**VALLUVAR COLLEGE OF SCIENCE AND MANAGEMENT – KARUR**

**PG AND RESEARCH DEPARTMENT OF COMMERCE**

**FINANCIAL SERVICES**

**Objective:**

To enable the students to know the nature and types of financial services.

**Unit - I**

Financial services – Meaning – Classification – Financial products and services –

Challenges facing the financial service sector – Merchant banking– Meaning – Functions

– SEBI Guidelines – Scope of merchant banking in India. NBFCs – RBI guidelines.

**Unit - II**

Hire purchase – Meaning – Features – Process – Hire purchase and credit sales – Hire

Purchase vs Instalment purchase – Banks and hire purchase business – Hire purchase and

Transport industry – Leasing – Concept – Steps involved in leasing – Lease vs Hire

Purchase – Types of lease – Problems and prospects of leasing in India.

**Unit - III**

Mutual funds – Meaning – Types – Functions – Advantages – Institutions involved –

UTI, LIC, Commercial banks – Entry of private sector – Growth of mutual funds in India

– SEBI Guidelines – AMC.

**Unit - IV**

Venture capital – Meaning – Features – Methods of venture capital financing – Modes of

Venture financing – Venture capital investment process – Factors determining venture

Investment – Exit mechanism – Advantages of venture capital – Issues of Indian venture

Capital industry.

**Unit - V**

Factoring – Concepts – Significance – Types – Factoring mechanism – Factoring vs bills

Discounting – Factoring in India – Forfaiting – Meaning – Forfaiting vs Export factoring

– Problems of Forfaiting/ factoring.

**Text and Reference Books (Latest revised edition only)**

1. Financial markets & services by E.Gordon and K.Natarajan – Himalaya publishing house, New Delhi

2. Financial services by E.Dharmaraj – S.Chand & Co., New Delhi

3. Financial Services by S.Mohan and R.Elangovan – Deep and Deep Publications, New Delhi

4. Financial Services by S. Gurusamy – Vijay Nicole Imprints (P) Ltd, Chennai

5. Lease Financing and Hire Purchase by Vinod Kothari – Wadhaw and Co., Nagpur

**INTRODUCTION**

In general all types of activities which are of a financial nature could be brought under the term” financial services “

 The term financial services in a broad sense mean “*mobilizing and allocating savings”.* Thus it excludes all activities involved in the transformation of savings into investments.

**MEANING:**

The financial service can also be called “*financial intermediation”.*

 Financial intermediation is a process by which funds are mobilized from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers. A well developed financial service industry is absolutely necessary to mobilize the savings and to allocate them to various investable channels and thereby to promote industrial development in a country.

**CONCEPT:**

Services offered by banking and financial companies are called financial services. Banking and financial companies includes both asset management companies and liability management companies. Asset management companies include leasing companies’ mutual funds, liability management companies consist of bill discounting and acceptance houses.

**FUNCTIONS OF FINANCIAL SERVIES:**

 The main objectives of financial services. They are:

Fund raising

Funds deployment

Specialized services

Regulation

Economic growth

**1. FUND RAISING:**

Financial services help to raise the required fund from investors, individuals, institutions, and corporate. For this purpose various instrument of finance are used.

**2. FUNDS DEPLYMENT:**

An array of financial services is available in the financial market, which helps the players to ensure an profitable deployment of funds raised.

 Financial services helps in the decision making regarding.

**3.SPECALISED SERVICES:**

The financial services sector provides specialized services such as credit rating, venture capital financing, lease financing factoring, mutual funds, merchant banking, depository etc.

 Institutions and agencies such as;

* + - * + Stock exchange
				+ General financial institutions
				+ Non banking finance companies
				+ Banks

**4. REGULATION:**

 In India, agencies such as the *SEBI, RBI* and the department of banking and insurance, go vt of India, regulate the functioning of the financial services institutions. The main objectives are to ensure an orderly functioning of the financial markets.

**5. Economic growth:**

 Financial services contribute in good measure to speeding up the process of economic growth and development. This take place through the mobilization of saving from section of people for the purpose of to invest.

Elements of Financial service sector:

 The financial service sector has three elements

* Instruments
* Market players
* Regulatory bodies and specialized institutions

**1. Insruments:**

 Financial instruments constitute an important part of financial services in market. The instrument include equity shares, debentures, convertible debenture, fixed deposit certificate etc.,

**2. Market players:**

 Financial services are offered by a institutions and agencies that understand the requirements of customers. The player include banks, financial institutions, mutual fund, merchant banks

**3. Regulatory bodies and specialized institutions:**

 This includes the SEBI, stock exchange, credit rating services, venture capital companies, department of banking and insurance companies

Scope of financial services:

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

* Traditional activities
* Modern activities

**1. Traditional activities:**

 Traditionally the, financial intermediaries are rendering a wide range of services to both capital and money market activities. It can be divided into two heads

1. Fund based activities
2. Non fund based activities

**a) Fund based activities:**

 It comes to under fund based activities are the following point.

1. Underwriting or investment in shares, debentures, bonds etc(primary market)
2. Dealing in secondary market
3. Participating in money market instruments like, commercial papers, treasury bills, certificate of deposit etc.
4. Dealing in foreign exchange market activities

**b) Non-fund based activities:**

 Financial intermediaries provide services on the basis of non based activities also it can also be called “fee based” activities. They include following points

* managing the capital issues
* the making arrangement for the placement of capital and debt instruments with investment institutions
* arrangement of funds from financial institution for the clients
* assisting in the process of getting all govt and other clearances

**2. Modern activities:**

 The financial intermediaries render many services in recent times.

* Rendering protect advisory services
* Preparation of protect report till the rising of fund for starting the protect to get the necessary approval
* Planning for merger and acquisition
* Recommending suitable changes in the management structure and management style
* Acting as trustees to the debenture holders
* Managing the portfolio of large public sectors
* Structuring the joint venture by identifying suitable joint venture partner and joint venture agreement
* Undertaking services relating to the capital market such as:
	+ - Clearing services
		- Registration and transfer
		- Safe custody of securities
		- Collection of income on securities

**Objectives of financial system:**

* Mobilization of financial resources by establishing link between the saver and user of finance.
* Providing liquidity to financial instruments through the mechanism of ready, continuous and well organized financial markets.
* Reduction of cost of finance through the medium of financial institution and intermediates
* Promotion of efficient and equitable allocation of financial resources to the divergent of the economic
* Regulation and control of risk in mobilization of resources and their allocation through the system of regulatory authority
* Contribution to equitable and over economic development through constant capital formation.
* Settlement of depts. And exchange of instrument and services through payment mechanism.
* Providing reliable and required information to all the players operating in financial market.
* Offers portfolio adjustment facilities
* Provides liquidity to financial assets.

**MERCHANT BANKING**

**Introduction:**

The term “merchant banking” came from the years of banking when only merchant required the facilitates of finance.

**Definitions:**

According to the securities and exchange board of India (merchant bankers) rules 1992

“ a merchant banker has been designed as any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities on acting as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management”.Merchant banking may be defined as “ an institutions which covers wide range of activities such as management of customer services, portfolio management, credit syndication, counseling, insurance, acceptance credit etc.,

**Qualities of merchant bankers**:

The success of the merchant bankers depends on the quality of service and soundness of advice to clients to perform these services effectively the merchant banker have certain qualities they are,

* Ability to analyze various aspects, such as technical, financial and economic aspect
* Knowledge about the various aspects of capital markets, trends in stock exchange, psychology of investing public, change in the economic and technological environment in the country
* Ability to build up the bank client relationship
* Innovative approach in developing capital market instruments to satisfy the ever changing needs of public.
* Integrity and maintenance of high professional standards are the essential qualities for the success of merchant banker.

**Guidelines for merchant banker**:

Merchant banking has been authority brought within the framework of the securities and exchange board of India under SEBI regulations, 1992

1.In terms of the guidelines issued during April 1990, all merchant bankers will require authorization by SEBI to carry out business

**Authorization includes**:

* Professional qualification in finance, law or business management.
* Infrastructure like adequate office space, equipment and man power.
* Capital adequacy
* Employment of two persons who have the experience to conduct business of merchant bankers.
* Fast track records, experience, general reputation and fairness in all transaction

2.SEBI issued further guidelines classifying the merchant bankers into fourcategories based on the nature and range of activities and their responsibilities

SEBI has issued revised guidelines on dec 22 1992 classifying the activities of merchant bankers are as follows

**1.First category:**

The first category consist of merchant bankers who carry on any activity of issue management consist of

* Preparation of prospectus and other information relating to issue
* Determining financial structure
* Advisor on consultant to an issue
* Fort polio manager and underwriter minimum net worth Rs.1 crore.

**2.Second category:**

It consists of those authorized to act in the capacity of company manager, advisor consultant, underwriter to an issue or portfolio manager.

Minimum net worth is Rs.50lacks

**3.Third category**:

It consist of authorized to act as underwriter, advisor or consultant to an issue

Minimum net worth is Rs.20lacks

**4.Fourth category:**

* It consist of merchant banker who act as advisor or consultant to an issue
* Minimum net worth is nil
* An initial authorization fee, an annual fee and renewal fee may be collected by SEBI
* All issues must be managed at least at one authorized banker, functioning as the sole manager or lead manager
* Ordinarily not more than two merchant bankers should be associated as lead manager but issue over 100crore the number of lead manager may go up to a maximum of four.
* The lead merchant banker holding a certificate under category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs.25lacks whichever is less.
* Each merchant banker is required to furnish to the SEBI half yearly unaudited financial results.
* SEBI has prescribed a code of conduct to the merchant bankers
* The banker must perform his duties with highest standard of integrity and fairness in all dealings. They render at all times high standard of services all the merchant bankers must adhere to the code of conduct.
* The above guidelines will be administered by SEBI and it will supervise the activities of merchant bankers
* SEBI has been rested with power to suspend or cancel the authorization in case of violation of the guidelines
* To ensure transparency and accountability in the operation of merchant bankers and to protect the investors.
* It has been decided to ask merchant bankers to enter into agreement with corporate body, allotment of fund, maintenance of books of accounts and submission of half reports to SEBI
* Inspections will be conducted by SEBI ensure that provisions of the regulations are properly complied with and to investigate the complaints from customers.

**Merchant Bankers commission:**

As determined by the finance ministry, govt of India, merchant bankers are eligible to charge a commission/fee from their clients detailed below.

* A merchant banker can charge 0.5% as the maximum commission for whole issue.
* They can charge a project fee
* A lead manager can claim a commission of 0.5% up to Rs.25crore and 0.2% in excess of RS.25crore.
* Underwriting commission

|  |  |  |
| --- | --- | --- |
| Types of security1.equity share 2.preference share a.upto Rs.5 lakh b.excess of RS.5 lakh | On amount devolving underwriters2.502.502.00 | On amount subscribed by public2.501.501.00 |

* Brokerage commission 1.5%
* Other expenses like advertising, printing, registrar expenses, stamp duty etc., connection with the issue can be reimbursed from its clients

**Objective/Function of merchant bankers**:

**1. Monitoring and managing issues**:

 Merchant banker are engaged in all types of services connected with the issue of corporate securities the type of service under this head included obtaining concept controller of capital issues of capital, preparation of prospectors arrangement of underwriting appointment of brokers and bankers to the issues, press publicities.,

**2. Credit promotion:**

 Merchant bankers help the promoters in obtaining term loan working capital, finance from various financial institutions. They under take preparation of project files, loan application for financial assistance on behalf of promoters

**3. Guide to promoters:**

 Merchant banking guide promotion in the matter of rules, regulation, capital goods clearness, import clearness etc.,

**4. Portfolio management**:

 It includes advising or investment in government securities to trust institutions, companies regarding their investment in companies with the provisions of various acts.

**5. Post issue service:**

 This includes the issuing of refund orders for rejected application or oversubscribed issues and also partial payment towards the shares such as the call money etc.,

**6. Corporate adviser services**:

 It advice corporation and firms relating to opening of issues receiving loans.

**7. Project appraisal**:

 This include helping those people who have finance but who do not have the competence or the technical know how required for running a successful business.

**8. Loan syndication**:

 Sometimes the merchant banker might the approached for loans by its clients such cases, the merchant bank survey the market and acquires loan from rich organization and also sometimes form foreign organization to be invested in the country

**9. off sharing banking**:

 Merchant banking are how allowed to get loan from other country and invest it safe and profitable venture have the merchant banker receives loans from a foreign country which can be invested in the home country.

**Obligatory responsibilities of merchant banker:**

* + - Special responsibilities must be taken up by each divisional or lead manager a statement of inter allocation of responsibilities prescribed formal, jointly singed by all lead manager has to be submitted SEBI
		- The certificate of due diligence satisfying the contents of the prospectors or letter of offer and the reasonable of the views expressed there is also has to be submitted to SEBI
		- The above mentioned documents together with a copy of the draft prospectors has to be submitted to SEBI at least 15 days before filling it with the register of companies
		- Each lead manager has to accept a minimum underwriting obligation of 5% of the total underwriting or Rs.25 lakes which is lower.
		- The lead managers have to ensure that the issues related publicity and all advertising material with the condense of the prospectors

**Scope of merchant banking in India:**

 There is vast scope for merchant bankers to enlarge their operation both in domestic and international market.

**1. Growth of new market:**

 The growth of new issue market is unprecedented since1990-91 the amount of annual average of capital issue by non-government public companies was only about 90 crores in the 70s, the same raise to over RS1000 crs in sthe 80s further to Rs1270 cro in the first four years 1990. The number of capital issues has also increased from 363 in 1990-91 to 900 to 1993-94. The trend is expected to continue in future.

**2. Entry of foreign investors**:

 An outstanding development in the history of Indian capital market was it operation in 1992 by allowing foreign institutional investors to invest in primary and secondary market and also permitting Indian companies to directly tap foreign capital through euro issues. Within two years to march 1994 the total inflow of foreign capital through these routes reached to about $5 billion. The increasing number of joint ventures abroad by Indian companies also requires expert services of merchant bankers.

**3. Changing policy of financial institutions**:

 With the changing emphasis in the leading policies of financial institution from security orientation to project, corporate orientation, would require the expert services of merchant bankers for project appraisal, financial management etc., the policy of decentralization and encouragement of small and medium industries also increases and demand of technical and financial services which can be provided by merchant bankers.

**4. Development of debt market**:

 The concept of debt market ha set to work through national stock exchange and the over the counter exchange of India. Expert feel that of the estimated capital issues of Rs.40000 crores in 1994-95 a good portion may be increased debt instruments.

**5. Innovation of financial instruments**:

 The Indian capital markets has witnessed innovation in the introduction of financial instruments such as non-convertible debenture with cumulative convertible preference shares, triple option bonds, floating rate bonds, auction rated debenture etc.

**6. Corporate restructuring:**

 As a result of liberalization and globalization the competition in the corporate sector becoming intense. To survive in the competition, companies are reviewing their strategies structure and functioning. This has led to corporate restructuring including mergers acquisitions, splits, disinvestments and financial restructuring.

**SECURITIES EXCHANGE BOARD OF INDIA (SEBI)**

**Introduction**

The Government has set up the Securities & Exchange Board of India (SEBI) in April, 1988. For more than three years, it has no statutory powers. Its interim functions during the period were (i) To collect information and advice the Government on matters relating to Stock and Capital Markets (ii) Licensing and regulation of merchant banks, mutual funds etc. (iii) To prepare the legal drafts for regulatory and development role of SEBI and (iv) To perform any other functions as may be entrusted to it by the Government. The need for setting up independent Govt. agency to regulate and develop the Stock and Capital Market in India as in many developed countries was recognized since the Sixty Five Year Plan was launched (1985) when some major industrial policy changes like opening up of the economy to outside world and greater role to the Private Sector were initiated. The rampant malpractices noticed in the Stock and Capital Market stood in the way of infusing confidence of investors which is necessary for mobilization of larger quantity of funds from the public and help the growth of the industry.

**OBJECTIVES OF SEBI**

* Investor protection, so that there is a steady flow of savings into the Capital Market.
* Ensuring the fair practices by the issuers of securities, namely, companies so that they can raise resources at least cost.
* Promotion of efficient services by brokers, merchant bankers and other intermediaries so that they become Competitive and professional.
* Regulate and develop a code of conduct for brokers, merchant bankers etc.
* To verify listing requirements, listing procedures, and ensure compliance of the same by companies.
* To have check on preferential allotment to promoters.

**FUNCTIONS OF SEBI**

SEBI has two major functions. They are

* + 1. Regulatory functions and
		2. Developmental functions

**Regulatory Functions**

* Registering the brokers and sub brokers
* Registration of mutual funds
* Regulation of stock exchanges
* Prohibition of fraudulent and unfair trade practices
* Controlling insider trading, take over bids and imposing penalties

**Developmental functions**

* Educating investors
* Training intermediaries in stock market transactions
* Promoting fair transactions
* Undertaking research and publishing useful information to all

**POWERS OF SEBI**

As per the act, SEBI has following powers

* To file complaints in court
* To regulate companies in the issue and transfer of shares including bonus and rights shares
* It can levy penalties on companies and on brokers for violating transactions
* Power to summon any broker or intermediaries and call for documents
* It can issue directions to all brokers for protecting the interests of the investors

**In addition to the above powers,**

* It can call for periodical returns from stock exchange
* Seek any information from stock exchange
* It can enquire into the functioning of stock exchange
* It can grant permission for the exchange of bye laws of any stock exchange
* It can compel listing of securities of public company
* It can control and regulate stock exchange
* It can grant registration to market intermediaries
* It can prohibit insider trading and prohibit fraudulent and unfair trade practices
* Promoting investor education
* Regulating purchase of shares and take over of companies

**MUTUAL FUNDS**

A mutual fund is a financial intermediary that pools the savings of investors for collective investment in a diversified portfolio of securities. A fund is “mutual” as all of its returns, minus its expenses, are shared by the fund’s investors. The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 defines a mutual fund as a ‘a fund established in the form of a trust to raise money through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market instruments’.

**Benefits of Mutual Funds**

An investor can invest directly in individual securities or indirectly through a financial intermediary. Globally, mutual funds have established themselves as the means of investment for the retail investor.

**Professional management**

An average investor lacks the knowledge of capital market operations and does not have large resources to reap the benefits of investment. Mutual funds are managed by professional managers who have the requisite skills and experience to analyse the performance and prospects of companies.

**Portfolio diversification**

An investor undertakes risk if he invests all his funds in a single scrip. Mutual funds invest in a number of companies across various industries and sectors. This diversification reduces the riskiness of the investments.

**Reduction in transaction costs**

Compared to direct investing in the capital market, investing through the funds is relatively less expensive as the benefit of economies of scale is passed on to the investors.

**Liquidity**

Often, investors cannot sell the securities held easily, while in case of mutual funds, they can easily encash their investment by selling their units to the fund if it is an open-ended scheme or selling them on a stock exchange if it is a close-ended scheme.

**Convenience**

Investing in mutual fund reduces paperwork, saves time and makes investment easy.

**Flexibility**

Mutual funds offer a family of schemes, and investors have the option of transferring their holdings from one scheme to the other.

**Tax benefits**

Mutual fund investors now enjoy income-tax benefits. Dividends received from mutual funds’ debt schemes are tax exempt to the overall limit of Rs 9,000 allowed under section 80L of the Income Tax Act.

**Transparency**

Mutual funds transparently declare their portfolio every month. Thus an investor knows where his/her money is being deployed and in case they are not happy with the portfolio they can withdraw at a short notice.

**Stability to the stock market**

Mutual funds have a large amount of funds which provide them economies of scale

by which they can absorb any losses in the stock market and continue investing in the stock market. In addition, mutual funds increase liquidity in the money and capital market.

**Equity research**

Mutual funds can afford information and data required for investments as they have large amount of funds and equity research teams available with them.

**TYPES OF MUTUAL FUNDS**

**Open-ended schemes**

 In case of open-ended schemes, the mutual fund continuously offers to sell and repurchase its units at net asset value (NAV) or NAV-related prices. Open-ended schemes do not have a fixed corpus. The corpus of fund increases or decreases, depending on the purchase or redemption of units by investors. There is no fixed redemption period in open-ended schemes, which can be terminated whenever the need arises. The key feature of open-ended funds is liquidity

**Close-ended schemes**

 Close-ended schemes have a fixed corpus and a stipulated maturity period ranging between 2 to 5 years. Investors can invest in the scheme when it is launched. The scheme remains open for a period not exceeding 45 days. Investors in close-ended schemes can buy units only from the market, once initial subscriptions are over and thereafter the units are listed on the stock exchanges where they dm be bought and sold.

**Interval scheme**

 Interval scheme combines the features of open-ended and close-ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

**Income funds**

 The aim of income funds is to provide safety of investments and regular income to investors. Such schemes invest predominantly in income-bearing instruments like bonds, debentures, government securities, and commercial paper. The return as well as the risk are lower in income funds as compared to growth funds.

**Growth funds**

The main objective of growth funds is capital appreciation over the medium-to-long- term. They invest most of the corpus in equity shares with significant growth potential and they offer higher return to investors in the long-term. They assume the risks associated with equity

investments. There is no guarantee or assurance of returns. These schemes are usually close-ended and listed on stock exchanges.

**Balanced funds**

 The aim of balanced scheme is to provide both capital appreciation and regular income. They divide their investment between equity shares and fixed nice bearing instruments in such a proportion that, the portfolio is balanced. The portfolio of such funds usually comprises of companies with good profit and dividend track records. Their exposure to risk is moderate and they offer a reasonable rate of return.

**Money Market Funds**

The money market consists of short-term debt instruments, mostly [Treasury bills](http://www.investopedia.com/terms/t/treasurybill.asp). This is a safe place to park your money. You won't get great returns, but you won't have to worry about losing your [principal](http://www.investopedia.com/terms/p/principal.asp). A typical return is twice the amount you would earn in a regular checking/savings account and a little less than the average [certificate of deposit](http://www.investopedia.com/terms/c/certificateofdeposit.asp) (CD).  **Income Funds**

Income funds are named appropriately: their purpose is to provide current income on a steady basis. When referring to mutual funds, the terms "fixed-income," "bond," and "income" are synonymous. These terms denote funds that invest primarily in government and corporate debt. While fund holdings may appreciate in value, the primary objective of these funds is to provide a steady cash flow to investors. As such, the audience for these funds consists of conservative investors and retirees.

**Bond funds**

Bond funds are likely to pay higher returns than certificates of deposit and money market investments, but bond funds aren't without risk. Because there are many different types of bonds, bond funds can vary dramatically depending on where they invest. For example, a fund specializing in high-yield [junk bonds](http://www.investopedia.com/terms/j/junkbond.asp) is much more risky than a fund that invests in government securities. Furthermore, nearly all bond funds are subject to interest rate risk, which means that if rates go up the value of the fund goes down

 **Equity Funds**

Funds that invest in stocks represent the largest category of mutual funds. Generally, the investment objective of this class of funds is long-term capital growth with some income. There are, however, many different types of equity funds because there are many different types of equities.

**UNIT TRUST OF INDIA**

The Unit Trust of India is a statutory public sector investment institution established under the Unit Trust of India Act, 1963. It began functioning on Ist July, 1964.

 For more than two decades it remained the sole vehicle for investment in the capital market by the Indian citizens. In mid- 1980s public sector banks were allowed to open mutual funds. The real vibrancy and competition in the MF industry came with the setting up of the Regulator SEBI and its laying down the MF Regulations in 1993.

**CAPITAL**

 It commenced its operations with an initial capital of Rs.5 crores contributed as follows -

Reserve Bank of India Rs.2.5 crores

Life Insurance Corporation Rs.75 Lakhs

State Bank of India Rs.75 Lakhs68 :: Business Studies

Scheduled Banks and other financial institutions Rs. 1 crore

With the amendment of the Public Financial Institutions Laws, the contribution made by RBI to the initial capital and the control exercised by it are vested in the IDBI with effect from 16th Feb.1976.

**Nature of the Trust**

The Unit Trust of India is an investment trust. It mobilizes the savings of people through sale of units. The savings as collected are invested in the shares and debentures of profit-making companies. The income received by the trust by way of interest and dividend is passed on to the unit holders by way of dividend after meeting management expenses of the trust. The small savers get benefit by participating in the investment schemes of UTI and thus in the industrial prosperity of the country.Investment through UTI results in lower risk of loss and higher return on investments due to professional management by U.T.I.

**What are units?**

The total investment made by UTI in industrial securities (shares, debentures and bonds) is divided into smaller parts called ‘units’. The Unit Trust of India sell units under different schemes and also buys back its own units at the purchase price fixed by it from time to time. Units have a face value of Rs.10 each.

**Objectives of UTI**

The main objectives of UTI are as under -

(i) To encourage savings of people belonging to middle and low income groups;

(ii) To mobilize savings from the small savers;

(iii) To channelize savings to industrial growth;

(iv) To allow investors to participate in the prosperity of the industries

**Functions of UTI**

The main functions of UTI are as follows -Role of specialized Financial Institutions :: 69

(i) To mobilize the savings of the community through sale of units;

(ii) To invest the savings so mobilized in corporate securities such as

shares and debentures, etc;

(iii) To serve unit holders along the length and breadth of the country;

(iv) To underwrite the issue of shares and debentures.

 **LEASE FINANCING**

**Leasing** is a process by which a firm can obtain the use of a certain fixed assets for which it must pay a series of contractual, periodic, tax deductible payments. The [lessee](http://en.wikipedia.org/wiki/Lease) is the receiver of the services or the assets under the [lease](http://en.wikipedia.org/wiki/Lease) contract and the lessor is the owner of the assets.

A lease transaction is a commercial arrangement whereby an equipment owner or Manufacturer conveys to the equipment user the right to use the equipment in return for a rental. In other words, lease is a contract between the owner of an asset (the lessor) and its user (the lessee) for the right to use the asset during a specified period in return for a mutually agreed periodic payment (the lease rentals). The important feature of a lease contract is separation of the ownership of the asset from its usage. Lease financing is based on the observation made by Donald B. Grant: “Why own a cow when the milk is so cheap? All you really need is milk and not the cow.”

**IMPORTANCE 0F LEASE FINANCING**

1. Leasing industry plays an important role in the economic development of a country by providing money incentives to lessee.
2. The lessee does not have to pay the cost of asset at the time of signing the contract of leases. Leasing contracts are more flexible so lessees can structure the leasing contracts according to their needs for finance.
3. To day, most of us are familiar with leases of houses, apartments, offices, etc.

**TYPES OF LEASE AGREEMENTS**

Lease agreements are basically of two types. They are (a) Financial lease and (b) Operating lease. The other variations in lease agreements are (c) Sale and lease back (d) Leveraged leasing and (e) Direct leasing.

**FINANCIAL LEASE**

Long-term, non-cancellable lease contracts are known as financial leases. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. Financial lease is also known as ‘capital lease’. In India, financial leases are very popular with high-cost and high technology equipment.

**OPERATING LEASE**

An operating lease stands in contrast to the financial lease in almost all aspects. This lease agreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Mines, Computers hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets.

**SALE AND LEASE BACK**

It is a sub-part of finance lease. Under this, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of lease rentals. However, under this arrangement, the assets are not physically exchanged but it all happens in records only. This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected depreciation but appreciation, say land.

**LEVERAGED LEASING**

Under leveraged leasing arrangement, a third party is involved beside lessor and lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and the asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset is entitled to depreciation allowance associated with the asset.

**DIRECT LEASING**

Under direct leasing, a firm acquires the right to use an asset from the manufacturer directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc

**ADVANTAGES OF LEASING**

**Saving of capital**

 Leasing covers the full cost of the equipment used in the business by providing 100% finance. The lessee is not to provide or pay any margin Manufacturer Lessor Lessee

Lender 232 money as there is no down payment. In this way the saving in capital or financial resources can be used for other productive purposes e.g. purchase of inventories.

**Flexibility and convenience**

 The lease agreement can be tailor- made in respect of lease period and lease rentals according to the convenience and requirements of all lessees.

**Planning cash flows**

 Leasing enables the lessee to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets.

**Improvement in liquadity**

 Leasing enables the lessee to improve their liquidity position by adopting the sale and lease back technique.

**HIRE PURCHASE**

A [system](http://www.businessdictionary.com/definition/system.html) by which a [buyer](http://www.businessdictionary.com/definition/buyer.html) [pays](http://www.businessdictionary.com/definition/pay.html) for a thing in regular installments while enjoying the use of [it](http://www.businessdictionary.com/definition/information-technology-IT.html). During the [repayment](http://www.businessdictionary.com/definition/refund.html) [period](http://www.businessdictionary.com/definition/period.html), [ownership](http://www.businessdictionary.com/definition/ownership.html) ([title](http://www.businessdictionary.com/definition/title.html)) of the item does not pass to the buyer. Upon the full [payment](http://www.businessdictionary.com/definition/payment.html) of the [loan](http://www.businessdictionary.com/definition/loan.html), the title passes to the buyer.

Hire purchase is a type of instalment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase. Under this transaction, the hire purchaser acquires the property (goods) immediately on signing the hire purchase agreement but the ownership or title of the same is transferred only when the last installment is paid.

**FEATURES**

• Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.

• Each installment is treated as hire charges.

• The ownership of the goods passes from the seller to the buyer on the payment of the last installment.

• In case the buyer makes any default in the payment of any installment the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charges.

• The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the sums already paid as such sums legally represent hire charges on the goods in question

**CONTENTS OF HIRE PURCHASE AGREEMNT**

A hire purchase agreement is in many ways similar to a lease agreement, in so far as the terms and conditions are concerned. The important clauses in a hire purchase agreement are:

**Nature of Agreement**

Stating the nature, term and commencement of the agreement.

**Delivery of Equipment**

The place and time of delivery and the hirer’s liability to bear delivery charges.

**Location**

The place where the equipment shall be kept during the period of hire.

**Inspection**

That the hirer has examined the equipment and is satisfied with it.

**Repairs**

The hirer to obtain at his cost, insurance on the equipment and to hand over the insurance policies to the owner.

**Alteration**

The hirer not to make any alterations, additions and so on to the equipment, without prior consent of the owner.

**Termination**

The events or acts of hirer that would constitute a default eligible to terminate the agreement.

**Risk**

Risk of loss and damages to be borne by the hirer.

**Registration and fees**

The hirer to comply with the relevant laws, obtain registration and bear all requisite fees.

**Indemnity clause**

The clause as per Contract Act, to indemnify the lender.

**Stamp duty**

Clause specifying the stamp duty liability to be borne by the hirer.

**Schedule**

Schedule of equipments forming subject matter of agreement.

**Schedule of hire charges**

The agreement is usually accompanied by a promissory note signed by the hirer for the full amount payable under the agreement including the interest and finance charges.

**DIFFERENCE BETWEEN LEASE AND HIRE PURCHASE**

**Ownership of the Asset**

In lease, ownership lies with the lessor. The lessee has the right to use the equipment and does not have an option to purchase. Whereas in hire purchase, the hirer has the option to purchase. The hirer becomes the owner of the asset/equipment immediately after the last installment is paid.

**Depreciation**

In lease financing, the depreciation is claimed as an expense in the books of lessor. On the other hand, the depreciation claim is allowed to the hirer in case of hire purchase transaction.

**Rental Payments**

 The lease rentals cover the cost of using an asset. Normally, it is derived with the cost of an asset over the asset life. In case of hire purchase, installment is inclusive of the principal amount and the interest for the time period the asset is utilized.

**Duration**

 Generally lease agreements are done for longer duration and for bigger assets like land, property etc. Hire Purchase agreements are done mostly for shorter duration and cheaper assets like hiring a car, machinery etc.

 **Tax Impact**

In lease agreement, the total lease rentals are shown as expenditure by the lessee. In hire purchase, the hirer claims the depreciation of asset as an expense.

 **Repairs and Maintenance**

Repairs and maintenance of the asset in financial lease is the responsibility of the lessee but in operating lease, it is the responsibility of the lessor. In hire purchase, the responsibility lies with the hirer.

**Extent of Finance**

Lease financing can be called the complete financing option in which no down payments are required but in case of hire purchase, the normally 20 to 25 % margin money is required to be paid upfront by the hirer. Therefore, we call it a partial finance like loans etc.

 **RESERVE BANK OF INDIA**

Reserve bank of India has a Central Board of directors consisting of 20 members. The head of Reserve Bank of India is called the Governor and he is assisted by four Deputy Governors. The Governor and Deputy governors are appointed by Government of India for a period of 5 years.

Reserve Bank of India has four local boards representing Delhi, Mumbai, Calcutta and Chennai. From each of the local board, one person is nominated to the central board. Apart from this, there are 10 directors representing various fields such as agriculture, trade, commerce, industry, banking, etc. One official from the Ministry of Finance will also be represented in the board. The board of directors are represented in the following diagram.



**Various Departments of Reserve Bank of India**

There are nearly 18 departments in Reserve Bank of which Issue department and Banking department are the two major departments. The 18 departments are Banking given below:

1. Banking Department
2. Issue Department
3. Planning and Reorganisation Department
4. Administration Personnel Department
5. Statistics Department
6. Secretary Department
7. Accounts & Expenditure Department
8. Premises Department
9. Industrial Department
10. Agricultural Credit Department
11. Industrial Finance Department
12. Legal Department
13. Non-banking Department
14. Exchange Control Department
15. Banking Operations & Development Department
16. Inspection Department
17. Service Board
18. Research Department



The functions of various departments are given below:

**ISSUE DEPARTMENT**

This is responsible for the issue of currency and other bank loans. RBI has responsibility to maintain the value of its currency in relation to foreign currency.

**BANKING DEPARTMENT**

This department undertakes the responsibility of performing the various Central bank functions.

There are 4 departments looking after the policy and administrative matters.

These are : (a) planning and reorganisation department. (b) administration personnel department. (c) Statistics department which collect information from fiscal sector. (d) Secretary department.

Planning and Reorganisation Department deals with policy matter and decision making.

The two major departments representing agriculture and industry provide finance to various agricultural projects and industrial projects.

The non banking financial department looks after the various private financ14 companies. There is also the Services Board which undertake recruitment **of** staff.

Accounts and expenditure department looks after the maintenance and supervision of accounts.

Premises department takes care of various buildings of Reserve Bank of India.

Banking operations and development department extends banking facilities to rural and semi-urban areas.

Legal department provides legal advice to all the departments.

Research and statistics department undertakes a study of economic, financial and banking conditions in India.

Exchange control department is in charge of foreign exchange transaction and all the supply and demand of foreign exchange are routed through this department.

**Inspection department:** It undertakes periodic internal inspection of all offices.

**FUNCTIONS OF RESERVE BANK OF INDIA**

The functions of RBI can be classified under 3 parts. They are: Tradition functions, promotional functions and supervisory functions.

**Traditional Functions**

1. **Issue of Currency**

RBI undertakes issue of currency and the system adopted in India is flit minimum reserve system. All the currency notes from Rs. 2, Rs. 5, Rs. 10, Rs. 50~ Rs. 100, Rs. 500 and Rs. 1,000 are issued by RBI and they carry the signature ofGovernor of Reserve Bank of India. They are called unlimited legal tender and any amount of payment can be made with these currencies subject to the regulations of Income Tax Act, 1961. The one rupee note and smaller coins of 10, 25, 50 pause are issued by the government and they are called limited legal tender which means that they can be demanded as a medium of payment only to a limited extent. The one rupee note carries the signature of secretary to the Ministry of Finance.

**(B) Banker to Government**

**RBI** acts as a banker to the government by maintaining the account of Central government and also that of the State government. It also provides overdraft facility to both State and Central governments. The public borrowings or government are done through Reserve Bank of India. Payments to the government such as income tax is also accepted by Reserve Bank of India.

**(C) Bankers' Bank**

The other traditional functions of RBI consisting of bankers' bank is done in the following manner:

1. Issuing licence to banks and allowing them to open branches under the provisions of Banking Regulation Act.
2. RBI also controls the working of these commercial banks and undertakes periodical inspection of these banks.
3. In case of violation of the Banking Regulation Act by any of the commercial banks, RBI will order for the closure of these banks.
4. The management of the commercial banks will also be controlled by RBI. All the top level management appointments of commercial banks require prior approval of RBI.
5. The credit requirements of commercial banks are met by discounting and re-discounting, eligible securities at the bank rate.

**(D) Credit Control Measures**

RBI exercising credit C01711-01 measures

1. The quantitative weapons of bank rate, open market operation and variable reserve ratio are exercised by RBI.
2. The modern weapon of selective credit control is also being exercised by RBI particularly on agricultural commodities.
3. The seasonal fluctuations in the money market is balanced by RBI through adequate finance during a period of financial stringency.

**(E) RBI acts as lender of last resort**

The commercial banks have to maintain as a part of statutory requirements certain percentage of their deposits with RBI which is called cash reserve ratio. By increasing or decreasing this percentage of cash reserve ratio, RBI allows adequate funds for lending purpose by commercial banks. When all the commercial banks are depositing with RBI in the form of cash reserve ratio, a sizeable amount of fund is available with RBI. This fund will be extended by RBI to any commercial bank which is facing crisis.

**(F) Exchange control**

In India, we have the exchange control since independence and RBI is given enough powers to exercise exchange control. Without the license of RBI no one can deal in foreign exchange. The exchange rate with different foreign currencies is provided by RBI to its authorised dealers consisting of nationalised and other private commercial banks. All the foreign exchange earnings in the country are kept by RBI in the form of foreign exchange reserve. RBI also has the responsibility of maintaining the value of domestic currency and take adequate measures so that its value does not depreciate abnormally in relation to foreign currencies.

**(G) Clearing house**

In all big cities RBI has its branches and clearing house operations are undertaken. Where RBI does not have its branch, the clearing house operations are undertaken by State Bank of India and its subsidiary banks. All the commercial banks in India are members in clearing house and they take part in the clearing of cheques.

**PROMOTIONAL FUNCTIONS**

**a) Branch expansion policy:** It is due to the steps taken by RBI, more branches of commercial banks have been opened in rural areas and this has helped in the rural population becoming familiar with banking activities. Some of the banks have been asked to adopt villages under the village adoption scheme. In this method, banks will be providing all the requirements of villages.

**b) Industrial and agricultural finance:** For the purpose of providing both industrial and agricultural finance, RBI has promoted separate institutions. IDBI, ICICI, SFC, SIDBI, are some of the institutions promoted by RBI along with Government. These institutions are providing direct as well as indirect finance to industry. For agriculture, NABARD (National Bank for Agriculture and Rural Development) was set up and it is providing rel financing facility to all commercial and co-operative banks for promoting agriculture and allied activities and also rural and cottage industries.

**c) Protecting the interest** of depositors and creditors: For the purpose of protecting the interest of depositors in commercial banks Deposit Insurance Corporation was set up as early as in 1962. The commercial bank will be paying 5 paise on every Rs.100 deposit to the Deposit Insurance Corporation as premium. In the case of collapse of the commercial bank, depositors up to Rs.30,000 will be paid in full their deposit amount by the Deposit Insurance Corporation. In 1972, the Reserve Bank of India promoted Credit Guarantee Corporation to protect the interest of creditors. Here also the bank will be paying 5 paise as premium on every Rs. 100 loan granted. When the loan becomes irrecoverable 75% of the loan will be indemnified by the Credit Guarantee Corporation. This has enabled the commercial bank to extend credit to the priority sector wherein security for the loan is not very much forthcoming. By 1978, the two corporations i.e., Deposit Insurance Corporation and Credit Guarantee Corporation were merged and it was called Deposit Insurance Credit Guarantee Corporation (DICGC).

**SUPERVISORY FUNCTIONS**

(a) RBI not only supervises the functions of commercial banks but also guides them periodically. After the nationalisation of commercial banks, there has been more loans to the weaker sections as well as to agriculture. But the performance of the banks were not to the satisfaction of RBI. The Accounting policy of commercial banks has undergone a change in conformity with the international banking standard. Accordingly, the balance sheet of commercial banks have undergone a change since 1994. The assets of the commercial banks have been classified as

standard assets – Which has liquidity and reasonable return sub-

standard assets – Liquidity with a low rate of return

doubtful asset – Low liquidity without any return

bad asset – Neither liquidity nor any return

On the above basis, the commercial banks have been asked to make provisions out of their profits. All the doubtful and bad debts must have 100% provisions. This has resulted in some of the nationalised banks coming out with true colours. In other words, such banks have incurred loss. The window dressing of the balance sheet is no longer possible. All these are possible due to the effective supervisory policy of RBI.

**MONETARY POLICY OF RESERVE BANK OF INDIA**

The monetary policy of RBI has four major objectives.

1. Exchange rate stability
2. Price stability
3. Encouraging employment growth
4. Assisting for rapid economic growth

**i) Exchange rate stability:** For the purpose of exchange rate stability, RBI has not only resorted to exchange control but has helped the exporters to earn more foreign exchange. It has provided export finance through commercial banks and has helped both the government and the exporters to earn foreign exchange. By maintaining adequate foreign exchange reserve, it has prevented the domestic currency value from declining.

**ii) Price stability:** The price fluctuation in our country is not only due to the interaction of supply and demand but also due to the activity of traders. Hoarding and black marketing are responsible for the price increase. Through selective credit control and by direct action, RBI has prevented the price rise to some extent. However, the presence of a large number of money lenders and indigenous bankers has prevented RBI from taking effective price control.

**iii) Full employment:** To promote more employment, both in rural and urban areas, RBI adopted the policy of Lead Bank Scheme. But when the system I'li led, in 1988, Service Area Approach was adopted. Accordingly, each bank branch was ear-marked certain area in which the bank will be sole authority to extend credit. This has helped in generating employment in rural, semi-urban and urban areas. RBI has directed commercial banks to extend credit facilities to priority sector which is aimed at increasing employment generation.

**iv) Assisting for rapid economic growth:** Economic growth can he achieved only when the country experiences a substantial increase in production in agriculture, industry and service sectors. In our Country, RHI has helped the government by mobilising savings of the people for investment. The balance of payment position should also be under control for achieving economic growth\_ Though the five year plans have an object of 5.5% of economic growth only three per cent could be realised which is due to an increase in population growth. Hence, RBI is helpless. If the government co-operates by controlling the population then the monetary policy of RBI will not only improve the economic growth but also help in the economic development of the country. That is increased production bringing an impact in the people in the form of higher standard of living.

 **FACTORING**

**MEANING:**

 The word ‘factor’ has been derived from the latin word ‘finance’ which means to make or to do. In other words it means ‘to get things done’. According to the dictionary factor is an agent as a banking or insurance company, engaged in financing the operations of certain companies or in financing wholesale or retail trade sales, through the purchase of account receivables.

**Definition**:

 Robert W.Johnson “factoring is a service involving the purchase by a financial organization, called a factor of receivable owned to manufacturers and distributors by their customers, with the factor assuming full credit and collection responsibilities”.

 **Modus operandi**:

 A factor provides finance to his client up to a certain percentage of the unpaid invoices which represent the sale of goods or service to approved customers. The modus operandi of the factoring scheme as follows:

* + There should be a factoring arrangement between the client and the factor which is the finance organization.
	+ Whenever the client goods to trade customers on credit he prepares invoices in the usual way.
	+ The goods are sent to the buyers without raising a bill of exchange but accompanies by an invoice.
	+ The debt due by the purchaser to the client is assigned to the factor by advising the trade customers to pay the amount due to the client to the factor.
	+ The factor makes an immediate payment up to 80% of the assigned invoice and the balance 20% will be paid on realization of the debt

**Terms and conditions**:

 The existence of agreement between the factor and the client is central to the function of factoring. The main terms and condition generally included in factoring agreement of are the following

* + Assignment of debt in favor of the factor
	+ Selling limits for clients
	+ Conditions within which the factor will have recourse to the client in case of non-payment by trade customer.
	+ Circumstances under which will have resource incase of non-payment
	+ Limit of any overdraft facility and the rate of interest to be charged by the factor

**Function:**

 In terms of ‘factoring’ simply refers to the process of selling trade debts of a company to a financial institution. But in practice, it is more than that. Factoring involves the following function

* Purchasing and collection debts
* Sales ledger management
* Credit investigation and undertaking of credit risk
* Provision of finance against debts
* Rendering consultancy services

**1. Purchasing and collection debts:**

 Factoring the sale of trade debts to the factor by the company. It is where factoring differs from discounting. Under discounting the financier simply discounts the debts backed by account receivables of the client. He does so as an agent of the client.

**2. Sales ledger management:**

 Sales ledger management function is a very important one in factoring. Once the factoring relationship is established, it becomes the factors responsibility to take care of all the function relating to the maintenance of sales ledger. The factor has to credit customer account whenever payment is received, send monthly statements to the customers to the maintain liaisons

With the client and the customer to resolve all possible disputes.

**3. Credit investigation and undertaking of credit of risk:**

 The factor has to minor the financial position of the customer carefully since, he assumes the risk of default in payment by the customers due to their financial inability to pay. This assumption of credit risk is one of most important function which he the factor accepts. Hence before accepting the risk he must be fully aware of the financial viability of the customer. His past financial performance record, his future ability his honesty and integrity in the business world

**4. Provision finance:**

 The finalization of the agreement and sale of goods by the client, the factor provides 80% of the credit sales as prepayment to the client. Hence the client can go ahead with his business plans or production schedule without any interruption. That is in the event of nonpayment the factor has to bear to loss of payment

**5. Rendering consultancy service:**

 The factor also provides management services to the client. He informs the client about the additional business opportunities available, the changing business and financial profiles of the customers the like hood of coming recession

**Types of factoring:**

 The type of factoring services varies on the basis of the nature of transcation between the client and the factor, the nature and volume of clients business the nature factors security. In general the factoring services can be classified follows;

* Full services factoring
* With resource factoring
* Maturity factoring
* Bulk factoring
* Invoice factoring
* Agency factoring
* International factoring

**1. Full service factoring:**

 A factor provides all kinds of services. Thus provides finance, administers, the sales ledger, collects the debts at his risk and renders consultancy service.

**2. with resource factoring:**

 If the debtors do not repay their dues in time and if their debts are outstanding beyond a fixed period, say 60 to 90 days from the due date, such debts are automatically assigned back to the client. The client has to take up the work collection of overdue account by himself. If the client wants the factor to go on with the collection work of overdue accounts the client has to pay extra charges.

**3. Maturity factoring:**

 The factor does not provide immediate cash payment to the client at the time of assignment of debts. He undertakes to pay cash as and when collection is made from the debtors. The entire amount collected less factoring fees is paid to the client immediately. Hence it is called collection factoring.

**4. Bulk factoring:**

 The factor provides fiancé after disclosing the fact of assignment of debts to the debtors concerned. This type of factoring is resorted to when the factor is not fully satisfied with the financial condition of the client. The work relating to sales ledger administration, credit control, collection work etc., has to done by client him self

**5. Invoice factoring:**

 The factor simply provides finance against invoices without undertaking any other function. All workers connected with sale administration, collection of dues etc have to be done by the client himself. The debtors are not all notified and hence they are not aware of the financing arrangement. This type of factoring also called confidential invoice.

**6. Agency factoring**:

 The word agency has no meaning as far as factoring is concerned. Under this type the factor and the client share the work between themselves as follows.

* + The client has to look after the sales ledger administration and collection work
	+ The factor has to provide finance and assume the credit risk

**7. International factoring**:

 The service of a factor in a domestic business is simply extended to international business. Factoring is done purely on basis of the invoice prepared by the exporter. Thus, the exporter is able to get immediate cash to the extent of 80% of the export invoice under international factoring.

**8. Suppliers guarantee factoring**:

 This type of factoring is suitable for business establishments which sell goods through middleman. Generally, goods are sold through wholesalers, retailers, or through middleman.

**9. Limited factoring**:

 This type the factor does not take up all the invoices of a client. He discounts only selected invoices on merit basis and converts credit bills into cash in respect of those bills only

**BENEFITS OF FACTORING:**

 Factors offer a number benefits to clients. Some of the important benefits are.

**1. Financial services**:

 Many of the manufacture and traders find their working capital being locked up in the form of trade debts. This has been a great handicap to the small and medium scale manufactures because they have wait for 3 months to 9 months to realize their debts. In the meantime the business may suffer due to want of funds. The major benefit of the factoring service is that the clients will be able to convert their trade debts into cash up to 80% immediately as soon as the credit sales are over.

**2. Collection service:**

 Collection of debts is another problematic area for many concerns. It is found that over 60% of the total sales of the SSI sector and over 50% of total sales of the medium and large scale sector are made on credit sales. It means that collection of debts becomes an important internal credit management and it requires more and more time. Now, collection work is completely taken up by the factoring organization leaving the client to concentrate on production alone. This is an important services rendered by factor to his client.

**3. Credit risk service**:

 In the absence of work factor the entire risk has to be borne by the client himself. Bad debts eat away the profits of a concern and in some cases; it may lead to the closure of a business. But once the factoring relationship is established the client need not bother about the loss due to bad debts.

**4. Consultancy service:**

 Factors are professionals in offering management services like consultancy. They collect information regarding the credit worthiness of the customer of their clients, ascertain their track of record, quality of portfolio turnover, average size of inventory etc. They also advise their clients important financial matters .

**5. Economy in servicing**:

 Factors are able to render very economic service to their client because their overhead cost is spreads over a number of clients. Moreover their service charges are also reasonable. Factoring is a cheap source of finance to the client because the interest rate is charged only on the amount actually provided to the client. Thus, clients are able to get factoring service at economic rates.

**6. Off- balancing sheet financing**:

 Factoring is an off-balance sheet means of finance. When the factor purchases the book debts of the client, these debts no longer exist on the current asset side of the balance sheet. It leads to reduction in debts and less collection problems. The client can utilize the money so received to reduce his current liabilities.

**7. Trade benefits**:

 It ensures a steady flow o inputs on the one hand and better market prospects on the other. Again factoring enables the supplier to concentrate on production and materials management without bothering about the financial management

**Factoring in India**:

 In India the idea providing factoring services was brought of by vaghul working group. It

Had recommended that banks and private non-banking financial companies should be encouraged to provide factoring services with view helping the industrialists and traders. The RBI subsequently constituted a study group in January 1988 under the chairmanship of Mr.C.S.kalayansundaram former managing director of the SBI to examine the feasibility to staring factoring services. On the recommendation of the committee, the banking regulation act was amended in July 1990 with a view to enabling commercial banks to take up factoring services by forming separate subsidiaries.

* The banks should not directly undertake the business of factoring
* The banks may set up separate subsidiaries or invest in factoring companies jointly with other banks
* A factoring subsidiary or joint venture factoring company may undertake the factoring business. But they should not finance other factoring companies
* The banks can invest in the shares of factoring companies not exceeding 10% of paid up capital and reserve of the bank concerned

But recently in February, 1994 the RBI has permitted all banks to enter into factoring business departmentally. Since factoring requires special skills and infrastructure the RBI has further stipulated that.

 Factoring activities should be treated on par with loans and advances and should accordingly be given risk weight 100 percent for calculation of capital to risk asset ratio

* Factoring services should be provided only in respect of those invoices which represent genuine trade transactions

In India the factoring service was first started by the state bank of India in association with the small industries development bank of India, union bank of India, state bank of sourashtra and state bank of Indore. The pioneering factoring company founded by the SBI is called “SBI-Factors and commercial services pvt.ltd (SBI FACS)”. It was started 1991 with a subscribed capital of Rs.25 crores. It has been allotted the western zone composing of Maharashtra, Gujarat, goa, Madhya Pradesh. In south, canera bank has already established can factors ltd. Now these two factoring companies can operated in the centers outside their given zones. Thus factoring service has got very bright future in India due to its superiority over other forms of financing

**International factoring:**

 Generally factoring services are very popular for domestic business. They are gradually entering into export business also. Just as domestic suppliers the exporters also find that there is a considerable delay in receiving payments from the importers. As a result they are hard pressed for money to ensure their profitability as well as to maintain and expand their export business. In this situation international factoring comes really handy to them to find the required resources

**Definition:**

 Factoring means an arrangement between a factor and his client which includes at least two of the following to be provided by the factor

1. Finance

2. Maintenances of accounts

3. Collection of debts

**Types of export factoring:**

 Factoring is done entirely on the basis of the invoice prepared by the exporter and so it purely an invoice based finance. International factoring there are four parties namely

* The exporter who is taking the place of a client in a domestic transaction
* The importer who is taking the role of customer in domestic transaction
* Exporter factor
* Importer factor

 The exporter factor enter into a agreement for export factoring which may take any one the following types

* Two factor system
* Single factor system
* Direct exporter factor system
* Direct import factor system

**1. Two factor system:**

 There are two factors under this system –one in the export country and the other in importer country. When exporter wants do business with some importer or importers, he approaches the factor in his country and informs him of his business proposal the likely size of business, the number of invoices likely to be raised, the value of the consignment and the currency involved.

**2. Single factor system**

 Under this system also two factoring companies as stated earlier, are involved. However the responsibility of making the payment, maintenance of books of accounts, administration etc., initially rest with the export factor. But the credit risk the export factor enters into an agreement with the import factor to collect the debt from the importer. In case the export factor is not able realize amount. Thus the import factor is called upon to assist the export factor only during the times of difficulties in realizing the debt. So it’s called single risk factor system

**3. Direct export factor system:**

 Under this system there factoring agreement directly between the exporter and the export factor and no other party is involved. The entire export credit risk, the administration of the account, the advances payment

**4. Direct import factor system**

 It is just opposite of direct export factor system. The agreement is between the exporter and the import in the importer country. The import factor assumes all responsibilities for the collection of the debt from the importer.

**PREVIOUS YEAR QUESTION PAPER**

**SECTION “A” –TWO MARKS**

1. What is merchant banking?
2. What is capital re – structuring services?
3. What is close ended mutual funds?
4. Write short notes on LIC
5. What is venture capital?
6. What do you mean by lease financing?
7. What is import leasing?
8. What is hire purchase?
9. What is meant by credit rating?
10. Define factoring.
11. What are the objectives financial services?
12. Write any two functions of merchant banking.
13. What is mutual fund?
14. What are the benefits of mutual funds?
15. What is financial lease?
16. Write any two merits of lease financing.
17. What is ‘hire purchase’?
18. What is ‘international lease’
19. Define the term factoring.
20. What is the meaning of forfeiting?
21. What is a financial services market?
22. What is ‘corporate counseling’?
23. What is UTI?
24. What is a close – ended mutual fund?
25. What is consumer leasing?
26. What is ‘financial lease’?
27. Write two advantages of ‘hire purchase’
28. What is the meaning of ‘hire purchase’?
29. What is ‘export factoring’?
30. What is meant by ‘credit control’?

**SECTION “B” – FIVE MARKS**

1. Discuss the scope of merchant banking.
2. What are the constituents of financial services market?
3. Explain the functions of mutual funds.
4. What is ATM/ state its uses.
5. What are the benefits of leasing?
6. What are the rights of lessor and lessee in financing?
7. What are the special features of hire purchase system?
8. Explain the difference between lease and hire purchase system.
9. Describe the different types factoring.
10. What are advantages of factoring?
11. What are the financial services? Explain its objectives and functions.
12. Explain the functions and services of merchant banking.
13. What are the UTI guidelines on mutual funds?
14. How will you evaluate the performance of mutual funds?
15. What are the advantages and disadvantages of leasing?
16. Discuss briefly role played by various participants in lease finance services.
17. Identify the different ways of determining the rate of interest under the hire purchase finance agreement
18. Distinguish between lease financing and hire purchase financing.
19. What are the advantages of hire – purchases?
20. Write the functions of a factor.
21. What are the constituents of financial services market?
22. Explain the problems involved in under writing of merchant bankers.
23. Explain the mechanism of mutual fund operation.
24. What are the functions of ‘AMC’?
25. What are the services rendered by a lessor in a lease?
26. Explain the difference between loan finance and lease.
27. What are the advantages of hire – purchases?
28. What are the rights of hire purchaser?
29. What are the features of ‘factoring’?
30. Explain the operational problems of the Indian factoring.

**SECTION “C” – TEN MARKS**

1. Discuss the various services of merchant bankers.
2. Discuss the growth of mutual funds in India.
3. Explain the types of lease.
4. Explain the interest calculation under hire purchase system.
5. Describe the various special features of factoring.
6. What is the need for regulating financial services sector in India?
7. Explain working mechanism of AMC.
8. What are the financial implications of leasing?
9. Outline the legal framework relating to hire – purchase transaction in India.
10. Describe the different types of factoring.
11. Explain the functions of financial services.
12. Explain the growth of mutual funds in India.
13. Explain the various advantages of lease financing.
14. What are the difference between hire purchase and lease?
15. Discuss the functions of a factor.

**\*\*\*\*\*\*\*\*\*\* ALL THE BEST \*\*\*\*\*\*\*\*\*\***