest streams. While fund holdings may appreciate in value, the primary objective of these funds is to provide steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees. Because they produce regular income, tax-conscious investors may want to avoid these funds.

7. International/Global Funds

An international fund (or foreign fund) invests only in assets located outside your home country. Global funds, meanwhile, can invest anywhere around the world, including within your home country. It's tough to classify these funds as either riskier or safer than domestic investments, but they have tended to be more volatile and have unique country and political risks. On the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification, since the returns in foreign countries may be uncorrelated with returns at home. Although the world's economies are becoming more interrelated, it is still likely that another economy somewhere is outperforming the economy of your home country.

8. Specialty Funds

This classification of mutual funds is more of an all-encompassing category that consists of funds that have proved to be popular but don't necessarily belong to the more rigid categories we have described so far. These types of mutual funds forgo broad diversification to concentrate on a certain segment of the economy or a targeted strategy. Sector funds are targeted strategy funds aimed at specific sectors of the economy, such as financial, technology, health, and so on. Sector funds can, therefore, be extremely volatile since the stocks in a given sector tend to be highly correlated with each other. There is a greater possibility for large gains, but a sector may also collapse.

9. Regional Funds

Regional funds make it easier to focus on a specific geographic area of the world. This can mean focusing on a broader region or an individual country. An advantage of these funds is that they make it easier to buy stock in foreign countries, which can otherwise be difficult and expensive. Just like for sector funds, you have to accept the high risk of loss, which occurs if the region goes into a bad recession.

10. Exchange Traded Funds (ETFs)

A twist on the mutual fund is the exchange traded fund (ETF). These are more popular investment vehicles pool investments and employ strategies consistent with mutual funds, but they are structured as investment trusts that are traded on stock exchanges and have the added benefits of the features of stocks. For example, ETFs can be bought and sold at any point throughout the trading day. ETFs can also be sold short or purchased on margin. ETFs also typically carry lower fees than the equivalent mutual fund. Many ETFs also benefit from active options markets, where investors can hedge or leverage their positions. ETFs also enjoy tax advantages from mutual funds. Compared to mutual funds, ETFs tend to be more cost effective and more liquid. The popularity of ETFs speaks to their versatility and convenience.

Regulations

Some of the regulations for mutual funds laid down by SEBI are:

- A sponsor of a mutual fund, an associate or a group company, which includes the asset management company of a fund, through the schemes of the mutual fund in any form cannot hold: (a) 10% or more of the shareholding and voting rights in the asset management company or any other mutual fund. (b) An asset management company cannot have representation on a board of any other mutual fund.

- A shareholder cannot hold 10% or more of the shareholding directly or indirectly in the asset management company of a mutual fund.
- No single stock can have more than 35% weight in the index for a sectoral or thematic index; the cap is 25% for other indices.
- The cumulative weight of the top three constituents of the index cannot exceed 65%.
- An individual constituent of the index should have a trading frequency of a minimum of 80%.
- AMCs must evaluate and ensure compliance to the norms at the end of every calendar quarter. The constituents of the indices must be made public by publishing them on their website.
- New funds must submit their compliance status to SEBI before being launched.
- All liquid schemes must hold a minimum of 20% in liquid assets such as government securities (G-Secs), repo on G-Secs, cash, and treasury bills.
- A debt mutual fund can invest up to only 20% of its assets in one sector; previously the cap was 25%. The additional exposure to housing finance companies (HFCs) is updated to 15% from 10% and a 5% exposure on securitized debt based on retail housing loan and affordable housing loan

portfolios.

- As per SEBI‘s recommendation, amortization is not the only method for evaluating debt and money market instruments. The mark-to-market methodology is also used.
- An exit penalty will be levied on investors of liquid schemes who exit the scheme within a period of seven days.
- Mutual funds schemes must invest only in the listed non-convertible debentures (NCD). Any fresh investment in commercial papers (CPs) and equity shares are allowed in listed securities as per the guidelines issued by the regulator.
- Liquid and overnight schemes are no longer allowed to invest in short-term deposits, debt, and money market instruments that have structured obligations or credit enhancements.
- When investing in debt securities having credit enhancements, a minimum of four times security cover is mandatory for investing in mutual funds schemes. A prudential limit of 10% is prescribed on total investment by such schemes in debt and money market instruments.

SEBI (The Securities and Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) is the regulatory body for securities and commodity market in India under the jurisdiction of Ministry of Finance, Government of India. Securities and Exchange Board of India (SEBI) was first established in 1988 as a non-statutory body for regulating the securities market. It became an autonomous body on 30 January 1992 and was accorded statutory powers with the passing of the SEBI Act 1992 by the Indian

Parliament. SEBI has its headquarters in Mumbai. Controller of Capital Issues was the regulatory authority before SEBI came into existence; it derived authority from the Capital Issues (Control) Act, 1947.

Responsibilities

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected there with or incidental there to".

SEBI has to be responsive to the needs of three groups, which constitute the market:

- issuers of securities
- investors
- market intermediaries

Structure of SEBI

SEBI has a corporate framework comprising of various departments each managed by a department head. There are about 20 departments under SEBI. Some of these departments are corporation finance, economic and policy analysis, debt and hybrid securities, enforcement, human resources, investment management, commodity derivatives market regulation, legal affairs, and more. The hierarchical structure of SEBI consists of the following members:

- The chairman of SEBI is nominated by the Union Government of India.
- Two officers from the Union Finance Ministry will be a part of this structure.
- One member will be appointed from the Reserve Bank of

India. Five other members will be nominated by the Union Government of India.

Functions of SEBI :

- SEBI is primarily set up to protect the interests of investors in the securities market.
- It promotes the development of the securities market and regulates the business.
- SEBI provides a platform for stockbrokers, sub-brokers, portfolio managers, investment advisers, share transfer agents, bankers, merchant bankers, trustees of trust deeds, registrars, underwriters, and other associated people to register and regulate work.
- It regulates the operations of depositories, participants, custodians of securities, foreign portfolio investors, and credit rating agencies.
- It prohibits insider trading, i.e. fraudulent and unfair trade practices related to the securities market.
- It ensures that investors are educated on the intermediaries of securities markets.
- It monitors substantial acquisitions of shares and take-over of companies.
- SEBI takes care of research and development to ensure the securities market is efficient at all times.
- For the discharge of its functions efficiently, SEBI has been vested with the following powers:
- to approve by−laws of Securities exchanges.
- to require the Securities exchange to amend their by−laws.
- inspect the books of accounts and call for periodical returns from recognised Securities exchanges.

- inspect the books of accounts of financial intermediaries.
- compel certain companies to list their shares in one or more Securities exchanges.
- registration of Brokers and sub-brokers

Authority and powers of SEBI:

The SEBI has three main powers:

i. **Quasi-Judicial:** SEBI has the authority to deliver judgements related to fraud and other unethical practices in terms of the securities market. This helps to ensure fairness, transparency, and accountability in the securities market.

ii. **Quasi-Executive:** SEBI is empowered to implement the regulations and judgments made and to take legal action against the violators. It is also authorized to inspect Books of accounts and other documents if it comes across any violation of the regulations.

iii. **Quasi-Legislative:** SEBI reserves the right to frame rules and regulations to protect the interests of the investors. Some of its regulations consist of insider trading regulations, listing obligations, and disclosure requirements. These have been formulated to keep malpractices at bay. Despite the powers, as stated earlier, the results of SEBI‘s functions still have to go through the Securities Appellate Tribunal and the Supreme Court of India.

♦ **SEBI committees**

- Technical Advisory Committee
- Committee for review of structure of infrastructure institutions
- Advisory Committee for the SEBI Investor Protection and

Education Fund

- Takeover Regulations Advisory Committee
- Primary Market Advisory Committee (PMAC)
- Secondary Market Advisory Committee (SMAC)
- Mutual Fund Advisory Committee
- Corporate Bonds & Securitisation Advisory Committee

Type of Brokers in Trading

There are two types of brokers:

1. **Discount brokers** - discount broker is a stockbroker who carries out buy and sell orders at reduced commission rates compared to a full-service broker. However, a discount broker does not provide investment advice or perform analysis on a client's behalf, unlike a full-service broker.
2. **Service or Merchant brokers -** Full-service brokers do not just execute buy and sell orders for their clients; they provide a whole host of services like research on trending topics, sectoral and stock research, and tax planning, etc. Discount brokerages are mostly self- directed and very active traders. Therefore, the services are also centred around helping such investors monitor movements regularly. Full-service brokerages have physical branches at multiple locations and provide both online and offline services, unlike discount brokerages. The transaction cost charged by a full-service brokerage is higher than that charged by discount brokerages.

PROVIDENT FUND

A provident fund is a government-managed, mandatory retirement savings scheme used in India, Singapore, and other developing nations. Employees Provident Fund (EPF) as it is known in India, is a scheme in which retirement benefits are accumulated. Under the scheme, an employee has to pay a certain contribution towards the scheme and an equal contribution is paid by the employer. An employee gets a lump sum amount including his and employer‘s contribution with interest on contribution made by both, on retirement. The Fund is managed by Employees Provident Fund Organization (EPFO) which came into existence by the Employees Provident Fund and Miscellaneous Provisions Act 1952. EPFO is one of the world‘s largest social security providers.

Eligibility

All establishments employing 20 or more employees are statutorily required to register with EPFO. Employees drawing monthly salary / wages below Rs.15,000/- should become members of EPFO. Employees drawing Rs.15,000/- and above can also become members of EPFO with the consent of employer and approval of EPFO. The limit of Rs.15,000/- per month salary to become members of EPFO came into force with effect from 01-09-2014. Employees drawing less than Rs 15,000 per month have to mandatorily become members of the EPF. In case of Cine-Workers, the required employees strength for the purpose of coverage under the Act is five.

Basics

The **Employees' Provident Fund Organisation** (EPFO) is the social security body that is responsible for running and supervising the largest mandatory state pension scheme for workers in India. The EPFO assists the Central Board in administering a compulsory contributory provident fund, pension and insurance scheme for the workforce engaged in India. It is also the nodal agency for implementing bilateral social security agreements with other countries. These schemes cover Indian workers as well as international workers in countries with which bilateral agreements have been signed.

As of May 2021, 18 such agreements are operational. The EPFO's apex decision making body is the Central Board of Trustees (CBT), a statutory body established by the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. This Body is under the jurisdiction of the Ministry of Labor and Employment. As of 2018, more than Rs.11 lakh crores are under EPFO management. EPFO is one of the World's largest Social Security Organisations in terms of clientele and the volume of financial transactions undertaken. At present it maintains 19.34 crore accounts (Annual Report 2016-17). Total 77.08 lakh net subscribers were added under EPFO during FY 20-21.

History and development

The question of providing for the future of industrial workers and their dependents after their retirement or premature death engaged the attention of the Central Government for a long time. The first Provident Fund Act, passed in 1925 for regulating the provident funds of some private concerns, was limited in scope. In 1929, the Royal Commission on Labour stressed the need for formulating schemes for instituting provident funds for industrial workers. In the Indian Labour Conference held in 1948, it was generally agreed that the introduction of a statutory provident fund scheme for industrial workers might be undertaken. To test such a scheme in a restricted field, the Coal Mines Provident Fund Scheme was launched in 1948.

The Constitution of India contains a provision that the State shall within the limits of its economic capacity make effective provisions for securing the right to work, to education and to public assistance in cases of unemployment, old-age, sickness & disablement, etc.

Accordingly, the last months of 1951 witnessed the promulgation of the Employees' Provident Funds Ordinance.

The Ordinance promulgated, on 15 November 1951, was replaced by the Employees' Provident Funds Act, 1952 which extended to the whole of India except Jammu and Kashmir. The Employees' Provident Funds Scheme, 1952, framed under section 5 of the Act was brought into force in stages and was implemented in its entirety by 1 November 1952. Industries such as cement, cigarettes, electrical, mechanical or general engineering products, iron, steel, paper, textiles (made wholly or in part of cotton, wool or jute or silk, whether natural or artificial) industries came under the scope of the Act. The Acts and Schemes framed under it are administered by the Central Board of Trustees which consists of representatives of central and state governments, employers, and employees. The Board administers a contributory provident fund, pension scheme and an insurance scheme for the workforce engaged in the organized sector in India. The board is chaired by the Union Labour Minister of India.

The Act extends to whole of India, except the State of Jammu and Kashmir. The Act is at present applicable to every establishment, which is a factory engaged in any industry specified in Schedule - I to the Act in which twenty or more persons are employed; and to any other establishment employing twenty or more persons or class of such establishments which the Central Government notifies in the Official Gazette.

Presently, the following three schemes are in operation under the Act:

1. Employees' Provident Fund Scheme, 1952
2. Employees' Deposit Linked Insurance Scheme, 1976
3. Employees' Pension Scheme, 1995

Organization Structure:

The EPFO has the dual role of being the enforcement agency to oversee the implementation of the EPF & MP Act and as a service provider for the covered beneficiaries throughout the country. The Act is administered by the Central Board of Trustees, EPF a Statutory Board constituted by the Central Government under Section 5A of the Act. The CBT, as the Board is informally called, consists of a Chairman, a Vice-Chairman, 5 Central Government Representatives, 15 State Government Representatives, 10 Employees' Representatives, 10

Employers' Representatives with Central P.F Commissioner and the Member Secretary to the Board. The Executive Committee of the CBT is constituted from among the members of the CBT to assist the Central Board in the discharge of its function related to administrative matters.

Administratively, the organisation is divided into zones that are headed by an Additional Central Provident Fund Commissioner. At present, there are 10 Zones across the country. Further below, the states have either one or more than one Regional Offices headed by Regional Provident Fund Commissioners (RPFC) (Grade I) which are again sub-divided into Sub-Regions headed by Regional Provident Fund Commissioners (Grade II). To assist them are Assistant Provident Fund Commissioners looking after the enforcement of the Act and Schemes

The Provident Fund Commissioners are vested with vast powers under the statute conferring quasi-judicial authority for the assessment of financial liability on the employer, search and seizure of records, levy of damages, attachment and auction of a defaulter's property, prosecution and arrest and detention of defaulters in civil prison etc.

Universal Account Number

On 1 October 2014, the Government of India launched a Universal Account Number for Employees covered by EPFO to enable Provident Fund number portability. The Universal Account Number (UAN) is a 12-digit number allotted to employees who are contributing to EPF. It will be generated for each of the PF members by EPFO. The UAN remains the same throughout the lifetime of an employee. It does not change with the change in jobs. The idea is to link multiple Member Identification Numbers (Member Id) allotted to a single member under a single UAN. This will help the member to view details of all the Member Identification Numbers (Member Id) linked to it. The UAN will help in easy transfer and withdrawals of PF claims online or offline. Along with these services facilities like Online Pass-Book, SMS Services on each deposit of contribution and Online KYC Update can be provided based on UAN number. When one changes job, he can transfer the EPF balance from previous employer to new employer account. The UAN portal allows to check EPF balance, download EPF passbook, check EPF balance, provident fund claim, and many more facility provided by new UAN portal.

General:

The member who is unable to withdraw PF for any reason can withdraw without consent of employer. They can submit FORM 19 for EPF (Employees Provident Fund) and FORM 10C for EPS (Employees‘ Pension Scheme) attested by Authorized Officer to EPFO office in which their EPF account is maintained. A UAN provided by EPFO can be used to track PF balance and PF claim status.

The Employee's Pension Scheme (EPS) is managed by the Employee‘s Provident Fund Organization (EPFO) since 1995. The main advantage of this scheme is to provide social security to its PF members. Under this scheme, a certain per cent age of employer‘s contribution to employee‘s PF Fund is transferred to Pension Fund. Employees working in the organized sector can avail the pension benefit on attaining the age of 58. This EPS is applicable for both new members and existing members.

As per PF rules in force now, a worker is required to contribute 12% of his wages / salaries to the provident fund, and an employer should make equal contribution on behalf of the employees. Employer‘s contribution is partly transferred to Employees Pension Fund. The money in the fund is then kept and handled by the government and given as pension to the employees on retirement or to his surviving families. The corpus lying in Pension Fund is used for paying monthly pension to the employees or his spouse, when the employee dies. In certain cases, a provident fund even pays out to the disabled, who are not in a condition to work.

The funds received from employees in PF account are pooled and held by a trust. The pooled funds receive interest at a rate decided by the government. This fund continues to grow with an employee‘s / employer‘s monthly contributions, as well as the necessary annual compound interest.

An employee can withdraw his or her provident fund:

- On retirement or when an employee hits the age of 58. He or she will apply for withdrawal of the provident fund via his or her employer.
- An employee can terminate the provident fund before hitting the retirement age. This can be done if an employee has been out of work for a period prescribed by the government, in which case he or she will be entitled to withdraw the provident fund.
- PF being a social security measure, withdrawal is permitted

when in service also for specified purposes, such as medical emergencies, marriage, house building, etc. The Central Government, as a special case, allowed withdrawal from PF by employees who became unemployed or not getting salaries / wages in the wake of out-break of covid 19 pandemic.

PENSION FUNDS

Pension means a regular payment made by the state to people of or above the official retirement age and to some widows, disabled people and other weaker sections in the society. Such regular payment of pension is paid to a person on his retirement or his dependent when the person dies, from an investment fund to which that person or his employer has contributed during his employment. Social security pensions paid to widows, disabled people and other weaker sections are provided by budget allocations. A regular payment made from budget allocation to a royal favorite or to an artist or scholar to enable them to carry on work of public interest or value are also known as pension.

PENSION FUNDS IN INDIA

In India pension funds are mainly administered and controlled by two Government of India Bodies,

(1) **Employees' Provident Fund Organisation** – a statutory social security body of the Government of India that administers a mandatory Provident Fund Scheme, Pension Scheme and a death/disability Insurance Scheme. EPFO pension scheme covers mainly workers / employees in the organized sector drawing salary / wages below Rs.15,000/- per month. Employees drawing monthly salary of Rs.15,000/- and above can also join EPFO pension scheme with the approval of EPFO authorities. EPFO is the largest social security organisation in India. Most commonly,

pension plans are defined benefit plans, which means that employees

will receive pension payments equal to a certain percentage of their average salary received throughout their last few years of employment.

(2) **National Pension Scheme** - a defined-contribution–based pension scheme launched by the Government of India open to all citizens of India on a voluntary basis and mandatory for the employees of central / state governments (except Indian Armed Forces) who are appointed on or after 1 January 2004. Indian citizens between the age of 18 and 65 are eligible to join.

(3) **Atal Pension Yojana** - Atal Pension Yojana is a pension scheme mainly aimed at the unorganized sectors such as maids, gardeners, delivery boys, etc. This scheme replaced the previous Swavalamban Yojana which wasn‘t accepted well by the people. The goal of the scheme is to ensure that no Indian citizen has to worry about any illness, accidents or diseases in old age, giving a sense of security. Private sector employees or employees working with such an organization that does not provide them pension benefit can also apply for the scheme. There is an option of getting a fixed pension of Rs 1000, Rs 2000, Rs 3000, Rs 4000, or Rs 5000 on attaining an age of 60. The pension will be determined based on the individual‘s age and the contribution amount. The contributor‘s spouse can claim the pension upon the contributor‘s death and upon the death of both the contributor and his/her spouse, the nominee will be given the accumulated corpus.

Features of pension funds in India

Here we will discuss the prominent features of the Pension Plan (other than EPFO & NPS) available in India.

1. **Guaranteed Monthly Income**: Most of the Pension Plan offers a fixed income upon retirement. Plans like Immediate Annuity allows one to receive monthly or annual income as soon as one invests. The pension can be paid either for a fixed period of time or until death. The same depends solely on the type of plan one chooses.
2. **Tax Benefits**: The most important feature of a Pension plan is its tax savings nature. Many such plans give a tax exemption of 10% to 40% under section 80C of the Income Act. Tax exemption depends on the plan one chooses. It is always advisable to start planning your retirement early so as to reap maximum tax benefits.
3. **Vesting Age**: Vesting age is where one starts receiving a monthly Pension. The minimum vesting age in most plans is 40 to 50 years and the maximum vesting age is up to 75 years. Between the vesting age, one can decide at which age he would want to start receiving a pension.
4. **Surrender Value**: Every Plan has a maturity date. It is very important to wait for the plan one has purchased to complete its maturity date so he gets the maximum benefit out of it. There are times when one still wants to surrender due to some unforeseen emergencies, the same can be done and one would still receive the surrender value of the same provided the plan has crossed the minimum duration. This feature is only available in Pension plans that include life insurance plan benefits.

Where Do Pension Funds Invest?

The main investment style of a pension fund is diversification and prudence. Pension funds aim for portfolio diversification, allocating capital to different investment instruments (stocks, bonds, derivatives, alternative investments, etc.).

However, for many years, pension funds were limited to investments primarily in government- backed securities, such as bonds with a high credit rating (investment-grade bonds) and blue-chip stocks. Since markets evolve and given a constant need for a relatively high rate of return, pension funds have been allowed to invest in the majority of asset classes.

Nowadays, many pension funds have transferred from active stock portfolio management to passive investment instruments, investing in index funds and in exchange-traded funds that track stock indexes. Emerging trends are to allocate capital to alternative investments, specifically to commodities, high-yield bonds, hedge funds, and real estate.

PFRDA

Pension Fund Regulatory and Development Authority (PFRDA) is a statutory regulatory body established by an Act of Parliament, to promote, develop and regulate Pension sector in India. The Pension Fund Regulatory & Development Authority Act was passed on 19th September, 2013 and the same was notified on 1st February, 2014. PFRDA is regulating National Pension System or NPS, subscribed by employees of Govt. of India, State Governments and by employees of private institutions/organizations & unorganized sectors (all citizens of India).

Background

The Government of India had, in the year 1999, commissioned a national project titled ―OASIS‖ (an acronym for old age social & income security) to examine policy related to old age income security in India. Based on the report of OASIS (Old age social and income security), which was a national project that the Government of India had initiated to examine policies related to old age income security in India, the government decided to replace the then defined benefit pension system to defined contribution pension system with respect to all new joinees of Central/State Government except armed forces. As per the recommendations of the OASIS report, IPRDA – Interim pension fund regulatory and development Authority bill was passed by Union parliament in February 2003, which established IPRDA to promote, develop, and regulate pension system in India. IPRDA was passed in order to have a system in place till the final and fool-proof system is implemented. And this final system i.e., PFRDA – Pension Fund Regulatory and Development Authority was established with the President‘s assent on 19 September 2013 and was made a permanent Act from 1st February 2014. The President of India was the guardian of PFRDA till Financial Year (FY) 2014-15 and it has become fully autonomous and functions independently from FY 2014-15.

Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except to Armed Forces, replacing the existing system of Defined Benefit Pension System. The contributory pension system was notified by the Government of India on 22nd December, 2003, now named the National Pension System (NPS) with effect from the 1st January, 2004. NPS was initially launched for new employees of central government, except armed forces, who joined on or after 01/01/2004. The NPS was subsequently extended to all citizens of the country w.e.f. 1st May, 2009 including self-employed professionals and others in the unorganized sector on a voluntary basis.

PFRDA is regulating NPS, subscribed by employees of Govt. of India, State Governments and by employees of private institutions/organizations & unorganized sectors. The PFRDA is ensuring the orderly growth and development of pension market.

Functions of PFRDA

- Regulate NPS and pension schemes to which PFRDA Act applies
- Establish, develop and regulate pension funds
- Protect the interest of pension fund subscribers
- Register and regulate intermediaries
- Approve schemes, terms and conditions, and laying down norms for management of corpus of pension funds
- Establish grievance redressal mechanism for subscribers
- Promote professional organisation connected with the pension system
- Settle disputes among intermediaries and also between intermediaries and subscribers
- Train intermediaries and educate subscribers and the general public with respect to pension, retirement savings and related issues
- Regulate the regulated assets
- Call for information, conduct inquiries, investigation and audit of intermediaries and other entities connected with pension funds

National Pension Scheme

NPS is a defined contribution pension system introduced by PFRDA whereby subscribers' contributions are collected and accumulated in an individual pension account using various intermediaries. Under NPS, individual contributions are pooled together into a pension fund and is invested as per approved investment guidelines.

Funds are generally invested in diversified portfolios consisting of government bonds, bills, corporate debentures, and shares, based on subscriber's choice. Subscribers also have an option, at the time of exit, to purchase a life annuity by using accumulated pension fund. As already mentioned, NPS is governed by PFRDA.

PFRDA also established an NPS trust under Indian Trust Act, 1882 in order to manage assets and funds under NPS in the best interest of subscribers. NPS Trust is managed by a Board of Trustees appointed by PFRDA who is the settler of the trust. Legal ownership of trust and funds is entrusted to the board of trustees.

The Board consists of a Chairman and up to 5 members including the chairman, and the Board meets once in 3 calendar months. NPS Trust is responsible for executing individual pension accounts in its name with the subscriber, protecting the properties of NPS, safeguarding interest of NPS and its subscribers, approving various documents and reports including audited financials submitted by various intermediaries of NPS trust, monitoring and evaluating operations of such intermediaries, exit the subscriber from NPS etc.

Central Record Keeping Agency (CRA)

CRA is an agency registered under PFRDA to perform functions of record-keeping, accounting, administration, and customer service to Pension scheme subscribers. National Securities Depository Limited e-governance infrastructure Ltd (CRA1) is one such agency appointed by PFRDA.

In case of private sector employee pension subscribers, an option is given to the employer to choose CRA1 as its Agency and in case of non-employee voluntary subscribers, option to choose the CRA is with the subscribers themselves.

In case of government sector subscribers and subscribers registered with Atal Pension Yojana, the respective

Government will choose the CRA and in case of NPS-Lite subscribers, it is the aggregator who has to choose the CRA.

Functions of CRA

- Acts as an operational interface for all intermediaries under the CRA system and liaisons with all necessary external agencies to accomplish operations and commissioning
- Issuance of PRAN (PRAN means Permanent Retirement Account Number, which is the unique and portable number provided to each subscriber under NPS and remains with him throughout), and dispatch of PRAN card, digitization and maintenance of the database of PRANs, and record transaction related to subscribers
- Initiation of the contribution made by subscribers to their PRAN account
- Receive instructions from subscribers and aggregate the instructions and pass it on to other intermediaries such as Trustee Bank, Annuity Service Providers and Pension Fund Managers.
- Facilitate credit subscribers' account and timely allocation of funds to Pension fund managers
- Offer various services directly to subscribers, including consolidated account statements
- Provide call centre facilities to subscribers
- Provide centralized grievance management system
- Process exits or withdrawal request of subscribers etc.

INSURANCE COMPANIES

Insurance means ‗An arrangement by which a company or the state undertakes to provide a guarantee of compensation for specified loss, damage, illness, or death in return for payment of a specified premium' or in simple terms ‗a thing providing protection against a possible eventuality‘. Insurance is a contract, represented by a policy, in which an individual or entity receives financial protection or reimbursement against losses.

Insurance Company is a company whose business is providing and selling insurance. The Company, which may be for-profit, non-profit, government-owned or in private, sells the promise to pay for certain expenses in exchange for a regular fee, called a premium. For example, if one purchases health insurance, the insurance company will pay for the client's medical bills, if any. Likewise, in life insurance, the company will give the client's beneficiary a certain amount of money when the client dies. The insurance company covers its expenses and / or makes a profit by spreading the risk of any one client over the pool of premiums from many clients.

History of Insurance Companies in India.

Though there is mention about existence of insurance in ancient India in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra), 1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency. 1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders‘ interests.

Meaning of some of the terms commonly used in insurance business :

1) **Insurance Policy Premium**: The premium of an insurance policy is the amount that you need to pay to purchase a specific amount of insurance cover. It is typically

expressed as a regular cost, be it monthly, quarterly, half-yearly, annually or one time, that you incur during the premium payment term. There are various factors based on which an insurance company calculates the premium of an insurance policy. The idea behind is to check the eligibility of an insured individual for the specific type of insurance policy that he/she wants to buy, e.g. if you are healthy and do not have a medical history of getting treatment for severe bodily diseases, you are likely to pay less for health insurance premium. You should also know that different insurance companies may ask for different premiums for similar types of policies. So, selecting the right one at a price you can afford does require some effort.

2) **Policy Limit**: It is defined as the maximum amount that an insurance company is liable to pay for the losses covered under the insurance policy. It is determined based on the period (policy term), loss or injury, and similar other factors. Typically, higher the policy limit, higher will be the premium payable.

3) **Sum assured**: For a life insurance policy, the maximum amount that an insurer pays to the nominee is known as the sum assured.

4) **The Insurer**: An ―insurer‖ refers to the company providing you with financial coverage in the case of unexpected, bad events covered in your policy happening to you. The ‗insurer' is the one calculating risks, providing insurance policies, and paying out claims.

5) **The Insured**: Refers to the person (or people / things) covered under the insurance policy.

6) **Insurance policy**: a document detailing the terms and conditions of a contract of insurance.

7) **Adjuster**: A claims or insurance adjuster is employed by

or acts on behalf of an insurance company to examine, evaluate and settle insurance claims.

8) **Beneficiary**: In life insurance, beneficiary is the person or entity entitled to receive the claim amount in the event of the insured's demise. The policyholder selects the beneficiary at the time of purchasing the policy. The eligibility of the person to be considered as a beneficiary depends on the legal norms and specifications of the policy.

Furthermore, if the life insurance beneficiary is a minor at the time of commencement of the policy, there are different guidelines. The policyholder can appoint a contingent beneficiary in such a situation. If you are purchasing an insurance policy, it is in your best interest to know what is a beneficiary and their rights to make an informed choice.

How Does Insurance Work?

As defined above, an insurance policy is a legal contract that binds both policyholder and the insurance company towards each other. It has all the details of the conditions or circumstances under which either the insured individual or policy nominee receives insurance benefits from the insurer. Insurance is a method by which you can protect yourself and your loved ones from facing a financial crisis. You buy an insurance policy for the same, while the insurance company takes the risk involved and offer insurance cover at a specific premium.

In case of any eventuality, the insured or nominee can file a claim with the insurer. Based on the evaluation criteria for claims, the insurer reviews the claim application and settles the claim.

Benefits of Insurance

Insurance policies benefit people as well as society as a whole in various ways. Along with the obvious benefits of insurance, others are not much discussed or talked about.

1. Cover against Uncertainties

It is one of the most prominent and crucial benefits of insurance. The insured individual or organizations are indemnified under the insurance policies against losses. Buying the right type of insurance policy is indeed, a way to get protection against losses arising from different uncertainties in life.

2. Cash Flow Management

The uncertainty of paying for the losses incurred out of pocket has a significant impact on cash flow management. However, with an insurance policy by your side, you can tackle this uncertainty with ease. The chosen insurance provider pays in the event of happening of an insured event whenever they occur.

3. Investment Opportunities

Unit linked insurance plan, invest a part of the premium into several market linked funds. This way, they enable you to invest money regularly and get the benefit of market linked returns and fulfill your life goals of making some savings and getting reasonable returns on your investment.

4) Tax Benefits of Insurance

Other than the protection benefits of insurance policies, you can also avail income tax benefits.

Section 80C: The premium paid to buy life insurance policies are eligible for deduction from the taxable income, Under Section 80C of the Income Tax Act. The upper limit for these deductions is Rs. 1.5 Lakh.

Section 80D: Health insurance premium paid to buy policies is also tax-deductible under Section 80D of income tax Act.

Section 10(10) D: The life insurance benefits that you or the insurance policy nominee will receive from the insurer are tax-exempted under this section. You can claim these tax benefits of insurance at the time filing your income tax returns.

Types of Insurance

Insurance providers in India can be broadly classified into two (1) Life Insurance and (2) non- Life or General Insurance:

1. ***Life Insurance***: Before independence, there were number of players in life insurance sector in India. The Government of India felt the need to bring the entire life insurance business under one umbrella in the Government sector. As a result the Indian Parliament enacted an Act to provide for the nationalization of life insurance business in India by transferring all such business to a Corporation established for the purpose and to provide for the regulation and control of the business, The Life Insurance Corporation was formed in 1956.

   Life Insurance Corporation of India popularly known as LIC is the largest life insurance company in India owned by the Government of India. LIC, one of the top 10 insurance companies in India, came into existence in the year 1956. LIC makes insurance accessible for every person in any corner of the country with 2048 branch offices, 113 divisional offices, 8 zonal offices and 1381 satellite offices. Currently, LIC's total asset under management is INR 31,11,847 crores (USD 450 billion). LIC being the dominant insurance player has a huge customer base of over 29 crores policyholders. LIC is a trusted insurance brand that offers great convenience to its customers through its excellent customer services on the digital platform and also through branch offices and various other tie-ups. LIC offers numerous life insurance products that can meet the unique needs of a variety of customer segments. For all the milestones it has achieved, LIC has been consistently recognized and received numerous awards and citations.

2. **General Insurance**: All insurance plans, which cannot be classified as life insurance, is known as general insurance policies. General insurance policies act as a contract of indemnity. It assures financial reimbursement for unexpected loss or damage of the insured object or person. General insurance policies have a shorter term, generally between one year and three years. Policyholders can choose to renew coverage before their existing protection lapses. Failure to renew these plans will lead to suspension of all policy benefits after the end of a particular tenure. In case of general insurance plans, the insured value is normally the value or the current market value of the item insured. The claim amount is determined by the extent of damage or the amount of loss suffered by the policyholder. For instance, in case of a car insurance claim, the insurer will check the extent of damage and assess the cost of initiating repairs. Based on this assessment, the insurance company offers monetary compensation. Death benefit clauses are not present in general insurance plans.

The most common types of general Insurance products that people buy are:

- Health Insurance
- Motor Insurance
- Home Insurance
- Theft / Burglary Insurance, etc.

IRDA (Insurance Regulatory and Development Authority)

IRDA is the regulatory body in India that governs both Life insurance and General insurance companies. IRDA is an autonomous regulatory body that protects the interests of the policyholder. They oversee the growth of the insurance sector in India and also maintain a speedy development.

Background

India is a vast country that offers great opportunities to varied segments one of which is the insurance sector. The process of re-opening of the insurance sector had begun in the early 1990s and gained momentum in the beginning of 21st century. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders‘ interests.

Functions of IRDA

(1) to protect the interest of and secure fair treatment to policyholders;

(2) To bring about speedy and orderly growth of the insurance industry (including annuity and superannuation payments), for the benefit of the common man and to provide long term funds for accelerating growth of the economy;

(3) To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;

(4) To ensure speedy settlement of genuine claims, to prevent insurance frauds and other malpractices and put in place effective grievance redressal machinery;

(5) To promote fairness, transparency and orderly conduct in financial markets dealing with insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;

(6) To take action where such standards are inadequate or ineffectively enforced;

(7) To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

Duties and Powers of IRDAI

Section 14 of IRDAI Act, 1999 lays down the duties, powers and functions of IRDAI. The powers and functions of the Authority shall include: -

1) issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
2) protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
3) specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents
4) specifying the code of conduct for surveyors and loss assessors;
5) promoting efficiency in the conduct of insurance business;
6) promoting and regulating professional organizations connected with the insurance and re- insurance business;
7) levying fees and other charges for carrying out the purposes of this Act;
8) calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;
9) control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
10) specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

Role of IRDA in the Insurance Sector in India

At one point of time, some insurance companies used to deny coverage of certain risks to their policyholders. The basis of the denial was either their choice of business to underwrite or was their understanding of good risk and bad risk. To regulate the market and minimize any sort of partial acts, the IRDA was established.

The banking system in India is regulated as per the guidelines of RBI. It restricts the bankers to not behave unruly with the account holders. The banking institutes are allowed to offer loans and interest as per the rates pre-defined by RBI. It leaves no room for the monopoly to take over which in turn works best for the masses. Financial Institutes like banks and insurance companies will be successful in our democracy until market practices are for the majority and not just for fraction of people.

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UNIT V
FOREIGN CAPITAL FLOWS

Capital Flows

Capital flows refer to the movement of money for the purpose of investment, trade, or business operations. Inside of a firm, these include the flow of funds in the form of investment capital, capital spending on operations, and research and development (R&D). On a larger scale, a government directs capital flows from tax receipts into programs and operations and through trade with other nations and currencies. Individual investors direct savings and investment capital into securities, such as stocks, bonds, and mutual funds.

International capital flows are transactions involving financial assets between international entities. Financial assets to be included can be bank deposits, loans, equity securities, debt securities, etc. Capital outflow generally results from economic uncertainty in a country, whereas large amounts of capital inflow indicate a growing economy.

In most of the period since the mid-1990s, external sector developments in India have been marked by strong capital flows. Capital inflows, which were earlier mainly confined to small scale official concessional finance, gained momentum from the 1990s after the initiation of economic reforms. As well as increasing in size, capital inflows have undergone a compositional shift from predominantly official and private debt flows to non-debt-creating flows in the post-reform period. Private debt flows have begun to increase again in the more recent period. Though capital flows are generally seen to be beneficial to an economy, a large surge over a short span of time in excess of domestic absorptive capacity can be a source of stress, leading to upward pressure on the exchange rate, overheating of the economy and possible asset price bubbles. In India, capital flows in the past few years increased sharply and have been well above the current account deficit, which has largely remained modest. This has posed new challenges for monetary and exchange rate management.

Benefits of Capital Inflows

- External capital can supplement domestic savings and stimulate economic growth.
- International borrowing and lending enable countries to neutralize fluctuations in income and attain smooth consumption streams. This improves welfare. However, as to the developing countries, capital inflows have been markedly pro-cyclical so that the gap between boom-time and bust-time consumption was actually widened and not narrowed.
- The lenders gain from higher return and better international portfolio diversification.
- Increase in the rates of savings and investments
- The inflow of capital from advanced countries, apart from removing the capital deficiencies, brings in advanced technology and skills, organizational expertise and market management, helps in training of domestic skills, establishment of infra-structure for scientific and technical research and creation of new varieties of products.
- Substantial inflow of foreign capital will help the developing countries to develop the structure of heavy and basic industries.

Dangers of Capital Flows

- The foreign capital, when easily available, is likely to be mutualized in the low priority projects engaged in the production of luxury goods or other wasteful products.

- There are restrictions on the remittances of profits and repatriation of capital. It results in a reduction in the inflow of capital from abroad.
- On account of the outflow of capital due to exit policy of foreign and indigenous investors coupled with heavy annual debt servicing liabilities, the capital outflow many often exceeds the inflow of capital.
- If the foreign capital is employed for unproductive purposes or for financing consumption, the burden of external debt tends to increase.
- Foreign aid has moderating effect on inflation. However, the foreign capital and investment may reinforce the inflationary pressures in the developing countries
- A larger flow of aid in the form of commodities, services and capital, tends to increase the BOP deficit.
- The aid-giving countries impose generally arbitrary and unacceptable conditions upon the recipient countries. For instance, they tie aid to the purchase of capital goods and raw materials from the specified suppliers belonging to these countries.
- The increased import of consumer goods by way of foreign assistance and greater priority to the production of luxury and semi-luxury goods causes an increase in consumption and consequent decline in domestic saving.

Forms of Foreign Capital

Any investment that is made in India with the source of funding that is from outside of India is a foreign investment. By this definition, the investments that are made by Foreign Corporates, Foreign Nationals, as well as Non-Resident Indians would fall into the category of Foreign Investment.

Funds from foreign country could be invested in shares, properties, ownership / management or collaboration. Based on this, Foreign Investments are classified as below: -

- Foreign Direct Investment (FDI)
- Foreign Portfolio Investment (FPI)
- Foreign Institutional Investment (FII)

1. Foreign Direct Investment (FDI)

A foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets in a foreign company. However, FDIs are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. Foreign Direct Investments are commonly made in open economies that have skilled workforce and growth prospect. FDIs not only bring money with them but also skills, technology and knowledge.

For example, if an American multinational firm opens up operations in China or India, either by opening up its own premises or by partnering with a local firm, that investment would be considered part of FDI. Economists track the flows of FDI between countries as this is seen as an important contributor to economic growth.

FDI can help foster and maintain economic growth, both for the recipient country and for the country making the investment. For example, a developing country might benefit from incoming FDI as a way of financing the construction of new infrastructure or providing employment for its local workforce. On the other hand, multinational companies can benefit from FDI as a way to expand their footprint into international markets. One of the main disadvantages of FDI, however, are that it tends to rely on the involvement or oversight of multiple governments, leading to higher levels of political risk.

Methods of FDI

A company can expand its business by investing directly in a foreign country. Amazon opening a new headquarters in Vancouver, Canada would be an example of this. Reinvesting profits from overseas operations, as well as intra-company loans to overseas subsidiaries, are also considered foreign direct investments.

There are multiple methods for a domestic investor to acquire voting power in a foreign company. Below are some examples:-

- Acquiring voting stock in a foreign company
- Mergers and acquisitions
- Joint ventures with foreign corporations
- Starting a subsidiary of a domestic firm in a foreign country

Benefits of FDI

I. Benefits to the Company:

- Market diversification
- Tax incentives
- Lower labor costs
- Preferential tariffs
- Subsidies

II. Benefits to the Host Country

- Economic stimulation
- Development of human capital

- Increase in employment
- Access to management expertise, skills, and technology

Disadvantages of FDI

Despite many benefits, there are still two main disadvantages to FDI:

- **Displacement of local business**: The entry of large firms, such as Walmart, may displace local businesses. Walmart is often criticized for driving out local businesses that cannot compete with its lower prices.
- **Profit Repatriation**: The firms may not reinvest profits back into the host country. This leads to large capital outflows from the host country. As a result, many countries have regulations limiting foreign direct investment.

2. Foreign Portfolio Investment (FPI)

Along with foreign direct investment (FDI), FPI is one of the common ways to invest in an overseas economy. Foreign Portfolio Investment involves an investor buying foreign financial assets. It involves an array of financial assets like fixed deposits, stocks, and mutual funds. Investors who invest in foreign portfolios are known as Foreign Portfolio Investors. The intent of investing in foreign markets is to diversify the portfolio and get some handsome return on investments. Investors expect to receive high returns owing to the risk they‘re willing to take.

An individual investor interested in opportunities outside their own country is most likely to invest through an FPI. On a more macro level, foreign portfolio investment is part of a country‘s capital account and shown on its balance of payments (BOP). The BOP measures the amount of money flowing from one country to other countries over one monetary year.

Securities and Exchange Board of India (SEBI) operates the FPIs. Recently, SEBI has introduced the Foreign Portfolio Investors Regulations, 2019. FPIs also need to follow the Income-tax Act, 1961 and Foreign Exchange Management Act, 1999.

Benefits of FPI

- FPI provides investors an opportunity to diversify their portfolio and achieve high returns.
- Investors can get access to increased amounts of credit in foreign countries.
- Sometimes, foreign market can be less competitive than the domestic market.
- Foreign Portfolio Investments provides high liquidity. An investor can buy and sell foreign portfolios seamlessly.
- An investor can leverage the dynamic nature of international currencies. Some currencies can drastically rise or fall, and a strong currency can be used in investor‘s favour.

Eligibility Criteria for FPI

- As per the Income-tax Act 1961, the applicant should not be a non-resident Indian
- Should not be a citizen of a country that falls under the public statement of FATF.
- Must be eligible to invest in securities outside the country.
- To invest in securities, he/she must have the approval of the MOA / AOA / Agreement.
- A certificate that grants the applicant holds an interest of the development of the securities market.
- In case the bank is the applicant, it must belong to a nation

whose central bank is a member of the Bank for International Settlements.

Critical Differences Between FDI and FPI

While both FDI and FPI involve putting money into a foreign country, the two investment options differ considerably. Following are some of the key differences between these two:

Parameters	FDI	FPI
Definition	FDI refers to the investment made by foreign investors to obtain a substantial interest in the enterprise located in a different country.	FPI refers to investing in the financial assets of a foreign country, such as stocks or bonds available on an exchange.
Role of investors	Active Investor	Passive Investor
Type	Direct Investment	Indirect Investment
Degree of control	High Control	Very low control
Term	Long term investment	Short term investment
Management of Projects	Efficient	Comparatively less efficient
Investment has done on	Physical assets of the foreign country	Financial assets of the foreign country
Entry and exit	Difficult	Relatively easy
Leads to	Transfer of funds, technology, and other resources to the foreign country	Capital inflows to the foreign country
Risks Involved	Stable	Volatile

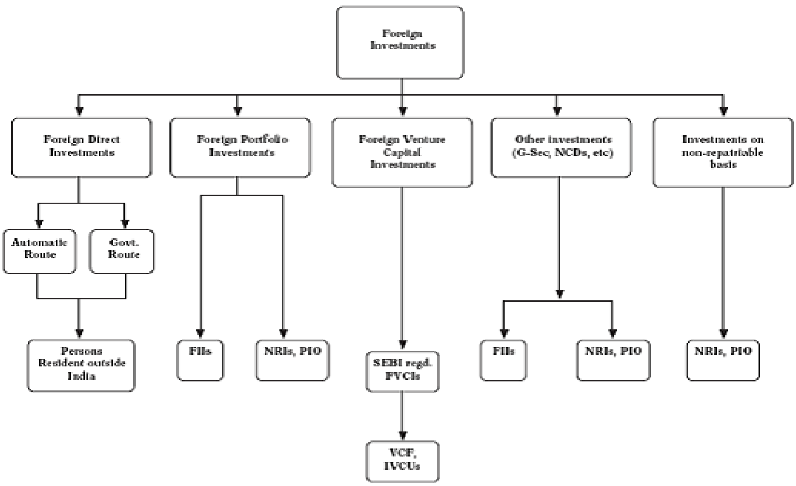
3. Foreign Institutional Investments (FII)

Foreign institutional investors (FIIs) are those institutional investors which invest in the assets belonging to a different country other than that where these organizations are based. Foreign institutional investors play a very important role in any economy. These are the big companies such as investment banks, mutual funds etc., who invest considerable amount of money in the Indian markets. With the buying of securities by these big players, markets trend to move upward and vice-versa. They exert strong influence on the total inflows coming into the economy.

Market regulator SEBI has over 1450 foreign institutional investors registered with it. The FIIs are considered as both a trigger and a catalyst for the market performance by encouraging investment from all classes of investors which further leads to growth in financial market trends under a self-organized system.

Regulations on Investing in Indian Companies

- FIIs are allowed to invest in India's primary and secondary capital markets only through the country's portfolio investment scheme.
- FIIs are generally limited to a maximum investment of 24% of the paid-up capital of the Indian company receiving the investment.



International Financial Instruments

International Financial instruments are an integral part of financial markets. It is the monetary contract created by two or more parties which can be transferred, traded and settled with cash, where one party has a liability interest and to another it is asset interest. It is a document that represents an asset to one party and liability to another.

Below are some international financial instruments: -

1. International Bonds/ Foreign Bonds

Foreign bonds are issued by foreign issuers in a foreign national market and are denominated in the currency of that market. Foreign bond issuance is regulated by the rules of the host national market. An example of a foreign bond is a bond denominated in US dollars issued by a German company in the United States.

2. Eurobonds

A Eurobond is a bond issued outside the home country of the issuer through an international syndicate and sold to investors residing in various countries. Eurobonds are usually denominated in a currency other than that of the country of placement. An example of a Eurobond is a bond denominated in US dollars issued by a US firm and placed in European and/or Asian countries. The Eurobond market is often referred to as a supranational market because Eurobonds are issued simultaneously by international syndicates of underwriters under loose regulation across many countries. Eurobonds are traded in various exchanges, but mostly in the LSE.

3. Global Bonds

International bonds placed in both the Euromarkets and domestic markets at the same time and are freely tradeable in any of the major capital market centers. As the issuance of both dollar- and non-dollar-denominated global bonds is rapidly increasing, there might well be less of a distinction in future between a Eurobond and a domestic bond.

4. Parallel Bonds

A parallel bond is a multinational issue consisting of several loans sold simultaneously among various countries each of which raises the loan in its own currency.

5. Global Depository Receipts

Global Depository Receipt (GDR) is an instrument which allows Indian Corporate, Banks, Non- banking Financial Companies etc. to raise funds through equity issues abroad to augment their resources for domestic operations. A corporate entity can issue any number of GDR issues in a year and the corporate involved in infrastructure projects need not have a past track record of financial performance.

A GDR is a dollar denominated instrument of a company, traded in stock exchanges outside the country of origin i.e., in European and South Asian Markets. It represents a certain number of underlying equity shares.

6. Foreign Currency Convertible Bonds

Foreign Currency Convertible Bonds (FCCBs) are issued in accordance with the scheme and subscribed by a non-resident in foreign currency and convertible into ordinary share of the issuing company in any manner, either in whole or in part on the basis of only equity related warrants attached to debt instrument. The FCCB is almost like the convertible debentures issued in India.

The Bond has a fixed interest or coupon rate and is convertible into certain number of shares at a prefixed price. The bonds are listed and traded on one or more stock exchanges abroad. Till conversion the company has to pay interest on FCCBs in dollars (or in some other foreign currency) and if the conversion option is not exercised, the redemption also has to be done in foreign currency. The bonds are generally unsecured.

7. American Depository Receipts

A foreign company might make issue in U.S. by issuing securities through appointment of Bank as depository. By keeping the securities issued by the foreign company, the U.S. Bank will issue receipts called American Depository Receipts (ADRs) to the investors. It is a negotiable instrument recognizing a claim on foreign security. The holder of the ADRs can transfer the instrument as in the case of domestic instrument and also entitled for dividends as and when declared.

8. External Commercial Borrowing

External Commercial Borrowings (ECBs) is a borrowing of over 180 days. ECB is the borrowing by corporate and financial institutions from international markets. ECBs include commercial bank loans, buyers‘ credit, suppliers‘ credit, security instruments such as floating rate notes and fixed rate bonds, credit from export-credit agencies, borrowings from international financial institutions such as IFC etc.

The incentive available for such loans is the relative lower financing cost. ECB‘s can be taken in any major currency and for various maturities. ECBs are being permitted by the Government for providing an additional source of funds to Indian corporate and PSUs for financing expansion of existing capacity as well as for fresh investment to augment the resources available domestically.

ECBs are approved with an overall annual ceiling.

Consistent with prudent debt- management keeping in view the balance of payments position and level of foreign exchange reserves.

Benefits of International Instruments to Indian Companies

(a) Better corporate image both in India and abroad which is useful for strengthening the business operations in the overseas market.

(b) Exposure to international markets and hence stock prices in line with international trends.

(c) Means of raising capital abroad in foreign exchange.

(d) Use of the foreign exchange proceeds for activities like overseas acquisitions, setting up offices abroad and other capital expenditure.

(e) Increased recognition internationally by bankers, customers, suppliers etc.

(f) No risk of foreign exchange fluctuations as the company will be paying the interest and dividends in Indian rupees to the domestic depository bank.

Benefits to Overseas Investors

(a) Assured liquidity due to presence of market makers.

(b) Convenience to investors as ADRs are quoted and pay dividends in U.S. dollars, and they trade exactly like other U.S. securities.

(c) Cost-effectiveness due to elimination of the need to customize underlying securities in India.

(d) Overseas investors will not be taxed in India in respect of capital gains on transfer of ADRs to another non-resident outside India.

Indian Depository Receipts (IDR)

An IDR is an instrument denominated in Indian Rupees in the form of a depository receipt created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India) against the underlying equity shares of issuing company to enable foreign companies to raise funds from the Indian securities Markets.

IDRs are purchased by investors as an alternative to the direct purchase of foreign stocks on foreign exchanges. For example, American traders can buy shares of the Swiss bank Credit Suisse Group AG or Swedish automaker Volvo AB directly from American exchanges via ADRs.

For the companies, the IDR makes it easier and cheaper to reach international buyers. The company is not required to comply with all of the listing and regulatory requirements of every country in which it wishes to sell shares. IDRs generally represent fractional ownership of the underlying stock, with each IDR representing one, two, three, or 10 shares. The price of the IDR usually trades close to the value of the underlying shares on a currency-conversion basis.

Eligibility Criteria

The eligibility criteria given under IDR Rules and Guidelines for a foreign issuing company are as under-:

- pre-issue paid-up capital and free reserves of at least US$ 50 million and have a minimum average market capitalization (during the last 3 years) in its home country of at least US$ 100 million;
- a continuous trading record or history on a stock exchange in its home country for at least three immediately preceding years;

- a track record of distributable profits for at least three out of immediately preceding five years;
- listed in its home country and not been prohibited to issue securities by any Regulatory Body and has a good track record with respect to compliance with securities market regulations in its home country.

Role of Foreign Capital in Indian Financial System

The term _foreign capital‘ is a comprehensive term and includes any inflow of capital in home country from abroad. It may be in the form of foreign aid or loans and grants from the host country or an institution at the government level as well as foreign investment and commercial borrowings at the enterprise level or both. Foreign capital may flow in ally country with technological collaboration as well. It is interesting to note that even in Russia and East European countries foreign capital has been allowed to flow in. Foreign capital is useful for both developed and developing countries. Advanced countries try actively to invest capital in developing countries. In India, foreign capital has been given a significant role, although it has been changing overtime.

In the case of India, technical assistance received from abroad has helped in filling up the technological gap in the following three ways:

(i) Provision of expert services

(ii) Training of Indian personnel abroad

(iii) Provision of educational, research and training institutions in the country.

In the planned economy of India, foreign capital has been assigned a significant role, although it has been changing over time. In the earlier phase of planning, foreign capital was looked upon as a means to supplement domestic investment. Many concessions and incentives were given to foreign investors. Later on, however, the emphasis shifted to encouraging technological collaboration between Indian entrepreneurs and foreign entrepreneurs. In more recent times, efforts are on to invite free flow of foreign capital. It would be instructive in this background to examine the Government‘s policy towards foreign capital.

Government Policy towards Foreign Capital

Foreign investment in India is subject to the same industrial policy as all other business ventures, plus some additional policies and rules specially governing foreign collaboration. The first articulate expression of free India‘s attitude towards foreign capital was embodied in the Industrial Policy Resolution, 1948 (IPR, 1948). The IPR, 1948 emphasized the need for carefully regulating as well as inviting private foreign capital. It laid special stress, inter-alia, on the need to ensure that in all cases of foreign collaboration, the majority interest was always Indian.

This was followed by the Fiscal Commission of 1949-50 which recommended that foreign investment may be permitted, first, in the public sector projects needing imported capital good, and secondly, in new capital industries where no indigenous capital or technical know- how was likely to be available. This was followed by a statement on policy towards foreign capital made by the Government on April 6, 1949. The underlying principles of the policy by and large are valid even now. These may be enumerated as follows: -

(i) Foreign capital once admitted will be treated at par with indigenous capital.

(ii) Facilities for remittance of profits abroad will continue.

(iii) As a rule, the major interest in ownership and effective control of an undertaking should be in Indians hands.

(iv) If an enterprise is acquired, compensation will be paid on a fair and equitable basis.

(v) The Government would not object to foreign capital having control of a concern for a limited period and each individual case will be dealt with on its merits.

In short, the Government promised non-discriminatory treatment of foreign investment and free remittance facilities for both profits and capital. An emphasis was laid down on the employment and training of the Indians in higher positions. In keeping with these guidelines, the general policy was to allow such foreign investments and collaborations as were in line with the priorities and targets of the Five-Year Plans. The policy was to restrict foreign collaboration to these cases which would bring technical know-how into the country such as was not available indigenously for developing new lines of production.

Overseas Investment Policy of India

Till 1991, India‘s economic integration with the rest of the world was very limited. But the new economic policy and the liberalization measures so introduced made way for the globalization of Indian businesses. Earlier, exports were a predominant way of expanding business abroad and hence the emphasis was on export promotion strategies with restrictions on cash outflows so as to conserve our foreign exchange reserves.

But over the year, its being realized that for expansion and growth of Indian companies, it is necessary that they increase their share in the world market not only by exporting their products but also by acquiring overseas assets and establishing their presence abroad. Accordingly, the policy for outward capital flows has evolved, marked by phased liberalisation.

The first policy in the form of guidelines for overseas direct investment was issued in 1969 by the Government of India. These guidelines defined the extent of participation of Indian companies in projects abroad. They permitted minority participation by an Indian party with no cash remittances. Association of local parties, local development banks, financial institutions and local Governments, wherever necessary was also favoured for promoting such investments.

The Government modified these guidelines by issuing a set of more comprehensive measures in 1978. These measures included provision for the approval, monitoring, evaluation of investment proposals at a focal point by the Ministry of Commerce. These guidelines also recognised the need of vesting the necessary powers with the Reserve Bank of India (RBI) for the release of foreign exchange to meet the preliminary and subsequent expenses of an Indian company relating to its investments abroad.

Such guidelines were subsequently revised in 1986, 1992 and 1995. The policy on Indian investments overseas was first liberalized in 1992. Under it, an Automatic Route for overseas investments was introduced and cash remittances were allowed for the first time with restrictions on the total value. The basic rationale for opening up the regime of Indian investments overseas has been the need to provide Indian industry access to new markets and technologies with a view to increasing their competitiveness globally and help the country‘s export efforts.

Further liberalisation and streamlining of procedures were undertaken in 1995. The guidelines of 1995 provided for a detailed framework by transferring the work relating to overseas investment from Ministry of Commerce to Reserve Bank of India (RBI), which became the nodal agency for administering the overseas investment policy. This provided a single window system for overseas investment approvals. Since then, all proposals for direct investment abroad are being made to and processed by the Reserve Bank of India (RBI).

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