Financial Markets and Institutions – Unit I

Financial Markets Meaning

- **A financial market is a broad term describing any marketplace where trading of securities including**
  equities,
  bonds,
  currencies,
  and derivatives occur.

Structure of Financial Markets

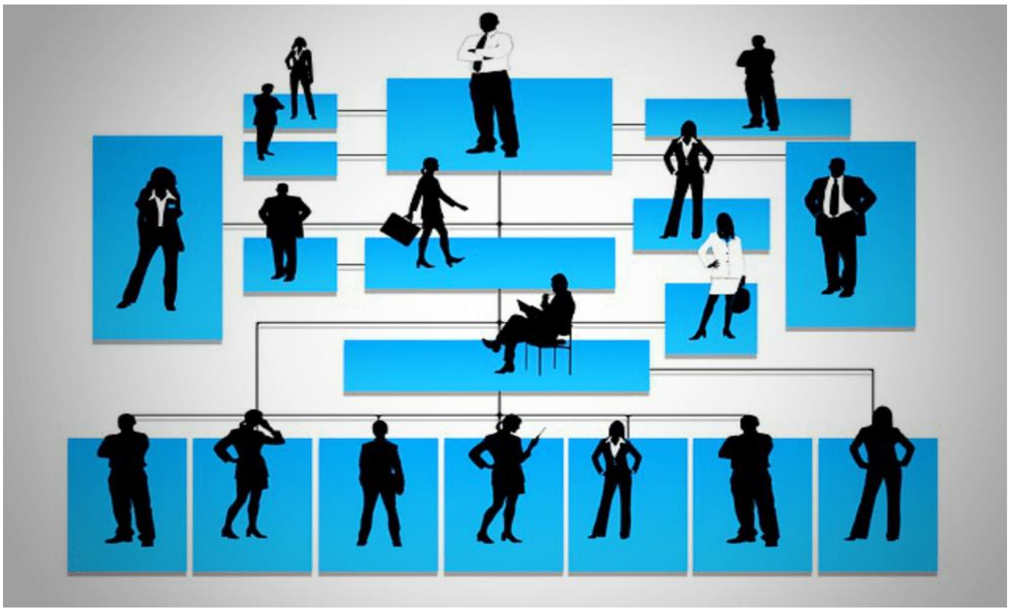
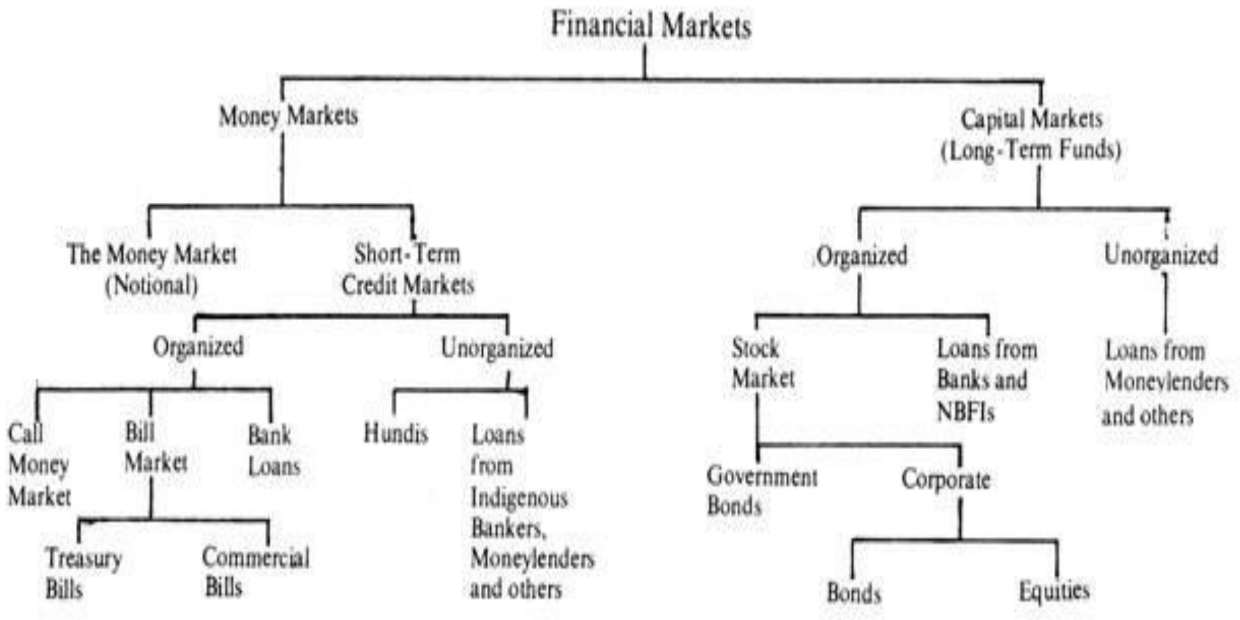
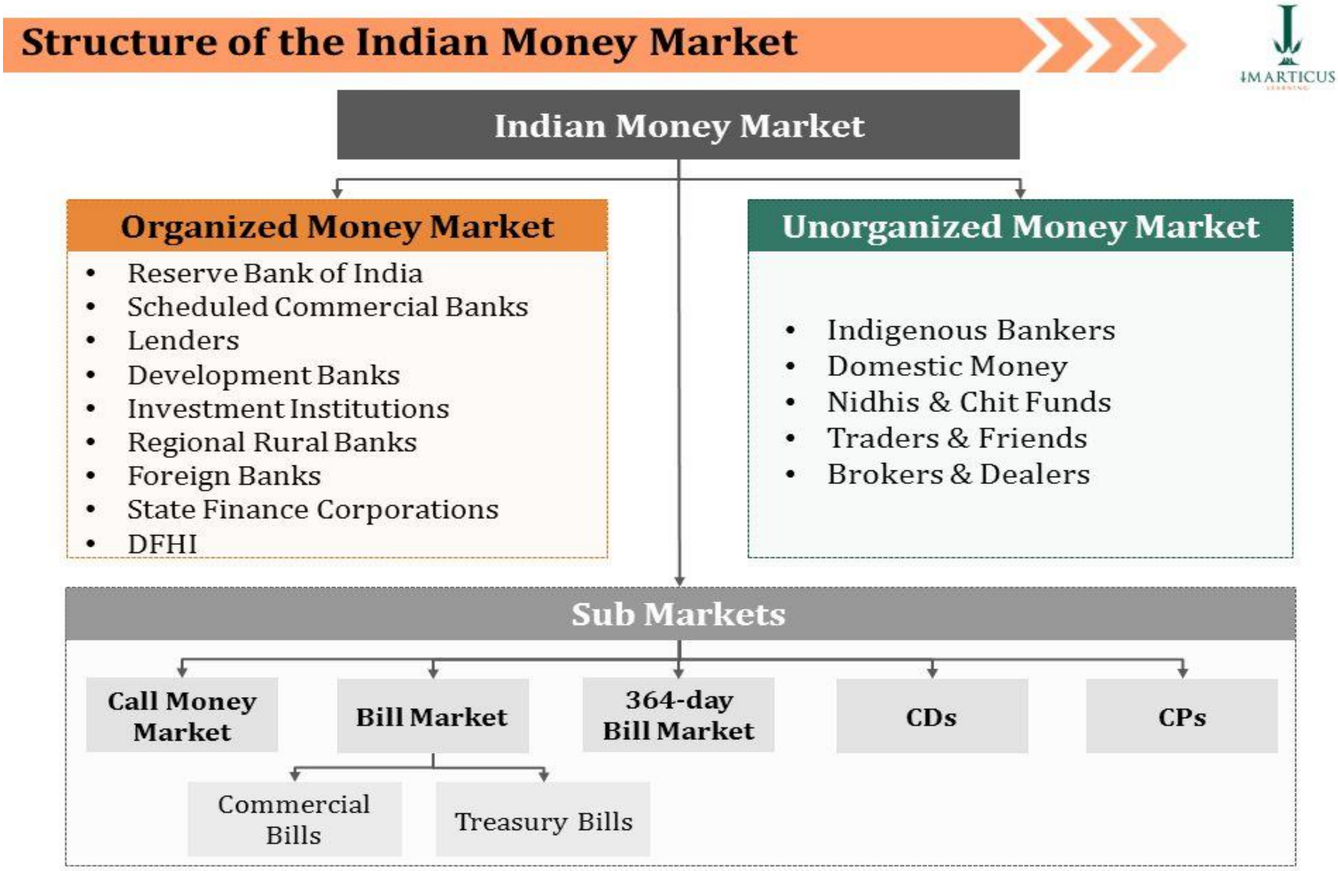


Figure 3.1
Functional-cum-Institutional Classification
of Financial Markets



Structure of Indian Money Markets



Structure of Capital Markets

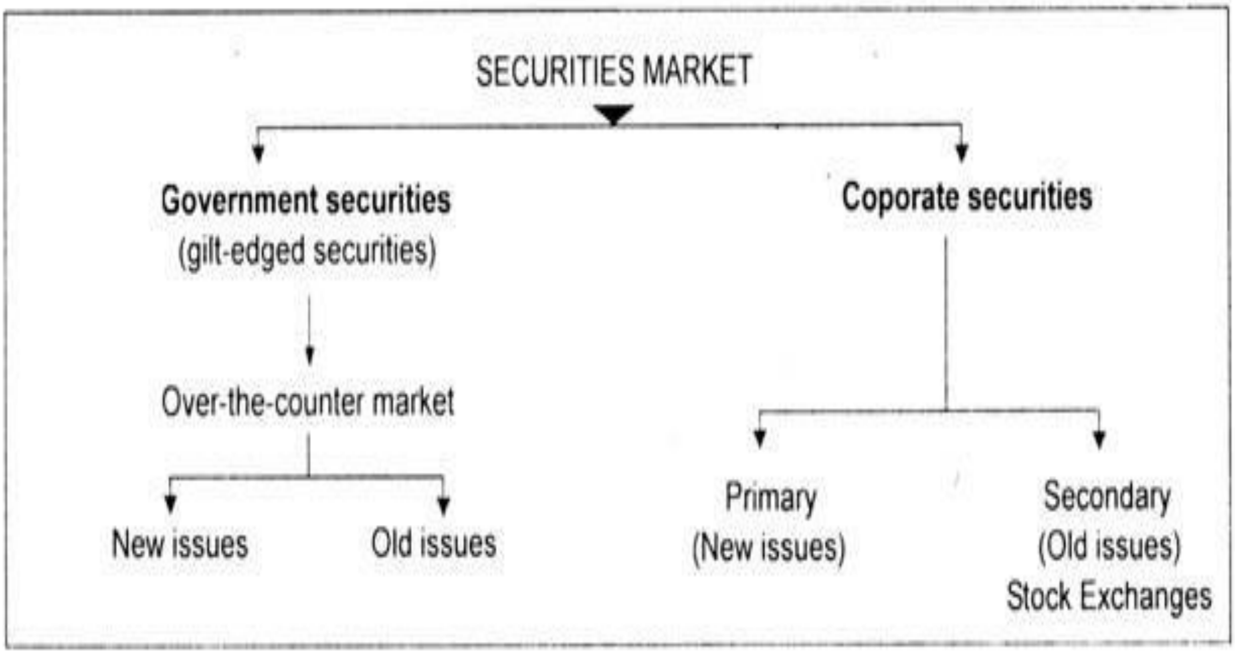


Fig. 10.2: Structure of Securities Market

DISTINGUISH BETWEEN MONEY MARKET AND CAPITAL MARKET

Money market	Capital market
1. Short term funds	1. Long term funds
2. Operational/WC needs	2. FC/PC requirements
3. Instruments are: bills, CPs, T-bills, CDs etc.,	3. Shares, debentures, bonds etc., are main instruments in capital market
4. Huge face value for single instrument	4. Small face value of securities
5. Central and coml. banks are major players	5. Development banks, investment institutions are major players
6. No formal place for transactions	6. Formal place, stock exchanges
7. Usually no role for brokers	7. Brokers playing a vital role

UNIT – II – FINANCIAL MARKETS AND INSTITUTIONS

MEANING OF NEW ISSUE MARKET

- It refers to the set-up which helps the industry to raise the funds by issuing different types of securities.
- These securities are issued directly to the investors (both individuals as well as institutional) through the mechanism called primary market or new issue market.
- The securities take birth in this market.

Functions of the New Issue Market

(a) New companies also called 'initial issues' and

(b) Old companies also called ‘further issues’.

A triple-service function:

(a) Origination

(b) Underwriting

(c) Distribution

(i) A preliminary investigation undertaken by the sponsors (specialised agencies) of the issue. This involves a/careful study of the technical, economic, financial and/legal aspects of the issuing companies to ensure that/it warrants the backing of the issue house.

(ii) Services of an advisory nature which go to improve the quality of capital issues. These services include/advice on such aspects of capital issues as: determination of the class of security to be/issued and price of the issue in terms of market conditions; the timing and magnitude of issues; method of flotation; and technique of selling and so on.

(a) Institutional Underwriters;

(b) Non-Institutional Underwriting.

(iii) The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

Capital Adequacy Norms

A merchant bank will be registered by SEBI in different categories on the basis of capital adequacy norms in terms of its "Net worth".

Category	Minimum amount
Category 1	5,00,00,000
Category 2	50,00,000
Category 3	20,00,000
Category 4	NIL

Merchant bankers categories

Category - 1

- Issue Management
- Advisor
- Consultant
- Manager
- Underwriter
- Portfolio manager

Category - 2

- Advisor
- Consultant
- Co manager
- Underwriter
- Portfolio Manager

Category - 3

- Advisor
- Consultant
- Underwriter

Category - 4

- Advisor
- Consultant

History

- Merchant banking started in Italy in late medieval times (from the fifth to the fifteenth century)
- Reached in France during the seventeenth century
- Italian merchant bankers introduces merchant banking into England in eighteenth century
- European bankers developed Merchant banking in USA
- In 1972, merchant banking started in South Africa.

History in India

- Foreign bank National Grindlays Bank started merchant banking in 1967
- Then Citibank in 1970 and State Bank of India in 1972 started Merchant banking
- Later ICICI setup its merchant banking division followed by Bank of India, Bank of Baroda etc..

Merchant Bank

Merchant banks provide financial services including underwriting, loan services, fundraising services, and financial advising to high net-worth individuals and small/mid-sized corporations.

Trading in stock market

- Listed securities of public limited companies.
- Purpose-facilitates the exchange of securities between buyers and sellers.
- Procedures in dealing stock market:

1. Selection of a broker –approach their banks
2. Placing an order –broker guides about time to purchase and sell
3. Marketing the contract- different post are there. Authorized clerk goes to concern post and express his intention to buy/sell.
4. Contract note – buying and seller brokers prepare notes after their mutual consent next day.
5. Settlement – the selling broker hands over the transfer form and share certificates to the buying broker after receiving the price.

Major players in stock market

- Stock brokers
  - Commission brokers
  - Jobber/speculator
  - Floor brokers –buy and sell to other brokers
  - Taraniwalla or jobber
  - Odd lot dealer
  - Budliwalla – financier in the stock exchange.
  - Arbitrageur –dealing in different stock exchanges
  - Security dealer – purchase and sale of govt. securities by security dealer.
- Financial intermediaries
  - Pooling funds from savers and provide the same to the borrowers
- Individual investors
  - Individual investor make implicit forecast about these factors without elaborate reports because they have no need to communicate beyond the purchase or sale order to their brokers.

Functions of stock market

- Ensure liquidity of capital
- Continuous market for securities
- Evaluation of securities
- Mobilizing surplus savings
- Helpful in raising new capital
- Safety in dealings
- Listing of securities
- Platform for public debt
- Clearing house of business information

Functions of New Issue Market

- Origination : the proposal is analyzed the nature of security, size, and timing of issue and floatation method.
- Underwriting
  - Time of floating of an issue
  - Type of issue- equity, preference ,debt etc.,
  - Price

- Distribution- sale of share-performed by the brokers

Features of Primary Market

- It Is Related With New Issues for long term capital
- Securities are sold first time in this market
- It is also called new issue market(NIM)
- Securities are directly issued to investor
- It facilitates capital formation in the economy.
- Funds generated in this market are utilized for the purchase of fixed assets.
- It does not include long term loans from financial institutions.
- Securities are issued by companies for setting new business and for expanding or modernizing existing business.
- It is the process of going public i.e., converting private capital into public capital.
- It Has No Particular Place
- It Has Various Methods Of Float Capital: Following are the methods of raising capital in the primary market:
  - i) Public Issue
  - ii) Offer For Sale
  - iii) Private Placement
  - iv) Right Issue
  - **v)** Electronic-Initial Public Offer
- It comes before Secondary Market

Services provided by Merchant Bank

- Project counselling
- Loan syndication
- Managers to issue
- Underwriting
- Portfolio Management
- Advising on mergers and takeovers
- Offshore finance

A **merchant bank** is historically a bank dealing in commercial loans and investment. In modern British usage it is the same as an investment bank. Merchant banks were the first modern banks and evolved from medieval merchants who traded in commodities, particularly cloth merchants. Historically, merchant banks' purpose was to facilitate and/or finance production and trade of commodities, hence the name "merchant". Few banks today restrict their activities to such a narrow scope.

Merchant Banking :

Merchant banking means the activity of rendering a number of services including Management of securities, Portfolio management, Underwriting and Insurance, Financial advice and project counseling etc. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer Merchant-Banking services.

The term merchant banking has been used differently in different countries. In UK merchant-banking is termed as accepting and issuing house and in the USA it is known as investment banking.The merchant banks mainly offer financial services for a fee.

Merchant Banking in India :

Even though the State Bank of India is the first institution to set up a separate division for merchant Banking services in 1972, merchant banking services were started in 1967 by National Grindlays Bank followed by Citi Bank in 1970.

The main difference between merchant banking and commercial banking is , commercial banking involves accepting deposits and granting loans and advances whereas merchant banking involves rendering of the services for a fee.

Functions of Merchant banks :

- (1) Underwriting of shares and debentures
- (2) Management of Public issues
- (3) Portfolio management
- (4) Credit syndication which involves all the steps of applying for a loan.
- (5) Corporate Advisory services.
- (6) Management of off shore funds.
- (7) Leasing and financing
- (8) Foreign collaborations and foreign currency management.
- (9)Investment services for non resident Indians.
- (10) Counselling small scale business organizations
- (11) Project finance and project promotion services.
- (12) Treasury management services

- (13) Disbursement of dividends.

In India Merchant banking services are provided by

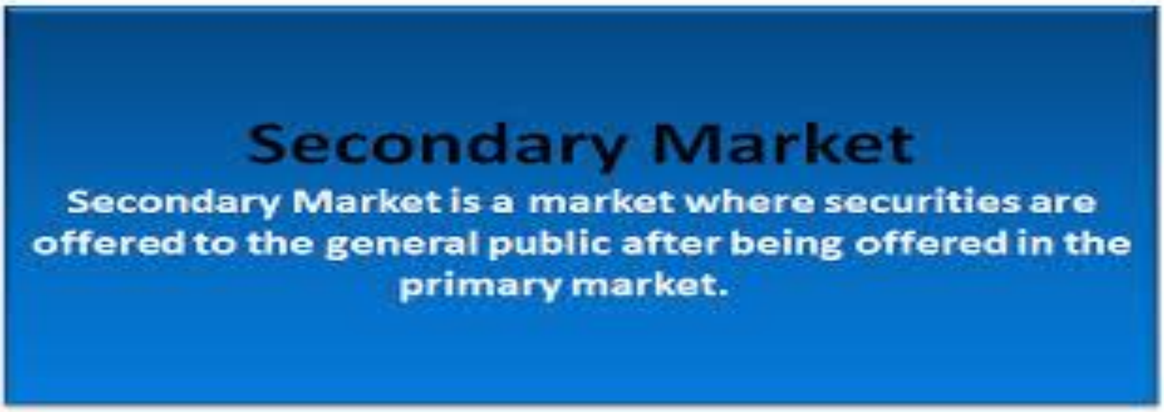
- (1) Commercial Banks
- (2) Financial Institutions
- (3) Private consultancy firms.

Classification of Merchant Banks :

In India Every organization providing merchant-Banking services should register with SEBI. On the basis of the Capital Adequacy and operational activities SEBI has classified the merchant bankers into following types :

Category	**Minimum Net Worth for Capital Adequacy**	**Activities Permitted by SEBI**
Category – I	Rs. 5 Crore	Issue Manager, Advisor, Consultant, Underwriter and Portfolio Manager
Category – II	Rs. 50 Lakhs	Advisor, Consultant, Underwriter and Portfolio Manager
Category – III	Rs. 20 Lakhs	Advisor, Consultant, Underwriter
Category – IV	-NIL	Advisor and Consultant Service Only

Unit III



Features of Stock Exchange:

1. Market for Securities

2. Deals in Second Hand Securities

3. Regulates Trade in Securities

4. Allows Dealings only in Listed Securities

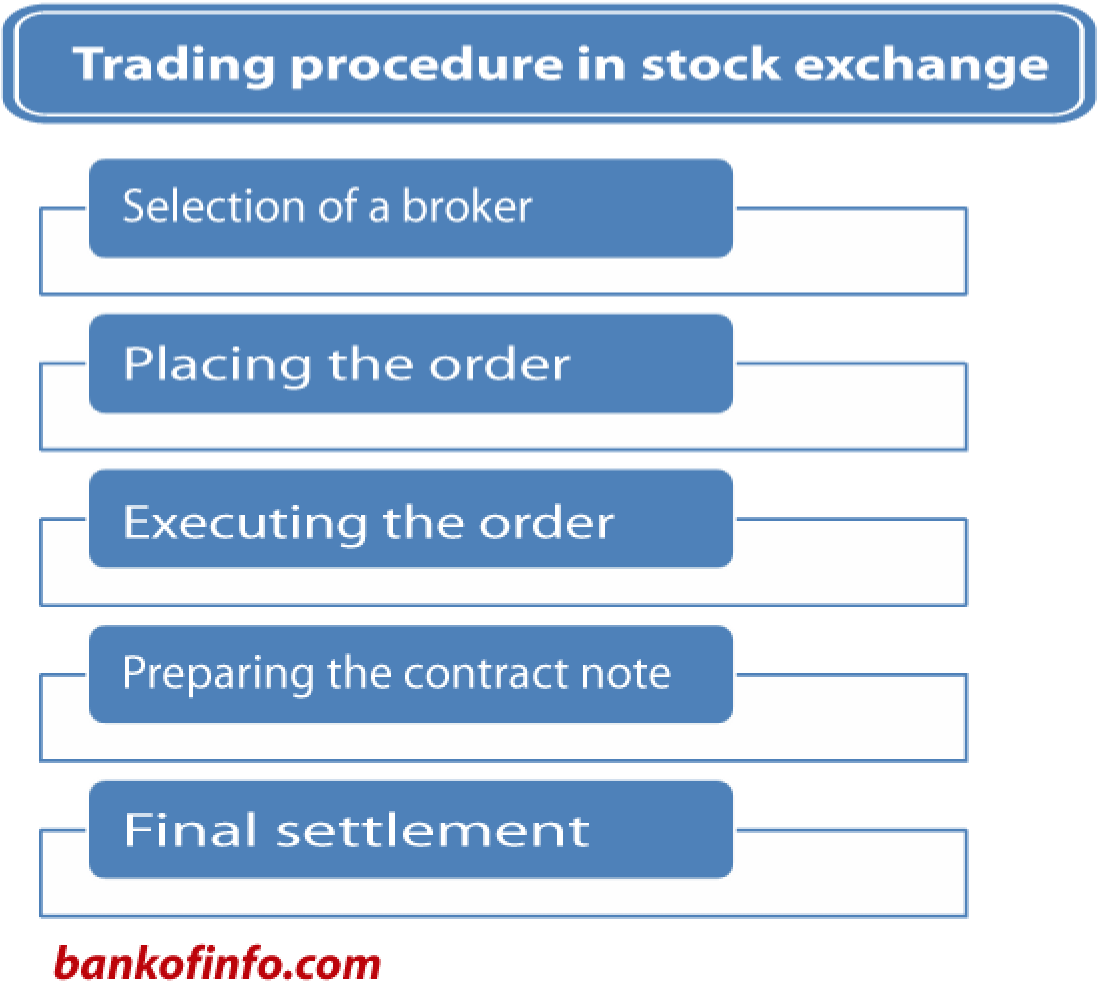
5. Transactions Effected only through Members

6. Association of Persons

7. Recognition from Central Government

8. Working as per Rules

9. Specific Location



Types of Speculators

Speculators in a stock market are of different types. They carry their names depending on their motive of trading in the stock exchange. They are named after animals as their behavior could be compared best with the behavior of animals.

Bull

A Bull or Tejiwala is an operator who expects a rise in prices of securities in the future. In anticipation of price rise he makes purchases of shares at present and other securities with the intention to sell at higher prices in future. He is called bull because just like a bull tends to throw his victim up in the air, the bull speculator stimulates the price to rise. He is an optimistic speculator.

Bear

A bear or Mandiwala speculator expects prices to fall in future and sells securities at present with a view to purchase them at lower prices in future. A bear does not have securities at present but sells them at higher prices in anticipation that he will supply them by purchasing at lower prices in future. A bear usually presses its victim down to ground. Similarly the bear speculator tends to force down the prices of securities. A bear is a pessimistic speculator.

Stag

A stag is a cautious speculator in the stock exchange. He applies for shares in new companies and expects to sell them at a premium, if he gets an allotment. He selects those companies whose shares are in more demand and are likely to carry a premium. He sells the shares before being called to pay the allotment money. He is also called a premium hunter.

Lame Duck

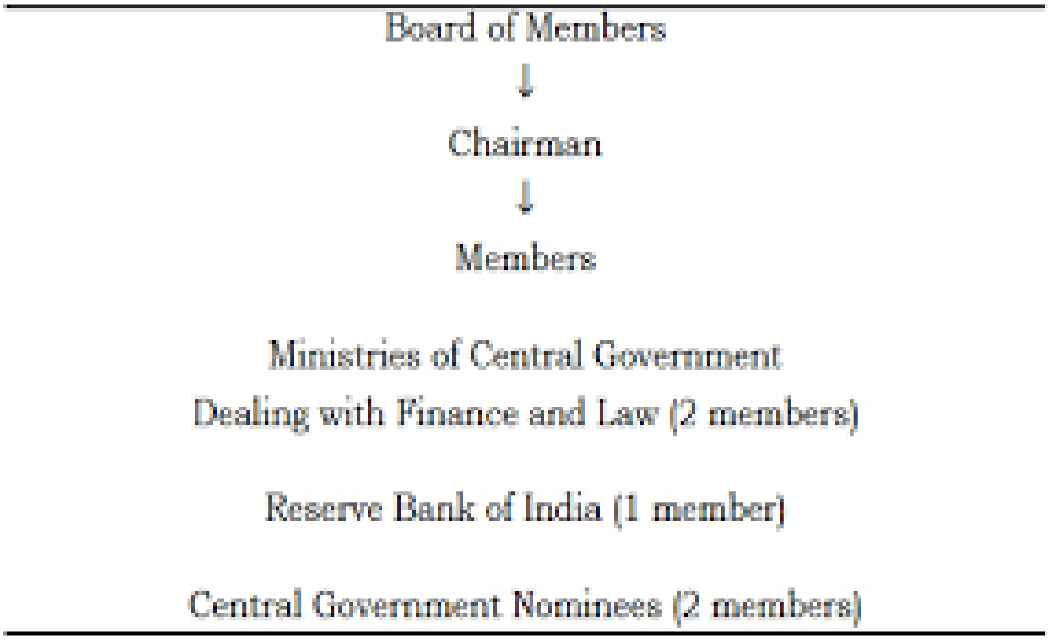
When a bear finds it difficult to fulfill his commitment, he is said to be struggling like a lame duck. A bear speculator contracts to sell securities at a later date. On the appointed time he is not able to get the securities as the holders are not willing to part with them. In such situations, he feels concerned. Moreover, the buyer is not willing to carry over the transactions.

SEBI

Securities and exchange Board of India (SEBI) was first established in the year 1988 as a non-statutory body for regulating the securities market. It was made as an autonomous body by The Government of India on 12 May 1992 and given statutory powers in 1992 with SEBI Act 1992 being passed by the Indian Parliament. SEBI has its headquarters at the business district of

BandraKurla Complex in Mumbai, and has Northern, Eastern, Southern and Western Regional Offices in New Delhi, Kolkata, Chennai and Ahmedabad respectively. additional statutory power by the Government of India through an amendment to the Securities and Exchange Board of India Act, 1992Initially SEBI was a non statutory body without any statutory power. However, in 1992, SEBI was given

Organization Structure of SEBI



Objectives of SEBI

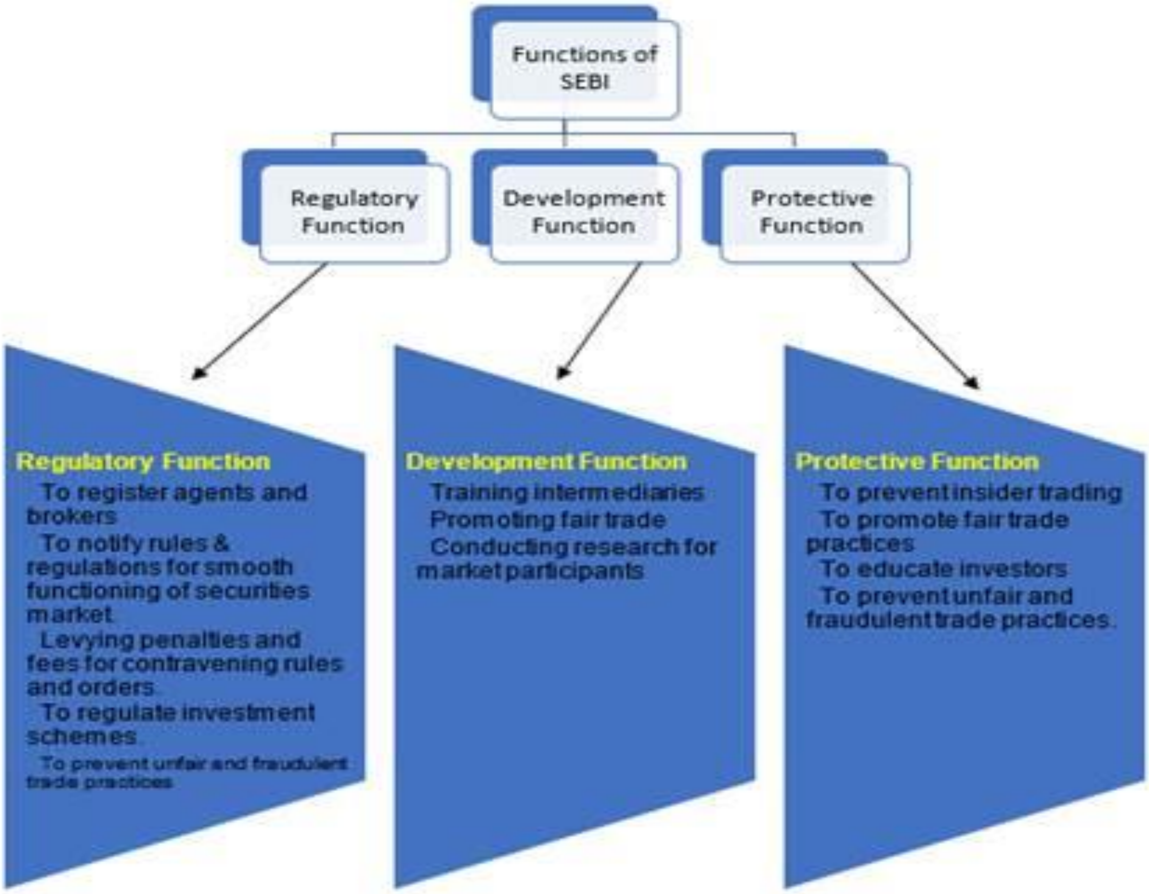
1. Regulation of Stock Exchanges

2. Protection to the Investors

3. Checking the Insider Trading

4. Control over Brokers

Functions of SEBI



Legal Framework of Capital Market (Contd.)

- **Regulations Framed By Exchanges (SRO)**
  - Memorandum & Articles of Association
  - Stock Exchange (Listing) Regulations, 2015
  - Stock Exchange (Settlement of Transactions) Regulations,2013
  - Stock Exchange (Settlement Guarantee Fund) Regulations,2013
  - Automated Trading Regulations, 1999
  - Short Sales Regulations, 2006
  - Investors Protection Funds Regulation
  - Internet Trading Regulations
  - Stock Exchange (Board & Administration) Regulations, 2013
  - Stock Exchange (Trading Right Entitlement Certificate) Regulations, 2013
  - Stock Exchange Bye Laws

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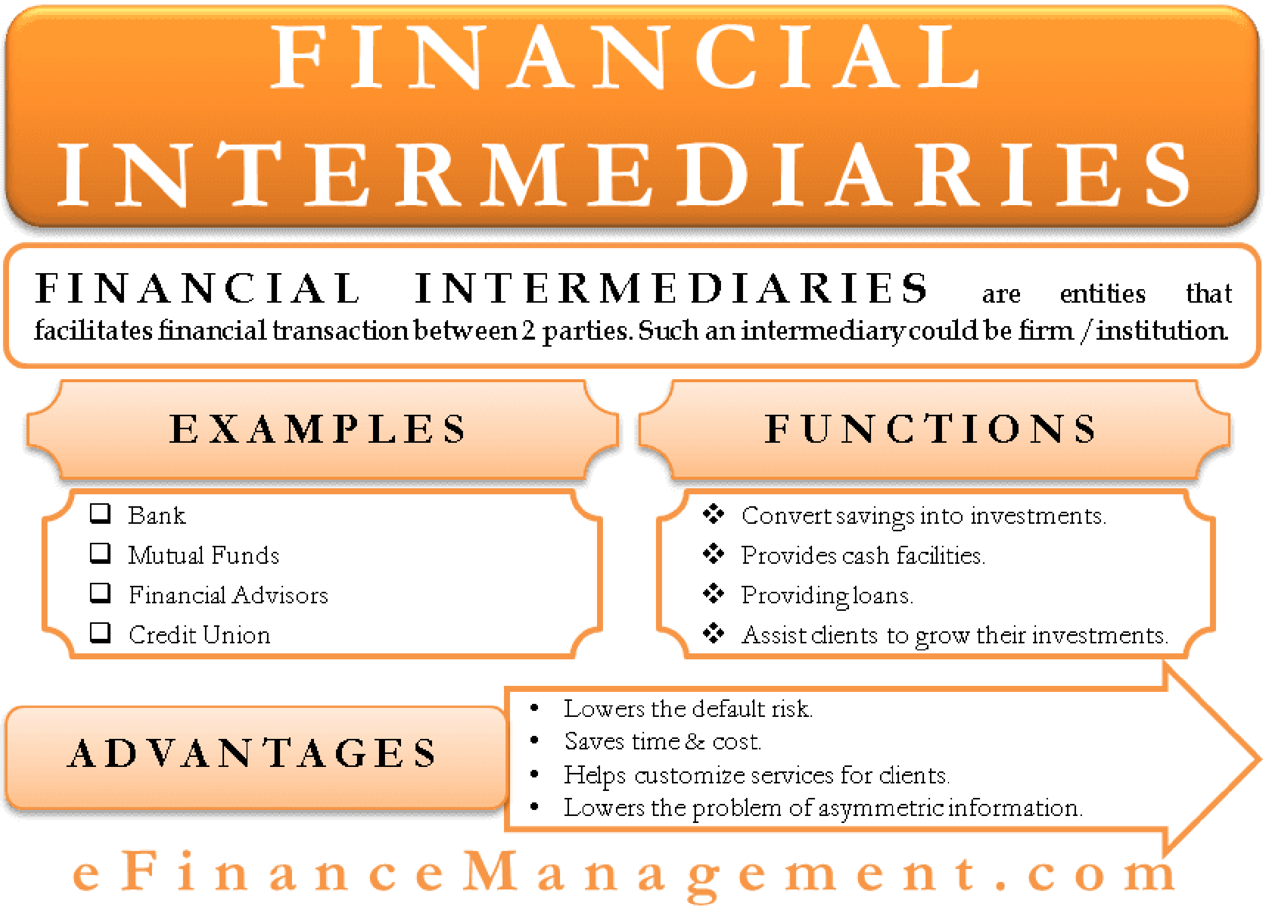
UNIT IV

Financial Intermediaries – Meaning, Functions And Importance

A financial intermediary is an entity that facilitates a financial transaction between two parties. Such an intermediary or a middleman could be a firm or an institution.



Functions of Financial Intermediaries

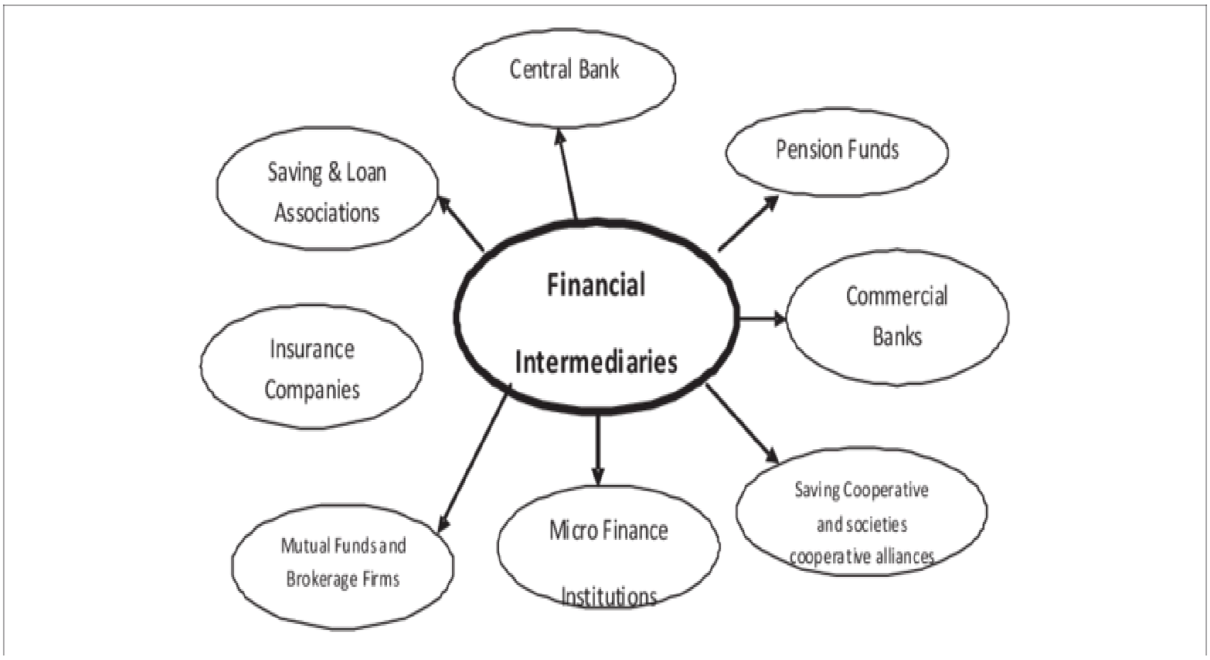
A financial intermediary performs the following functions:

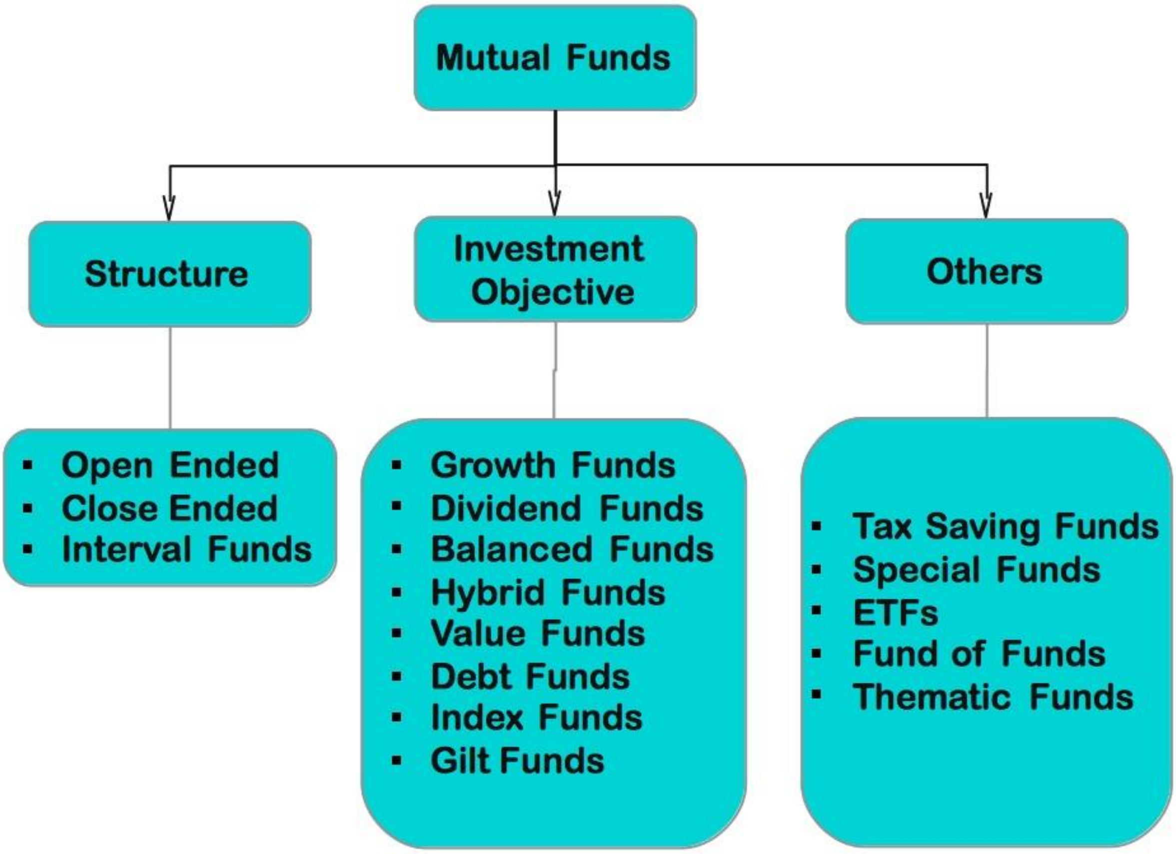
- As said before, the biggest function of these intermediaries is to convert savings into investments.
- Intermediaries like commercial banks provide storage facilities for cash and other liquid assets, like precious metals.
- Giving short and long term loans is a primary function of the financial intermediaries

Advantages of Financial Intermediaries

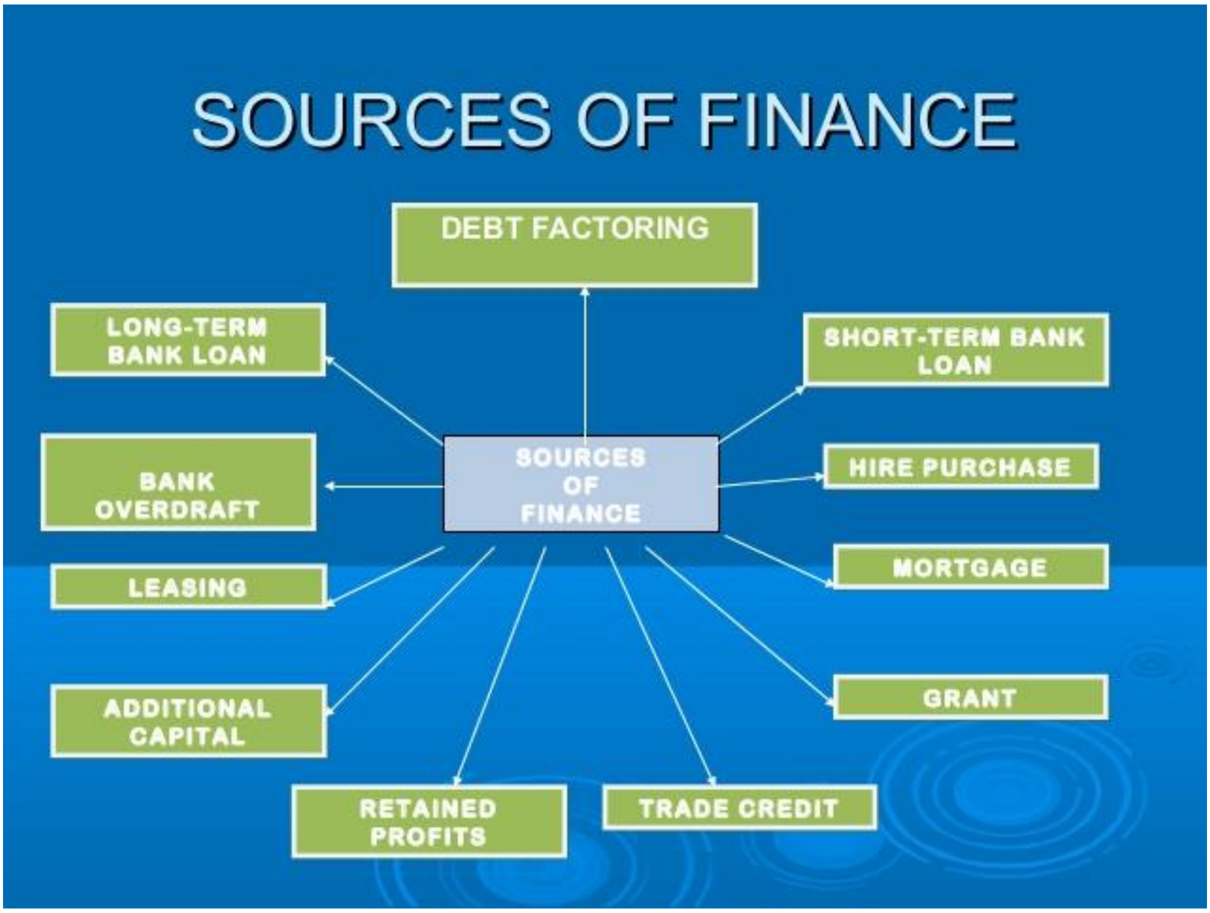
- They help in lowering the risk of an individual with surplus cash by spreading the risk via lending to several people. Also, they thoroughly screen the borrower, thus, lowering the default risk.
- They help in saving time and cost. Since these intermediaries deal with a large number of customers, they enjoy economies of scale.
- Since they offer a large number of services, it helps them customize services for their client. For instance, banks can customize the loans for small and long term borrowers or as per their specific needs. Similarly, insurance companies customize plans for all age groups.

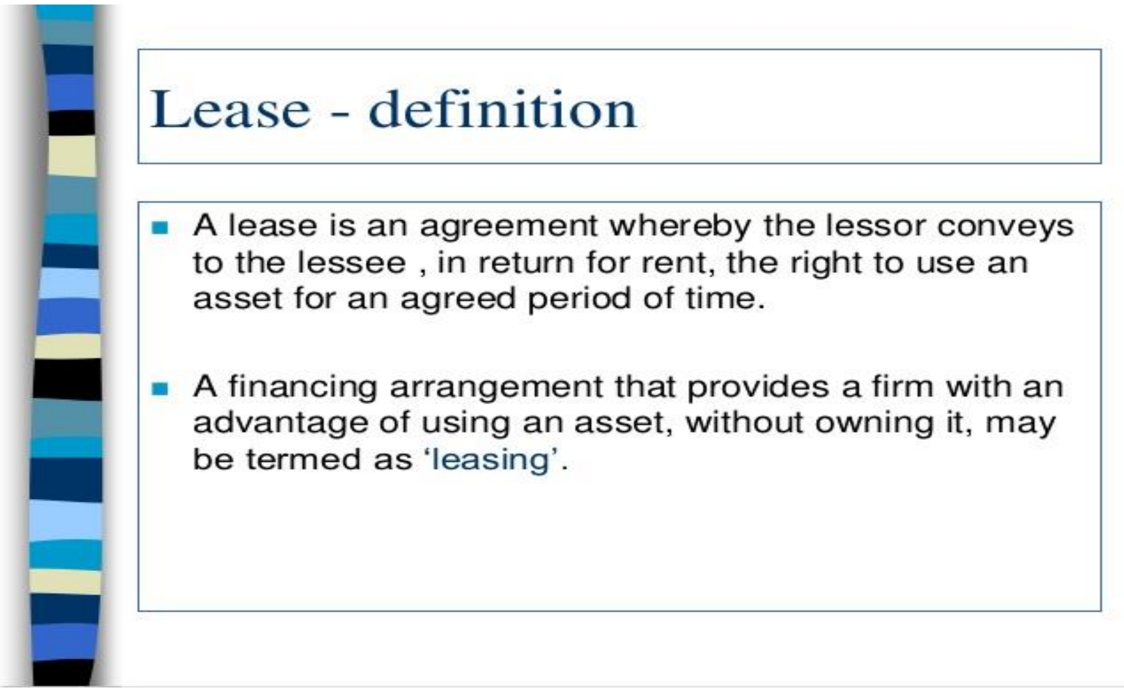
- They accumulate and process information, thus lowering the problem of asymmetric information.

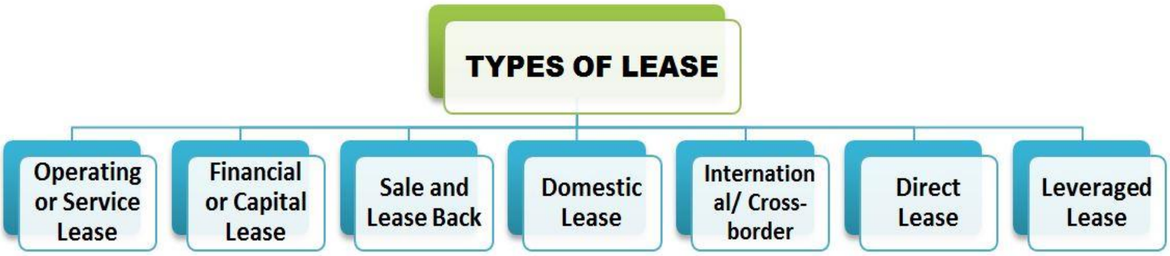




UNIT V


SOURCES OF FINANCE
DEBT FACTORING
LONG-TERM BANK LOAN
SHORT-TERM BANK LOAN
SOURCES OF FINANCE
BANK OVERDRAFT
HIRE PURCHASE
LEASING
MORTGAGE
ADDITIONAL CAPITAL
GRANT
RETAINED PROFITS
TRADE CREDIT

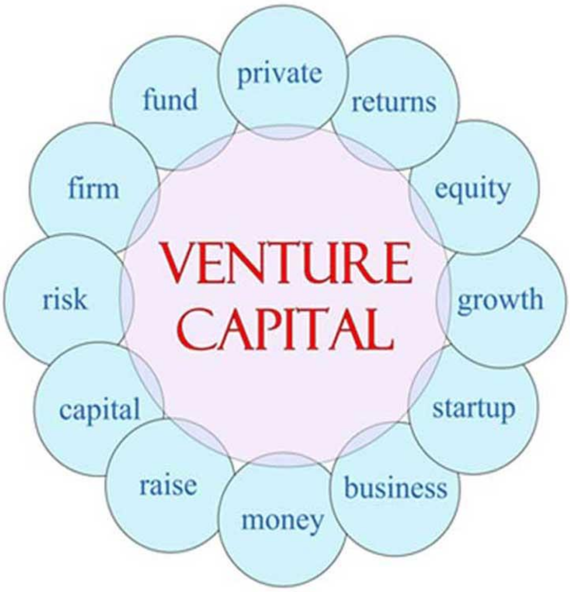

Lease - definition
A lease is an agreement whereby the lessor conveys to the lessee , in return for rent, the right to use an asset for an agreed period of time.
A financing arrangement that provides a firm with an advantage of using an asset, without owning it, may be termed as 'leasing'.


TYPES OF LEASE
Operating or Service Lease
Financial or Capital Lease
Sale and Lease Back
Domestic Lease
International/ Cross-border
Direct Lease
Leveraged Lease

REASONS FOR GROWTH OF VENTURE CAPITAL

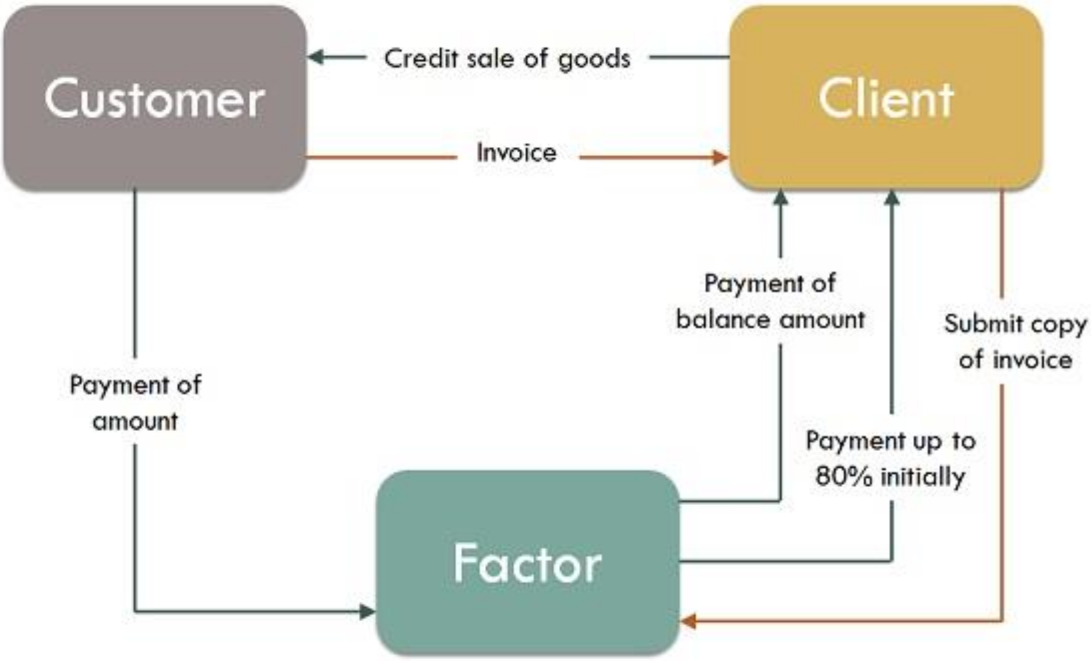
- High Technology
- Human Resource Capital
- Scientific & Technical Research
- Government Initiative
- SEBI Initiative

EDUPRISTINE
Empowering Professionals

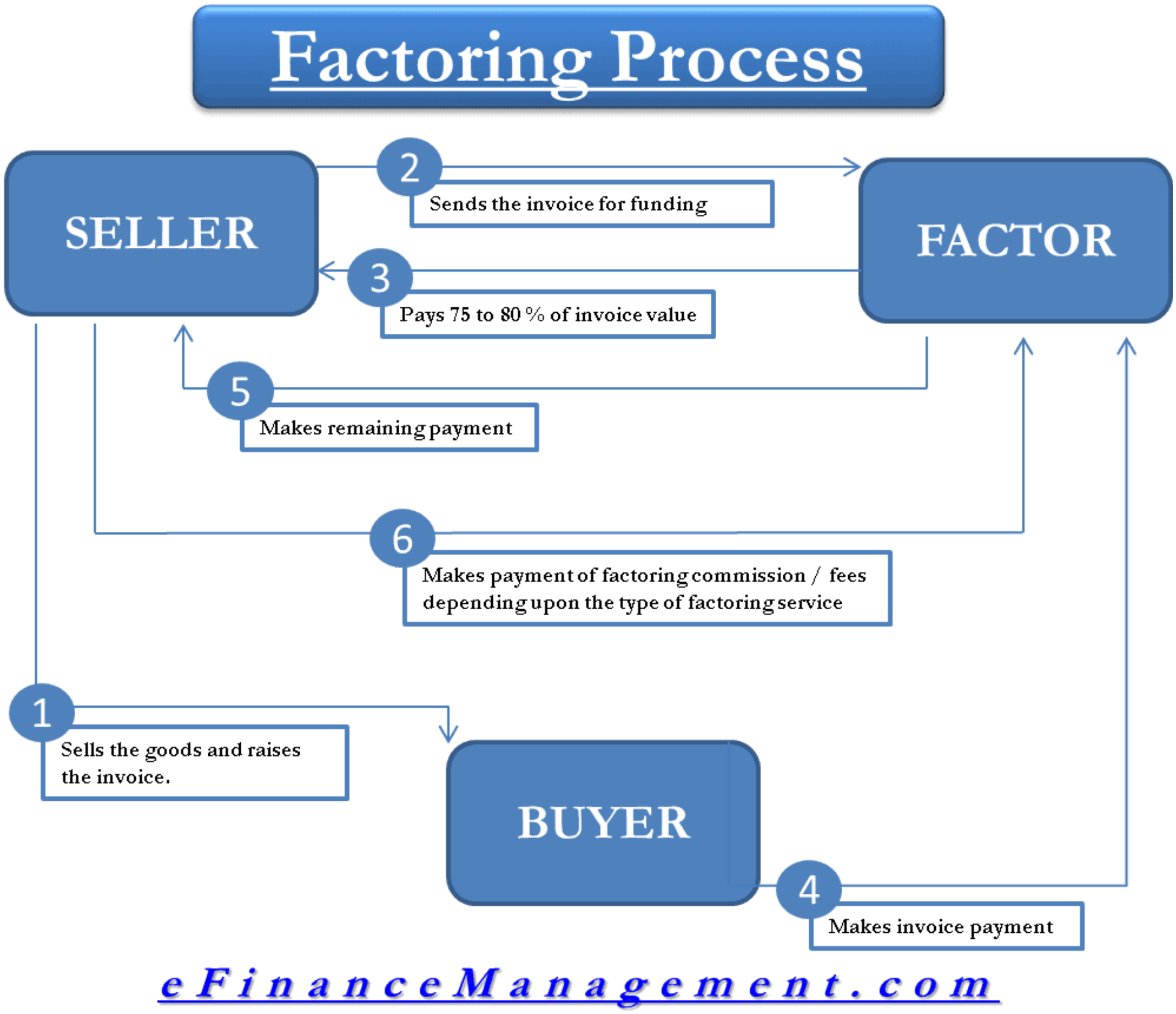


Factoring - Meaning

- Is a financial service
- Institution called 'Factor' which -
- Undertakes the task of realizing 'receivables', i.e. accounts receivables, book debts, bills receivables &
- Also the 'Factor' manages the sales registers, sundry debts of the commercial firms/trading agents , for a commission.
- This activity is called 'Factoring'



(OR)


Factoring Process
SELLER
FACTOR
BUYER
1
Sells the goods and raises the invoice.
2
Sends the invoice for funding
3
Pays 75 to 80 % of invoice value
4
Makes invoice payment
5
Makes remaining payment
6
Makes payment of factoring commission / fees depending upon the type of factoring service
eFinanceManagement.com

TYPES OF FACTORING

1. Recourse & Non-Recourse Factoring	• Based on the assumption of credit risk associated with the collection of the receivables.
2. Advance, Maturing & Participation Factoring	• Related to the time of payment on account of receivables by the factor to the client.
3. Disclosed & Undisclosed Factoring	• Based on the disclosure or non-disclosure of the name of the factor in the invoice.
4. Domestic & Export/Cross-border/ International Factoring	• Based on the domicile of the parties involved.
5. Full Factoring	

SECURITIZATION

SECURITIZATION refers to the process of converting debt (assets, usually illiquid assets) into securities, which are then bought & sold in the financial markets.

PROCESS

Banks/Financial Inst. will collect money into a pool.

Division of pool into small parts & selling them as securities.

Buyers of these securities, get interest/mortgage payments.

These securities are called "Mortgage Backed Securities".

USEFULNESS

- Boosts liquidity.
- Helps raising funds.
- Portfolio diversification.
- Quality returns.

LIMITATIONS

- Risky for lenders.
- Difficult to assess the risk factor in securities.