Financial services

Unit-1

 Introduction to financial services- Merchant banking, meaning- Scope, function- Management of new issue-Indian experience-Securities And Exchange Board of India (SEBI) guidelines.

Unit-2

 Mutual fund: Meaning- types- function- advantages- institution involved- UTI, LIC, and commercial bank entry of private sector- performances- growth of mutual funds in India- SEBI guidelines- AMC.

Unit-3

 Lease financing: The concept- merits & demerits of leasing- types- the Indian leasing scenario.

Unit-4

 Hire purchase: meaning- RBI guidelines- H.P & Transport Industry- Lease Vs H.P- Problems & prospect of hire purchase in India

Unit-5

 Factoring: concepts-signification- types- factoring mechanism- factory Vs leasing- factoring in India- forfeitures- Kalyanasundaram committee recommendation

Financial services

Unit-1

PART- A 2MARK

1. What do you mean by financial services?

The term “financial services” in a broad sense mean “mobilizing and allocating saving”. Thus, it includes all activities involved in the transformation of saving into investment.

2. Write any two features of financial services.  It is a customer-intensive industry. Identification of need and wants of customer is the first step. It will help the financial service firms to design the financial strategy, which gives due respect to costs, liquidity and maturity consideration.  Demand and supply must be properly balanced.

3. Define merchant banking.

The standard definition to the word „merchant bank‟ is given under: “Merchant banking means any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, underwriting or subscribing to the securities underwriter, manager, consultant, advisor or rendering corporate advisory in relating to such issue management”.

4. What do you mean by merchant banking?

 “An organization that underwrite corporate securities and advise clients on issue like corporate mergers, etc. involved in the ownership of commercial ventures”.

5. Write a short note on public issue.

By using prospectus, companies raise fund from the public. This is a most common method of raising fund. Companies issue prospectus to issue shares. Shares issues through prospectus are in a fixed number.

6. What is right issue?

 Existing share holders have pre-emptive right in taking part in the right issue. In right issue, shares are offered to existing share holders according to the proportion of their share holding.

7. What is private placement?

 The direct sale of shares by a company to investors is called private placement. No prospects are issued in private placement. Private placement covers equity shares, preference shares and debentures.

8. Write a note on „Project Counselling‟.

 Project counseling includes preparation of project reports, deciding upon the financing pattern to finance to the cost of the project and apprising project report the financial institutions or banks.

9. Write a note on portfolio management.

 Portfolio management refers to maintaining proper combination of securities in a manner that they give maximum return with minimum risk.

10. Write a note on issue management.

 Management of issue involes marketing of corporate securities viz., equity shares, preference shares and debentures or bonds by offering them to public.

11. Write any two advantage of public issue.

 It provides liquidity for the existing share. The reputation and visibility of the company increase. It commands better valuation for the company.

12. Write a note on forfeiting.

 Forfeiting is a technique by which a forfeiter discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills.

13. Write short notes on Commercial Paper.

 A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.

14. What do you mean by Treasury bill?

A treasury bill is also a money market instruments issued by the central government. It also issued at a discount and redeemed at par. Recently, the government has come out with short term Treasury bill of 182-days bills and 364-days bills.

15. What is the certificate of deposit?

 The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity.

16. What is the deep discount bond?

 There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large discount to their nominal value. This bond could be gifted to any person.

 17. Write short notes on Option bonds.

 These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity.

18. Write short notes on Equity with 100% safety net.

Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at any, irrespective of the market price.

19. Write short notes on Convertible bonds.

 A convertible bond is one which can be converted into equity shares at per-determined timing either fully or partially. They are compulsory convertible bonds which provide fore conversion within 18 months of their issue. There are optionally convertible bonds which provide for conversion within 36 months.

20. Write short notes on Easy exit bonds.

 As the name indicates, this bond enables the small investors to encase the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.

21. Write short notes on Carrot and stick bonds.

Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price.

22. Write short notes on Global depository Receipt (GDR).

 Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. or both. It represents a certain number of underlying equity shares.

 23. Write short notes on Blue chip share.

 Share of well known and established companies are called blue chip share. They must show consistent growth over the years. These shares have bright future prospects and they are expected to contribute sustained growth in the future also.

24. Write short notes on Defensive shares.

 These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors‟ money.

25. Write short notes on Growth shares.

 Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.

26. What is the difference between Cyclical Vs Non-cyclical shares?

 Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc. If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.

27. What do you mean by Turn around Shares?

 Turn around shares is those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.

 28. What do you mean by Active Shares?

 Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold at least three times a week. Investors can buy or sell these shares quite easily in the market.

29. What do you mean by Alpha Shares?

 Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

30. What do you mean by Sweat shares?

 Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

31. What do you mean by Financial Engineering?

 Thus, the growing need for innovation has assumed immense importance in recent times. This process is being referred to as financial engineering. Financial engineering is the lifeblood of any financial ability “Financial engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance”

32. What do you mean by Loan Syndication?

This is more or less similar to „consortium financing‟. It refers to a loan arranged by a bank called leader manager for a borrower who is usually a large corporate customer or a Government Department. The other banks who are willing to lend can participate in loan by contributing an amount suitable to their own lending polices. Since a single bank can not provide such a huge sum as loan, a number of banks joint together and form a syndicate.

33. What do you mean by Leasing?

 A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called “rental charges”. The lessee can not acquire any ownership to the asset, but he can use it and have full control over it. He is expected to pay for all maintenance charges and repairing and operating costs.

34. What you mean by Venture Capital?

 A venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project. It is in contrast to the conventional “security based financing”. Much thrust is given to new ideas or technological innovations. Finance is being provided not only for „start-up capital‟ by the financial intermediary.

35. What do you mean by Securitization?

Securitization is a technique where by a financial company converts its ill-liquid, nonnegotiable and high value financial assets into securities of small value which are made tradable and transferable. A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc.

36. What do you mean by Reverse Mortgage?

 In a Reverse Mortgage the owner of a house property surrenders the title of his property to a lender and raises money, a lender does not pay the entire amount. On the other hand, he pays out a regular sum each month for the agreed time. The owner, normally a senior citizen, can use the property and stay with his spouse for the rest of their lives. Thus, the owner can ensure a regular cash flow in times of need and enjoy the benefit of using the property. Usually, after the death of the owner, the spouse can continue to use the property. In case, both die during the period of the RM scheme the

lender will sell the property, take his share and distribute the rest among the heirs. It is called reverse mortgage because the payment steam is “reversed”.

 37. Write short notes on Derivative Security.

 A derivative security is a security whose value depends upon the value of other basic variables backing the security. In most cases, these variables are nothing but the prices of traded securities. A derivative security is basically used as a risk management tool and it is to cover the risks due to price fluctuations by the investments manager. Naturally the value of a derivative security depends upon the value of the backing security.

38. Write short notes on Forward contracts.

 A forward transaction is one where the delivery of a foreign currently takes place at a specified future date for a specified price. It may have a fixed maturity for, e.g. 31st May or a flexible maturity for e.g. 1st to 31st May. Forward contracts are permitted only for genuine business transactions.

39. What do you mean by Swaps?

 A swap refers to a transaction where in a financial intermediary buys and sells a specified foreign currency simultaneously for different maturity dates-say, for instance, purchase of spot and sale of forward or vice versa with different maturities. Thus, swaps would result in simultaneous buying and selling of the same foreign currency of the same value for different maturities to eliminate exposure risk.

40. Write short notes on Letter of credit (LOC).

 It is an innovative funding mechanism for the import of goods and service on deferred payment terms. LOC is institution/bank of one country with another institution/bank/agent to support the export of goods and services so as to enable the importers to import no differed payment terms. This may be backed by a guarantee furnished by the institution/bank in the importing country. The greatest advantage is that it saves a lot of time and money on natural‟s verifications of bonafides, source of finance etc. It serves as a source of forex.

PART-B 5mark

1. Explain the characteristics of financial services. 

 It is a customer-intensive industry. Identification of need and wants of customer is the first step. It will help the financial service firms to design the financial strategy, which gives due respect to costs, liquidity and maturity consideration.  Financial services are intangible in nature. The institution providing the services should have a good image and confidence of the client. The have to focus on quality and innovativeness of their services, this will build credibility and gain the trust of clients.  Production and supply of financial services must be performed simultaneously. This demands a clear-cut organization and their clients.  Demand and supply must be properly balanced. This is because of the perishable nature of financial services.  Marking of financial people intensive. It is subject to variability of performance and quality of service. The personnel in financial services firms need to be selected, based on their suitability.  Financial services firm should always be proactive in visualizing in advance what the market wants, or reactive to the needs and wants of customers. They must always be changing to the tune of the market.

1. What are the classifications of financial services industry?

The financial intermediaries in India can be traditionally classified into two:  Capital market intermediaries and  Money market intermediaries. The capital market intermediaries consist of term lending institutions and investing institutions which mainly provide long term funds. On the other hand, money market consists of commercial banks, co-operative banks and other agencies which supply only short term funds. Hence, the term „financial services industry‟ includes all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers.

1. Examine the scope of merchant banking in India.  Growth of new issue market

 The growth of new issue market is unprecedented since 1990-91. The amnt of annual average of capital issue by non-government public companies was only about 90crs in 70s, the same rose to over Rs.1000crs in the 80‟s and further to Rs.12700crs in the first 4 years of 1990‟s. The figure could be well beyond Rs.40000crs by the end of 1994-95.  Entry of foreign investors An outstanding development in the history of Indian capital market was its opening up in 1992 by allowing foreign institution investors to invest in primary and secondary market and also permitting Indian companies to directly tap foreign capital through euro issue. Within two years to march 1994, the total inflow of foreign capital through these routes reached to about 5bills.  Changing policy of financial institutions With the changing emphasis in the lending policies of financial institutions from security ordination to project orientation, corporate enterprises would require the expert services of merchant bankers for project appraisal, financial management.  Development of debt market The concept of debt market has set to work through national stock exchange and the over the counter exchange of India. Experts feel that of the estimated capital issue of Rs.40000crs in 1994-95 a good portion may be raised through debt instruments. The development of debt market will offer tremendous opportunity to merchant bankers.  Innovations in the instruments The Indian capital market has witnessed innovations in the introduction of financial instrument such as non-capital debentures with detachable warrants, cumulative convertible preference shares, zero coupon premium notes, floating rate bonds, auction rate debentures etc.

 Corporate restructuring As a result of liberalization and globalization the competition in the corporate sector is becoming intense. To survive in the competition; companies are reviewing their strategies, structure and function.

1. Discuss the guidelines for merchant bankers issued by Securities and Exchange Board of India (SEBI).

Merchant banking has been statutorily brought within the framework of the securities and exchange board of India under SEBI [merchant bankers] regulation, 1992. 1. The criteria for authorization include: Professional qualification in financier, law or business management. Infrastructure like adequate office space, equipment and manpower. Employment of two persons who have the experience to conduct business of merchant bankers. Capital adequacy. Past track of record, experience, general reputation and fairness in all transactions. 2. Securities and Exchange Board of India (SEBI) issued further guidelines classifying the merchant banker into four categories based on the nature and range of activities and their responsibilities to SEBI investors and issuers of securities. The second category consists of those authorized to act in the capacity of co-manager/advisor, consultant, and underwriter to an issue or portfolio manager. The third category consists of those authorized to act as underwriter, advisor or consultant to an issue. The fourth category consists of merchant bankers who act as advisor. The above classification was valid up to December 1997 only. 3. An initial authorization fee, an annual fee and renewal fee may be collected by Securities and Exchange Board of India (SEBI) All issues must be managed at least by one authorized banker, function as the sole manager or the lead manager. Ordinarily not more than two merchant bankers should be association as lead managers.Each merchant banker is required to furnish to the Securities and Exchange Board of India (SEBI) half yearly unaudited financial result when required by it with a view to monitor the capital adequacy of the merchant banker.The lead merchant banker holing a certificate under category I shall accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakhs whichever is less.

The above guidelines will be administered by Securities and Exchange Board of India (SEBI) and it will supervise the activities of merchant bankers. 8. Securities and Exchange Board of India (SEBI) has been vested with power to suspend or cancel the authorization in case of violation of the guidelines. The notification procedure relating to action to be initiated against merchant banks in case of default has been detailed out. The regulations empower Securities

Exchange Board of India (SEBI) to take action against defaulting banker such as suspension/cancellation of registration.

1. Explain the detail the merchant banking in India.

 In India prior to the enactment of Indian companies act, 1956, managing agents acted as issue hours for securities, evaluated project reports, planned capital structure and to some extent provided venture capital for new firms. Few share broking firms also functioned as merchant bankers. The need for specialized merchant banking service was felt in India with the rapid growth in the number and size of the issues made in the primary market. The merchant services were started by foreign banks, namely the national grind lays bank in 1967 and city bank in 1970. The banking commission in its report in 1972 recommended the setting up of merchant banking institutions, this market the beginning of specialized merchant banking in India. The begin with, merchant banking services were offered along with other traditional banking services in the mid-eighties, the Banking Regulations Act was amended

permitting commercial banks to offer a wide range of financial services through the subsidiary rule. The state bank of India was the first Indian banks to set-up merchant its merchant banking division in 1972. Later bank ICICI set up its merchant banking division followed by bank of India, bank of Baroda, Punjab national bank and UCO Bank. The merchant banking gained prominence during 1983-84 due to new issue boom.

1. Explain the issue management.

 Issue management refers to management of securities offering of client to the general public and existing shareholders on right basis. Issue managers are known as merchant banker or lead managers. Merchant banker has many more tasks to be carried out. Of which, issue management is the most important and sizable function within. The terms „merchant banking‟ and „issue management‟ are generally used interchangeably. Public issue and right issue of more than Rs.50lakhs is required to be managed by a category merchant banker under Securities and Exchange Board of India (SEBI) guidelines. Industry of present is badly in need of funds. Issue management has tremendous scope and potential in supplying such funds to the industry. Merchant bankers provide their skills and experience to clients in managing the capital issues. It essentially aims at converting the saving of household into viable investment of clients. The investment covers investment on new projects, expansion, modernization and diversification of existing units and augmenting the long-term sources for working capital purpose. Issues are of three types, a) public issue b) Right issue, C) Private Placement.

1. Discuss the functions of a Merchant Banker.

 The following comprise the main functions of Merchant Banker: Management of debt and equity offerings This forms the main function of the Merchant Banker. He assists the companies the raising from the market. The main areas of work in this regard include: instrument designing, pricing the issue, registration of the offer document, underwriting support, and marketing of the issue, allotment and refund, listing on stock exchanges.

 Promotional activities A merchant bank functions as a promoter of industrial enterprises in India. He helps the entrepreneur in conceiving an idea, identification of projects, preparing feasibility reports, obtaining Government approvals, and incentives etc. Placement and distributions The merchant banker helps in distributing various securities like equity shares, debt instruments, mutual fund products, fixed deposits, insurance products, commercial papers to name a few. The distribution network of the merchant banker can be classified as instructional and retail in nature. Project advisory services Merchant bankers help their clients in various stages of the project undertaken by the clieThey assist them in conceptualizing the project idea in the initial stage. Once the idea is formed, they conduct feasibility studies to examine the viability of the proposed project. Loan syndication Merchant bankers arrange to tie up loans for their clients. This takes place in a series of steps. First, they analyze the pattern of the client‟s cash flows, based on which the terms of borrowing can be defined. Then the merchant banker prepares a detailed loan memorandum, which is circulated to various banks and financial institutions and they are invited to participate in the syndicate. The banks then negotiate the terms of lending based on which the final allocation is done. Providing venture capital and mezzanine financing Merchant bankers help companies in obtaining venture capital financing for financing their new and innovative strategies. Leasing Finance Merchant Bankers provide leasing finance facilities to their clients. Bought out deals It involves a deal where the entire securities are bought in lots. It is done with an intention of offloading them later in the market. The deal is done in two stages –first, the client issues shares to the retail investors at a higher price. The merchant banker is required to appraise the project, invest in the client and offer the shares to the public for

subscription. The client, on the other hand, need not wait for months together to use the issue proceeds and gets an attractive price for his shares. In addition, it allows companies to raise capital without facing the uncertainties of the market place. Non-resident Investment The merchant bankers provide investment advisory services in terms of identification of investment opportunities, selection of securities, portfolio management, etc. to attract NRI investment in the primary and secondary markets. Advisory services relating to mergers and acquisitions Mergers and takeovers are popular in these days. There may be several reasons for mergers and acquisitions. They vary from elimination of competition, expansion of capital through tie-ups and to go global. Portfolio management Merchant bankers offer services not only to the clients issuing the securities but also to the investors. They advise their clients, mostly institutional investors, regarding investment decisions. Merchant bankers even undertake the function of purchase and sale of securities for their clients to provide them: (a) To identity the potential targets of takeovers, (b) To appraise the merger/takeover proposals with respect to financial viability and technical feasibility, (c) To negotiate with interested parties, (d) To determine the purchase consideration and the appropriate exchange offer, (e) To assist in matters related to procedural and legal aspects, and (f) To obtaining necessary approvals.

1. Explain the scope of financial services.

 Financial services cover a wide range of activities. They can be broadly classified into two namely: (i) Traditional activities (ii) Modern activities

  Traditional activities Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads viz;  Fund based activities and  Non- fund based activities Fund based activities The traditional services which come under fund based activities are the following: (i) Underwriting of or investment in shares, debentures, bonds etc, of new issues (primary market activities) (ii) Dealing in secondary market activities. (iii) Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc. (iv) Involving in equipment leasing, hire purchase, venture capital. Seed capital etc. (v) Dealing in foreign exchange market activities. Non-fund based activities Financial intermediaries provide services on the basis of non-fund activities also. This can also be called “fee based” activity. They expect more from financial service companies. Hence, a wide variety of service, are being provided under this head they including the following: (i) Making arrangements for the placements of capital and debt instruments with investments institutions. (ii) Arrangements of fund from financial institutions for the clients‟ project cost or his working capital requirements. (iii) Assisting in the process of getting all government and other clearances.  Modern activities Besides the above traditional services, the financial intermediaries render innumerable service in recent times. Most of them are in the nature of non-fund based activity. In view of the importance, these activities have been discussed in brief under the head „New financial

products and services‟. However, some of the modern services provided by them are given in brief hereunder: (i) Rendering project advisory services right from the preparation of the project report till the raising of funds for starting the project with necessary government approval. (ii) Planning for mergers and acquisitions and assisting for their smooth carry out. (iii) Guiding corporate customers in capital restructuring. (iv) Acting as trustees to the debenture-holders. (v) Recommending suitable changes in the management structure and management style with a view to achieving better result.

1. Write any ten innovative financial instruments

 Commercial paper A commercial is a short-term negotiable money market instruments. It has the character of an unsecured promissory note with a fixed maturity of three to six months. Banking and non-banking companies can issue this for raising their short term debt. It also carries and attractive rate of interest.  Treasury bill A treasury bill is also a money market instruments issued by the central government. It also issued at a discount and redeemed at par. Recently, the government has come out with short term Treasury bill of 182-days bills and 364-days bills.  Certificate of deposit The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates. This is also money market instruments and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity.  Deep discount bonds There will be no interest payments in the cash of keep discount bonds also. Hence, they sold at a large discount to their nominal value. This bond could be gifted to any person.  Option Bond

These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds. In the case of cumulative bonds, interest is accumulated and is payable only on maturity.  Equity with 100% safety net Some companies make “100% safety net” offer to the public. It means that they give a guarantee to the issue price. Suppose, the issue price is Rs.40/- per share the company is ready to get it back at Rs.40/- at any, irrespective of the market price.  Convertible bonds A convertible bond is one which can be converted into equity shares at per-determined timing either fully or partially. They are compulsory convertible bonds which provide fore conversion within 18 months of their issue. There are optionally convertible bonds which provide for conversion within 36 months.  Easy exit bond As the name indicates, this bond enables the small investors to encash the bond at any time after 18 months of its issue and thereby paving a way for an easy exit. It has a maturity period of 10 years with a call option any time after 5 years.  Carrot and stick bonds Carrot bonds a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price.  Global depository Receipt (GDR) Global depository Receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. or both. It represents a certain number of underlying equity shares.

1. Explain the Classification of equity shares 

 Blue chip share Share of well known and established companies are called blue chip share. They must show consistent growth over the years. These shares have bright future prospects and they are expected to contribute sustained growth in the future also.

 Defensive shares These shares tend to fall less in a bear market when compared with other shares and they provide a safe return for the investors‟ money.  Growth shares Growth shares represent the shares of fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long term investment, although the current yield of such shares can be insignificant because of their higher P/E ratios.  Cyclical Vs Non-cyclical shares Cyclical shares are those which rise and fall in price with the state of the national economy of the industries to which they belong like construction, automobile, cement, engineering etc. They may also be affected by international economy of industries such as shipping, aviation and tourism. They also include shares which are affected by natural phenomena like fertilizers, tea, etc. If the shares are not affected by such cyclical changes either due to the state of the national economy or the international economy, they are called non-cyclical shares. Shares of drug companies, insurance companies and basic food stuffs of many consumer products companies come under this category.  Turn around Shares Turn around shares is those which either rise or fall all in a sudden due to turn around situations prevailing in companies. They offer opportunities to investors to pick up the shares when their price is low.  Active Shares Active Shares are those in which there are frequent and day-to-day dealings. They must be bought and sold atleast three times a week. Investors can buy or sell these shares quite easily in the market.  Alpha Shares Alpha shares are those which are most frequently traded in the market. They are also called specified shares or cleared securities. They are included under Group A shares while listing on a stock exchange.

 Sweat shares Sweat shares refer to those shares which are issued to employees or workers who contribute for the development of a company by providing necessary know how using their intellectual property. There must be value addition to the company because of their active involvement in the company and they contribute their might for the progress of the company.

1. Write about challenges facing the financial services sector.

However, the financial service sector has to face many challenges in its attempt to fulfill the ever growing financial demands of the economy. Some of the important challenges are briefly reported hereunder:  Lack of qualified personnel The financial services sector is fully geared to the task of financial creativity. However, this sector has to face many challenges. In fact, the dearth of qualified and trained personnel is an important impediment in its growth.  Lack of investor awareness The introduction of new financial products and instruments will be of no use unless the investor is aware of the advantages and uses of the new and innovative products and instruments.  Lack of transparency The whole financial system is undergoing a phenomenal change in accordance with the requirements of the national and global environments. It is high time that this sector gave up their orthodox attitude of keeping accounts in a highly secret manner. Hence, this sector should opt for better levels of transparency.  Lack of specialization In the scene, each financial intermediary seems to deal in different financial service lines without specializing in one two areas. In other words, each intermediary is acting as financial super market delivering so many financial products and dealing in different varieties of instrument.  Lack of recent dada Most of the intermediaries do not spend more on research. It is very vital that one should build up proper date base on the basis of which one could embark upon financial

creativity. Moreover a proper date base would keep oneself abreast of the recent developments in other parts of the whole world and above all, it would enable the fund managers to take sound financial decisions.

1. Critically analyses the present position of the financial service sector in India. 

 Conservation to dynamism At present, the financial system in India is in a process of rapid transformation, particularly after the introduction of reforms in the financial sector. The main objective of the financial sector reforms is to promote an efficient, competitive and diversified financial system in the country. This is essential to rise the allocate efficiency of available savings, increase the return on investment and thus to promote the accelerated growth of the economy as whole.  Emergence of Primary Equity Market Now, we are also witnessing the emergence of many private sector financial services. The capital markets which were very sluggish have become a popular source of raising finance. The number of stock exchanges in the country has gone up from 9 in 1980 to 22 in 1994. The aggregate funds raised by the industries in the primary markets have gone from Rs. 5976 crore in 1991-92 to Rs. 32382 crore in 2006-07.  Concept of Credit Rating There is every possibility of introducing Equity Grading. Hitherto, the investment decisions of the investors have been based on factors like name recognition of the company, operations of the Group, market sentiments, reputation of the promoters etc. Now, grading from an independent agency would help the investor in his portfolio management and thus, equity grading is going to play a significant role in investment decision-making.  Process of Globalisation Again, the process of globalization has paved the way for the entry of innovative and sophisticated financial products into our country. Since the government is very keen in removing all obstacles that stand in the way of inflow of foreign capital, the potentiabilities for the introduction of innovative international financial products in India are very great.

 Process of Liberalization Realizing all these factors, the government of India has initiated many steps to reform the financial services industry. The government has already switched over to free pricing issues by the controller of capital issues. The interest rates have been deregulated. The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized.

Unit-II

 PART-A 2MARK

1. Define Mutual Funds.

According to Weston J.fed and Brigham, Euqene, F., units trust are “corporations which accept dollars from savers and then use these dollars to buy stock, long term bonds, short term debt instruments issued by business or government units; these corporations pool funds and thus reduce risk y diversification.”

2. What is a Mutual fund?

A mutual fund is a trust that pools the saving of number of investors who share a common financial goal.

Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors.

3. Mention the different types of Mutual Funds.

 Operational classification Open ended mutual fund Close ended mutual fund Interval funds

 Portfolio classification

 Growth oriented funds Income oriented funds Balanced funds Bond funds

 Stock funds Index funds

 Geographical funds classifications

 Structural classification

4. State the regulation of SEBI on the Mutual funds.

 The mutual fund company must be a registered company

 Capital structure must be according to the regulations stipulated by SEBI

 Every mutual fund company must give their Net Asset value periodically preferably weekly in the leading newspapers of the country.

5. What is Net Asset Value?

The Net Asset value of the fund is the cumulative market value of the assets of the fund net of its liabilities. In other words, the find is dissolved or liquidated by selling off all the asset in the fund, this is the amount that the shareholders would collectively own.

6. What is balanced fund?

This is otherwise called “Income-cum-growth” fund it is nothing but a combination of both income and growth funds. It aim at distributing regular income as well as capital appreciation this is achieved by balancing the high growth equity shares and also the fixed income earning securities.

7. What is Gilt fund?

These funds invest exclusively in government securities have no default risk NAVS of these schemes also fluctuate due to change in interest rates and others economic factors as is the case with income of debt oriented schemes.

 8. Explain the term Money Market Mutual fund?

These funds are generally invested in money market instruments such as treasury bills certificate of deposit. Commercial paper, bills discounting, etc. these are regulated on the basis of specified guidelines laid down by the reserve Bank of India.

9. What is specialized fund?

A large number of specialized funds are existence abroad. They offer special schemes so as to meet the specific needs of specific categories of people like pensioners. Widows etc. There are funds for investments in securities of specified areas.

10. What is UTI?

UTI was set up in 1964 by an act of parliament. It commenced its operation from July 1964 with a view to encouraging saving and investment and participation in the income, profit and gain accruing to corporation from the acquisition, holding management and disposal of securities.

11. What are Index funds?

Index funds invest only in those shares which are included in the market indices and in exactly the same proportion. Whenever the market index goes up the value of such index funds

also goes up. Conversely when the market index comes down the value of such index funds also goes down.

12. Write any two features of Closed – ended funds.

The period and/or the target amount of the fund are definite and fixed beforehand.

Once the period is over and/or the target is reached, the door is closed for the investors they cannot purchase any more units.

13. Write any two features of Open – ended funds.

These units are not publicity traded but, the fund is ready to repurchase them and resell them at any time.

The main objectives of this fund is income generation the investors get dividend relight or bonuses as rewards for their investment

 PART-B 5MARK

1. Discuss the types of Mutual funds?

Mutual funds can be classified under four different categories

1. Operational classification 2. Portfolio classification 3. Geographical classification 4. Structural classification

Operational classification

Mutual funds are broadly categorized into three types, namely

a) open ended mutual funds,

b) close ended mutual funds,

c) Interval funds

Open ended Mutual funds:

SEBI regulations defines open ended schemes “a scheme of a mutual funds which is offering units for sales or has outstanding any redeemable units and which does not specify any duration for redemption or repurchase or units” open ended mutual funds all open throughout the year for investment and redemption the units are bought and sold directly by the fund.

Closed ended Mutual funds:

Closed end mutual funds have a definite period after which their shares / units are redeemed. The units are offered to the investors through the public issue and after the date of closure, the entry to the investor is closed. Closed end mutual fund schemes are generally trades among the investors in the secondary. Market since they are to be quoted stock exchange.

Interval funds:

Interval funds combine the features of open ended and closed ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

Portfolio classification:

Mutual funds differ with reference to their instruments therefore, different mutual funds are designed to meet the needs of the investors this section discusses the types of mutual funds classified on the basis of their portfolio

Income oriented funds:

The main objectives of this fund is to provide regular income to the investors in the form of dividends the dividends may be cumulative or non-cumulative on a quarterly, half yearly, or yearly basis.

Balanced funds:

These funds aim at distributing both income and capital appreciation to the investors. Technically the corpus of this scheme is invested quality in high growth equity shares and fixed income earning debentures.

Geographical classification:

On the basis of geographical limits, mutual funds schemes can be classified as domestic mutual funds and off share mutual funds.

Domestic mutual funds:

Domestic mutual fund schemes mobilize the savings of the citizens of the county. However the NRIs and foreign investors can invest in these schemes. All the schemes in vogue in the country are the domestic mutual fund schemes.

Off share Mutual funds:

These funds enable the NRIs and international investors to participate in Indian capital market further these funds are governed by the rules and procedures laid down for the purpose of approving and monitoring their performance by the department of economic affairs, ministry of finance and the direction of RBI.

Structural classification:

 Structure, mutual funds can be divided in two categories namely a capital market mutual funds and money market mutual fund. Mutual funds generally invest the pooled resources in capital market instruments whereas money market mutual funds invest in money market instrument

2. What are the advantages of Mutual fund?

 Advantages of mutual funds

Mutual funds represent pooled savings of numerous investors invested by professional fund managers as diversified portfolio to obtain optimum return on investments with least risk to the investors. The dividend fluctuates with the income on mutual funds‟ investments mutual funds are advantages to individual investors in relation to their direct involvement in investment portfolio activity covering the following aspects.

1. Reduced Risk:

Mutual funds provide investors access to reduced investment risk resulting from diversification, economics of scale in transaction cost and professional finance management.

2. Diversified investment

Small investors participate in larger basket of securities and share the benefits of efficiently managed portfolio by expects and are freed of keeping any records of share certificates etc.

3. Stress free investment

Investors get freedom from emotional stress involved in buying or selling securities mutual funds relieve them from such stress as it is managed by professional experts who act scientifically with right timing in buying and selling for their clients.

4. Revolving type of investment

Automatic reinvestment of dividends and capital gains provides relief to investors so that invested funds generates higher return to them the members of mutual funds.

5. Wide investment opportunities

A ailment of wider investment opportunities that create an increased level of liquidity for the funds holders become possible because of package of more liquid securities in the portfolio of mutual funds.

6. Selection and timings of investment

Expertise in stock selection and timing is made available to investors so that invested fund generates higher returns to them.

3. Review the growth of Mutual funds in India?

The fundamentals are strong and macro-economic indicators are strong one would expect most sectors to perform well and are expecting a bull run in the market is expected to gain around 20-25% and mutual funds will be able to provide those kind of returns enabling one to take advantage of the markets.

The economy slowly picked up after Septembers issues. In year 2002 however poor monsoon affected the stock markets.

Disinvestments stores, securitization bill, security interest bill, entrance of it players in It element and other positive news boosted the stock market and that helped the equity funds to post the good returns.

Fixed income markets witnessed a steep decline in interest rate of around 300 basis points in 2001.

4. Mention the various schemes of UTI for different categories of investors?

Specific investment schemes of UTI as a mutual fund that are beneficial to mutual fund holders are given below.

1. Income Plan 2. Growth Plan 3. Reinvestment Plan 4. Systematic Plan 5. Systematic withdrawal plan 6. Insurance plan

Income plan

The mutual funds distribute a substantial part of the surplus to investors in the dividends.

Growth plan

An investors realize only capital appreciation on the investment and normally does not get any income in the form of income distribution.

Investment plan

Here, the accrued income is reinvested in the purchase of additional units.

Systematic investment plan

The investor is given the option of managing investment on a periodical basis and thus inculcating a regular saving habit. He may issue pre-determined number of postdated cheques in favour of the fund.

Systematic withdrawal plan

This is quite opposite to the systematic investment plan. In systematic withdrawal plan, investor is given the open of withdrawing his investment among at a pre-determined date and among from the fund.

Insurance plan

Here, the investors are given an insurance cover against life or personal accident example L unit linked insurance plan UTI.

5. To want expend commercial Banks in India are better fitted to take up the Mutual funds

Commercial banks and mutual funds:

With a view to providing wider choice to small investors, the government of India has permitted the banks to enter into the field of mutual funds due to the following reason.

Banks are not able to provide better field to the investing public with their saving and fixed deposit interest rates whereas many financial intermediates with innovative market instrument offering very attractive returns, have earner the financial market.

The gross domestic savings has risen from 10% in fifties to 20% in righties, thanks to the massive branch expansion programmed of banks and their growing deposit mobilization.

Indian investors, particularly small and medium ones, are not very keen in investing any substantial amount directly in capital market instrument. They may also hesitate to invest in an indirect way through private financial intermediaries.

Earlier banks were not permitted to tap the capital market for funds or to invest their funds in the market. Now a green signal has been given to them to enter into this market and reap the maximum benefits.

Banks can provide a wider range of products services in mutual fund by introducing innovative schemes and extend their professionalism to the mutual fund industry.

Banks, as merchant banks have wide experience in the capital market and hence managing mutual fund may not be a big problem for them.

The entry of banks would provide much needed competition in the mutual fund industry which has been with to monopolize by the UTI. The competition will improve customer service and wider customer choice also.

6. What are the features of open ended funds?

 There is complete flexibility with regard to one‟s investment or disinvestment. In other words, there is free entry and exist of investors in an open ended fund.

 These units are not publicly traded but the fund is ready to repurchase them and resell them at any time.

 The investor is offered instant liquidity in the sense that the units can be sold on any working day. In fact, the fund operates just like a bank account where in one can get cash across the counter for any number of units sold.

 The main objective of this fund is income generation. The investors get dividend, right or onuses as rewards for their investment.

 Since the units are not listed on the stock market, their prices are linked to the net asset value of units. The NAV is determined by the fund and it varies from to time.

 Generally, the listed prices are very close to their Net Asset value. The fund fixes a different price for their purchases and sales. The find manager has to be very careful in managing the investment because he has to meet the redemption demands at any time made during the life of the scheme.

Units III PART-A 2MARK

 1. Define leasing

 Dictionary of business management „lease is a form of contract transferring the use or occupancy of land, space, structure, or equipment, in consideration of a payment usually in the form of a rent.

2. What do you mean by leverage lease and non- leveraged leases?

 The value of the assets leased may be of a huge amount which may not be possible for the lessor to financial so the lessor involves one more financial who will have charge over the leased asset.

3. Explain the term financial lease

 Financial lease is a contract involving payment over a longer period. It is long term lease and the lessee will be paying much more than the cost of property or equipment to the lessor in the form of lease charges it is irrecoverable. In this type of leasing the lessee has to bear all costs and the lessor does not render any services.

4. What is operating lease?

 The lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice.

 In this type of leasing (a) lessor bears all expenses (b) lessor will not be able to the realise the full cost of the asset (c) specialized services are provided by the lessor.

5. What is cross border lease?

 Lease across national frontiers are called cross border lease shipping , air service . etc., will come under this category.

6. What are the advantages of leasing?

 1. Permit alternative use of funds

 2. Faster and cheaper credit

 3. Flexibility

 4. Facilitates additional borrowings

 5. Protection against obsolescence

 6. No restrictive covenants

 7. Hundred Percent tenanting

 8. Boom to small firm.

7. What are the two disadvantages of leasing?

 1. Certain tax benefits incentives such as subsidy may not be available on leased equipment.

 2. The cost of financing is generally higher than that of debt financing.

8. Mention the different types of leasing

 1. Financial lease.

 2. Operating lease.

 3. Leveraged and non leveraged lease

 4. Conveyance type lease

 5. Sale and lease pack

 6. Full and non pay – out lease.

 7. Specialized service lease.

 8. Net and non – net lease.

 9. Sales aid lease.

 10. Cross border lease.

 11. Tax oriented lease.

 12. Import leasing.

 13. International lease.

9. What do you mean by flexibility?

 Leasing arrangement may be tailored to the lessee‟s needs more easily that ordinary financing. Lease rentals can be structured to match the lessee‟s cash flows. It can be skipped during the months when the cash flows are expected to below.

10. Explain the two contents of lease agreement

 1. Description of the lessor, the lessee, and the equipment.

 2. Amount, time, and place of lease rental payments.

 3. Time and place of equipment delivery.

11. Mention the problems of leasing

 1. Unhealthy competition

 2. Lack of qualified personnel

 3. Tax considerations

 4. Stamp duty

 5. Delayed payment and bad debts.

12. What is lease finance?

 Here a third party comes into the contract by financing the lessor for purchasing the asset or equipment which is meant for leasing. The financial may have a control over machinery by a separate contract with lessor.

PART-B

 5mark

1. What are different types of leasing?

Definition of leasing

 “Lease is a contract where by the owner of an asset grants to another party the exclusive right to use the asset usually for an agreed period of time in return for the payment of rent”.

Types of leasing

1. Financial leasing.

2. Operating leasing.

3. Leveraged and non – leveraged leases.

4. Conveyance type lease

 5. Sale and lease pack

 6. Full and non pay – out lease.

 7. Specialized service lease.

 8. Net and non – net lease.

 9. Sales aid lease.

 10. Cross border lease.

 11. Tax oriented lease.

 12. Import leasing.

 13. International lease.

Financial lease:

 It is a contract involving payment over a longer period it is a long – term. lease and the lessee will be payment much more than the cost of the property or equipment to the lessor in the form of lease charges.

Operating lease:

 The lessee used the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks.

1. Lessor bears all expenses

2. Lessor will not be able to realize the full cost of the asset.

3. Specialized service is provided by the lessor.

 Leveraged and non – leveraged leases

 The value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So the involves one more financier who will have charge over the leased asset.

Conveyance type lease:

 Here the lease will be for a long- period with a clear intention of conveying the ownership of title on the lessee.

Sale and lease pack:

Here a company owning the asset sells it to the lessor. The lessor pays immediately for the assets but leases the asset to the seller. This arrangement is done so that the selling company obtains finance for running the business along with the asset.

Full and non pay- out lease:

 A full pay- out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay– out lease. The lessor leases out the same asset over and over again.

Specialized service lease:

 The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only leases out but also gives specialized personal service to the lessee. Examples are electronic goods automobiles, air conditioners, etc.

Net and non- net lease:

 In non-net lease, the lease in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with the above maintenance expenditure. The lessor confines only to financial service.

Sales aid lease:

In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

Cross border lease:

 Lease across national frontiers are called cross border lease. Shipping, air service, etc. will come under this category.

Tax oriented lease:

 Where the lease is not a loan on security but qualities as a lease, it will come under this category.

Import leasing:

 Here the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

International lease:

 Here the parties to the lease transactions may belong to different countries which are almost similar to cross border lease.

2. What are the advantages of leasing?

 Most of the leasing agreements are modified according to the requirement of the lessee.  The lessee is able to derive the benefits out of the asset without owning it.  The lessee is able to save considerable amount of capital which otherwise will be locked up the asset.  Leasing is the cheapest and fastest mode of acquiring an asset, from the creditor‟s point of view; it is the safest method of finance as they have a good security in the form of asset.  Capital projects can be financed by leasing method and hence most of the financial institutions have started entering leasing business.  Because of leasing, the lessee is able to have better debt- equity ratio. He can also go for additional borrowings in case of business requirement.  It is only by leasing method, 100percent finance is available for buying equipment  Equipment which is likely to be obsolete very soon can be acquired under operating leasing.  Small scale industries will be benefited by leasing as they can go for modernization of production.  Technocrats will get more benefits by leasing as the promoters will find it difficult to contribute margin money.  The lease charge forms a part of profit & loss a/c and does not appear in the balance sheet. Hence, the return on investment for the investment capital.  Tax benefits are available to both lessor and lessee in leasing.  Leasing is the best method available to monopoly companies to escape MRTP commission.

3. Different between financial lease and operating lease.

Financial lease

Operating lease

1. The asset is procured purely for the benefit of the lessee and the lessor has lesser benefit compared to the lessee.

2. The risk and benefit of the asset is passed on to the lessee and only owner ship is with the lessor.

3. It the asset becomes obsolete, it is the risk of the lessee.

4. The lessor is more concerned with the rent or lease amount as there is repayment of the principal amount along with the interest.

5. The lease is non revocable or irrevocable by either party.

6. Lease period goes along side with life of the asset and there is primary and secondary period.

7. The lessor is only financier and does not

1. The asset is meant for a number of lessees.

2. The lessee is in possession of the asset only for a particular time and hence risk is more borne by lessor.

3. Since the lease time is short. The risk of obsolescence is with the lessor.

4. The lessor is not only concerned with the rentals. But also the asset as it has to be given to number of lessees.

5. The lease is revocable especially by the lessee.

6. The lease period is small and the lessor leases the asset number of time with different users.

bear the cost of operation.

8. It is mostly a single lease by which the lease repays the cost of the asset with interest

7. The lessor bears cost of repair, maintenance etc.

8. The lease is non pay-out and lessor can recover the value of asset only by repeated leasing to different lessees.

4. What are disadvantages of leasing?

 Lease is not suitable mode of project finance. This is because rental are repayable soon after entering into lease agreement which in new projects cash generations may start only after a long gestation period.  Certain tax benefits/ incentives such as subsidy may not be available on leased equipment.  The value of real assets such as land and building may increase during lease period. In such a case the lessee loses the advantages of a potential capital gain.  The cost of financing is generally higher than of debt financing.  A manufacturer who wants to discontinue a particular line of business will not in a position to terminate the contract except by paying heavy penalties. If it is a owned asset the manufacturer can sell the equipment at his well.  If the lessee is not able to pay rentals regularly, the lessor would suffer a loss particularly when the asset is a sophisticated one and less liquid.  In case of lease agreement, it is lessor who has purchased the asset from the supplier and not the lessee. Hence, the lessee by himself is not entitled to any protection in case the supplier commits breach of warranties in respect of the leased assets.  In the absence of exclusive laws dealing with the lease transaction several problems crop up between lessor and lessee resulting in unnecessary complications and avoidable tension.

5. Explain the structure of leasing industry in India

 The present structure of leasing industry in India consists of (i) private sector leasing and (ii) Public sector leasing.

 The private sector leasing consists of:

 Pure leasing companies.  Hire purchase and finance companies, and  Subsidiaries of manufacturing group companies.

The public sector leasing organizations are divided into

 Leasing divisions of financial institutions.  Subsidiaries of public sector banks. And  Other public sector leasing organizations.

Pure leasing companies

 These companies operate independently without any like or association with any other organization or group of organization. The first leasing company of India limited. The twentieth century finance corporation limited, and the Grover leasing limited, full under this category.

Hire purchase and finance companies:

 The companies started prior to 1980 to do hire purchase and finance business especially for vehicles added to their activities during 1980 some of them do leasing as mojor activity and some other do leasing on a small scale as a tax planning device sundaram finance limited and motor and general finance limited belong the company.

 Subsidiaries of manufacturing group companies

 There companies consist of two categories.

 (a) Vendor leasing

 (b) In house leasing

(a) Vendor leasing:

 These types of companies are formed to boost and promote the such of its parent companies products through offering leasing facilities.

(b) In house leasing:

 In house leasing or capture leasing companies are set up to meet the fund requirement or to avoid the income tax liabilities of the group companies.

Public sector leasing:

(i) Financial institutions

 The financial institutions such as IFCI, ICICI, IRBI and NSIC have setup their leasing business. The shipping credit and investment company of India offers leasing facilities in foreign currencies for ships, deep, seas fishing vehicles and related equipment to its clients.

Subsidiaries of banks:

 The commercial banks in India can, under section 19(1) of the banking Regulation Act 1949, setup subsidiaries for undertaking leasing activities. The SBI was the first bank to start a subsidiary for leasing business in 1986.

Other public sector organizations.

 A few public sector manaufacturing. companies such as bharat electronics limited. Hinadustan packaging company limited. Electronic corporation their equipment through leasing.

6. What are the problems of leasing in India?

 Leasing has great potential in India. However, leasing in India faces serious handicaps which may mar its growth in future. The following are some of the problems.

i) Unhealthy competition:

 The market for leasing has not grown with the same pace as the number of lessors. As a result, there is over supply of lessors leading to competition, with the leasing business becoming more competitive, the margin.

 Profit for lessors has dropped from four to five percent to the present 2.5 to 3 percent. Bank subsidiaries and financial institutions have the competitive edge over the private sector concerns because of cheap source of finance.

ii) Lack of qualified personnel:

 Leasing requires qualified and experienced people at the helm of its affairs. Leasing is a specialized business and persons constituting it top management should have expertise in accounting, finance, legal and decision areas. In India, the concept of leasing business is of recent one and hence it is difficult to get right man to deal leasing business on account of this, operations of leasing business are bound to suffer.

iii) Tax consideration:

Most people believe that lessees prefer leasing because of the tax benefits if offers. In reality, it only transfers, the benefit, ie, the lessee‟s tax shelter is lessor‟s burden. The lease becomes economically viable only when the transfer‟s effective tax rate is low. In addition, taxes like sales tax, wealth tax, additional tax, surcharge, etc. add to the cost of leasing. Thus leasing becomes more expensive from of financing than conventional mode of finance such as hire purchase.

iv) Stamp duty:

 The states treat a leasing transition as sales for the purpose of making them eligible to sales tax. On the contrary, for stamp duty the transaction is treated as a pure transaction. Accordingly a heavy stamp duty is lived on lease document. This adds to the burden of leasing industry.

v) Delayed payment and bad debts:

 The problem of delayed payment of rents and bad debts add to the costs of lease. The lessor does not take into consideration this aspect while fixing the rentals at the time of lease agreement. These problems would disturb prospects of leasing business.

UNIT –IV

 PART-A 2 MARKS

1. What do you mean by “Hire purchase”?

Hire purchase is a method of selling goods. In a hire purchase transaction the goods are let out on hire by a finance company (creditor) to hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditors and passes on to hirer on the payment of last installment.

2. Who is Hire Purchaser?

Hire purchaser of hirer means the person who purchase an asset under hire purchase system

3. Who is Hirer?

Hirer means the person who acquires or has acquired the possession of the goods from an owner under a hire purchase agreement, and includes a person to whom the hirer’s rights of liabilities under the hire purchase agreement have been passed by assignment or by operation of law.

4. What do you mean by Hire?

Hire means the amount payable periodically by the hirer, under the hire purchase agreement.

5. who is Hire Vendor?

Hire vendor or hire seller is the person who sells the goods on hire purchase system.

6. Explain the term cash price?

Cash price or cash value of an asset is the price payable on the outright purchase of the asset.

7. What do you mean by “Hire Purchase Price”?

 Hire purchase price is the price payable for the purchase of an asset on hire purchase system. It comprises the cash price of the asset plus in the interest payable on the unpaid balance of the cash price till the end of the period of hire purchase agreement.

8. What IS meant by down payment?

 Down payment or advance payment means the advance paid or the cash payment made on the date of signing the hire purchase agreement.

9. What is meant by total interest?

 Total interest for all the installments is the total amount of interest for all the installments. It is the difference between of hire purchase price and the cash price of the asset.

10. Who is a owner?

 Owner means the person who lets or has let delivers or has delivered possession of goods to a hirer under hire purchase agreement and includes a person to whom the owner’s property in the goods or any of the owner’s rights or liabilities under the agreement has passes by assignment or operation of law.

11. Define hire purchase agreement?

 As per section 2 (c) of the hire purchase Act 1972, hire purchase agreement means an agreement under which goods are let or hire and under which the hirer has an option to purchase these goods let on hire in accordance with the agreement and also includes the following.

The possession of goods is delivered by the owner thereof to a person on condition that such person pays the agreed amount in periodical installments. 2. The property in the goods is to pass to such person on the payment of the last such installments and 3. Such a person has a right to terminate the agreement at any time before the property so passes.

PART- B 5MARKS

1 Distinguish between Hire purchase and leasing

1. Ownership

2. Method of financing

3. Depreciation

4. Tax benefits

5. Salvage Value

6. Deposit

7. Rent-Purchase

8. Extent of finance

9. Maintenance

10. Reporting

1) Ownership:

 In a contract of lease, the Ownership rests with the lesser through out and the lessee (hirer) has no option to purchase the goods.

2)Method of financing:

 Leasing is a method of financing business assets whereas hire purchase is a method of financing both business assets and consumer articles.

3)Depreciation:

 Leasing, depreciation and investment allowance cannot be claimed by the lessee, in hire purchase, depreciation and investment allowance can be claimed by the hirer.

4) Tax Benefits:

 The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

5) Salvage Value:

 The lessee, not being the owner of the asset, does not enjoy the salvage Value of the asset. The hirer in purchase, being the owner of the asset, enjoys Salvage Value of the asset.

6) Deposit:

 Lessee is not required to make any deposit whereas 20% deposit is required in hire purchase.

7) Rent – Purchase:

 With lease, We rent and with hire purchase we buy the goods.

8) Extent of finance:

 Lease financing is invariably 100 percent financing. It requires no immediate down payment or margin money by the lessee. In hire purchase, a margin equal to 20-25 percent of the cost of the asset is to be paid by the hirer.

9) Maintenance:

 The cost of maintenance of the hired asset is to be borne by the hirer himself. In case of finance lease only, the maintenance of leased asset is the responsibility of the lessee.

10) Reporting:

 The asset on hire purchase is shown in the balance sheet of the hirer. The leased assets are shown by way of foot note only.

2) Enumerate the features of Hire Purchase agreement.

1. Under hire purchase System, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments. 2. Each installment is treated as hire charges. 3. The ownership of the goods passes from buyer to seller on the payment of the installment 4. In case the buyer makes any default in the payment of any installment the seller has right to repose’ the goods from the buyer and forfeit the amount already received treating it as hire charge. 5. The hirer has the right to terminate the agreement any time before the property passes. There 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 charge on the goods in question.

3) What is the condition to be fulfilled under Hire purchase Agreement?

 According to the Hire Purchase Act 1972, on agreement which fulfills the following conditions, is a hire purchase agreement:

i. The possession of the goods is delivered by the owner there of to a person on condition that such person pays the agreed amount in periodic installments; ii. The property in such goods is to pass to such a person on the payment of the last of such installment; and

iii. Such person has the right to terminate the agreement at any time before the property so passes.

Therefore the two distinct aspects of a hire purchase transaction are:

i. The option to purchase the goods at any time during the term of the agreement; and ii. The right available to the hirer to terminate the agreement at any time before the payment of the last installment. Thus, a hire purchase transaction is one where the hirer(user) has, at the end of the fixed term of hire an option to buy the asset at a taken value. In other words, financial leases with a bargain buyout option at the end of the term can be called a hire purchase transaction.

4) Explain the problem of Hire purchase:

1) Taxation

2) Shortage of law-cost funds

3) Slow Market growth

4) Less Number of players

5) Increasing conservatism in the Market

1) Taxation;-

The leasing and hire purchase companies in India pay central Sales tax, Services tax of 5 per cent local sales tax of 4 per cent to 14 per cent and income tax. The industry has been asking for the removal of either sales or service tax of late, the government has recognized these activities as sale, and hence service tax on hire purchase or lease transactions is totally unjustifiable. 2) Shortage of low-cost funds;- There is an acute shortage of low-cost funds available to hire purchase and leasing companies in the light of the stringent RBI norms. The industry

feels that the banks are meeting out step-motherly treatment. This has squeezed the industry’s margins to the minimum. 3) Slow Market Growth:- In 1997 -98 the total base of leased assets in India in the formal market was estimated as US $ 37.0 billion. This value represents nominal growth of 7.6 per cent from 1996 – 97 when the value of leased assets totaled US $ 34.0 billion. The latter figure was up 20 per cent from US $ 28.5 billion in 1995 – 96.

4) Less Number of Players;- Between 1991-94, when financial markets were booming, a large number of companies entered the leasing and hire purchase markets with little regard for the quality of clients. Since, 1996, with the market slowing, clients began defaulting on payments consequently, a number of lease financing companies faced a severe asset – liability mismatch, which led to a repayment crisis and bankruptcy. 5) Increasing conservatism in the Market;-

Since 1996, a most existing leasing company have become more conservative in their lending practices following the collapse of several leasing and hire purchase finance companies. Companies that were same what conservative to begin with have weathered the crisis and have become more conservative.

The government in response to the above problems has begin to increase its regulation of the market to ensure better compliance and prudent business practices. The step-up in regulation induded stricter requirements for deposit mobilization, capital adequacy, and registration and de-registration of NBFCs and periodic performance reviews to ensure that only financially sound companies are in the market.

5) Explain the features of Hire purchase:

 The main features of a hire purchase arrangement are as follows:

1. The hire – vendor gives the asset on hire to the hirer. 2. The hirer is required to make down payment of around 20 per cent of the cost of the equipment and repay the balance in regular hire purchase installments over a specified period of time. These installments cover interest as well as the principal repayment. In some cases, the finance company that gives hire purchase finance insists that the hirer give a deposit, which may be around 20 percent of the cost of the asset. The deposit carries interest and is returnable at the end of the hire purchase period. 3. When the hirer pays the last installment, the title of the asset is transferred from hire vendor to the hirer. 4. The hire-vendor charges interest on a flat basis. This means that a certain rate of interest is charged on the initial investment and not on the diminishing balance. 5. During the currency of the contract the hirer can opt for an early repayment and purchase the asset. The hirer exercising this option is required to pay the remaining amount of hire purchase installments less on interest rebate. 6. Theoretically the hirer can exercise the cancelable option and cancel the contract after giving due notice to the finance company.

6) Distinguish between sale and Hire purchase.

1. In the case of a sale, the ownership of the goods passes from the seller to the buyer as soon as the contract of sale is over. But in the case of hire purchase, the ownership of the goods passes from the hire seller to the hire purchaser only after the last installment is paid. 2. In the case of a sale, if the purchase fails to pay the price of goods, the seller cannot take back the goods from the buyer as the ownership of the goods had been passed from the seller to the buyer on the date of sale itself. On the other hand, in the case of a hire purchase. If the hire purchaser, as the ownership of the

goods is not passed on from the hire seller to the hire purchaser till last installment is paid. 3. In the case of a sale, generally, the goods cannot be returned by the buyer. But in the case of a hire purchase the goods can be returned by the hire purchaser to the hire seller before the ownership of the goods is passed on to him. 4. In the case of a sale, the price of the goods is generally, paid in one lump sum, either immediately or after sometime. But in the case of hire purchase the price of goods is paid, not in one lump sum, but in a number of installments. 5. In the case of a sale whether it is a cash sale or a credit sale, the purchaser is required to pay only the cash price of the goods. But in the case of a hire purchase, the hire purchaser is required to pay the cash price of the goods plus the interest for the various installments. 6. In the case of a sale, the buyer’s position is like that of an owner. But in the case of a hire purchaser position is like that of a bailee till the ownership of the goods is passed to him.

7) What are the contents of Hire purchase Agreement?

Every hire purchase agreement must be in writing. It must contain the following particulars i. The hire purchase price of the goods ii. The cost price of the goods iii. The date on which the agreement commences. iv. The number of installments and the amount of each installment, the dates on which the installments are payable and the person to whom and the place where are installments are payable. v. The description of the goods covered by the hire purchase agreement if the hire purchase agreement contravenes this provision can rescind the agreement by instituting a suit. As in the case of sale of Goods Act, the hire purchase Act also implies certain conditions and warranties.

 UNIT-V PART-A

2 marks

1. Define the term „Factoring‟

 Factoring is a method of financing where by a company sells its trade debts at a discount to a financial institution, factoring is a continuous arrangement between a financial institution.

2. What is forfaiting?

 Forfaiting is the non-recourse purchase by a bank or any other financial institution, of receivables arising from an export of goods and service.

3. What is domestic factoring?

 Factoring that arises from transaction relating to domestic sales is known as domestic factoring.

4. Give any two important functions of factoring

 Factoring simply refers to the process of selling trade debts of the company to a institution. Factoring involves the following function.

 i) Purchase and collection of debts.

 ii) Sales ledger management

5. Who are the players in the factoring arrangement?

 The buyer, the seller, the factor are the players in the factoring arrangement.

6. What is “cross border factoring”?

 “Cross border factoring” involves the claims of an exporter which are assigned to a banker or any financial institution in the importer‟s country and financial assistanee is obtained on the strength of the export documents and guan teed payment.

 7. Give any two types of export factoring

 i) Two factor system

 There two factors under the system one in the export‟s country and other in the importers country.

 ii) Single factor system

 The export factor himself will do all the work. So it is called single factor system.

8. What is Edi factoring?

 To assist international factoring, the FCI has developed a special communication system for its member called electronic data interchange factoring (Edi factoring).

9. Define “International Factoring”

 “Factoring means an arrangement between a factor and his client which includes at least two of the following service to provide by the factor:

 1. Finance

 2. Maintenances of accounts

 3. Collection of debts and

 4. Protection against credit risks

10. Define Forfaiting.

 Forfaiting has been define as “the non resources purchase by a bank or any other financial institution, of receivable arising from an export of goods and service”.

11. Give any two advantages of factoring.

 1. Leverage benefit – this advantage of factoring is that it helps improve the scope of operating leverage.

 2. Enhanced return- factoring is considered attractive users as it helps enhanced return.

12. What do you mean by direct export factor system?

 Under the system, there is a factoring agreement directly between the exporter and the exporter factor and no other party is involved. The entire export credit risk, the administration of the account, the advance payment etc. have to be done only by export factor. Hence it is called direct export factor system.

 PART-B

5marks

1. Explain the mechanism involved in factoring

 Under the factoring arrangement, the seller does not maintain a credit or collection department. The job instead is handed over to specialized agency, called the „factor‟. After each sale, a copy of the invoice and delivery challan, the arrangement and other related papers are handed over the factor.

 The factor, in turn, receives payment from the buyer on the due date as agreed, where by the buyer is reminded of the due determent account for collection. The factor remits the money collected to the seller after deducting and adjusting its own service charges at the agreed rate. Thereafter, the seller close all transactions with the. The seller passes on the paper to the factor for recovery of the amount.

2.Explain Factoring in India

There are two factoring companies in public sector banks.

 1. SBI factors and commercial service ltd.

 2. Can bank factor ltd.

1.SBI Factor and commercial service ltd, was floated jointly by SBI, SIDBI and union bank of India in march 1991. This factory company has become an associate member of the factors chain international, based in Amsterdam. It also joined recently EDIFACT- which is a communication network of chain international of electronic data interchange.

2. Can bank factor ltd.

 Can bank factor ltd was jointly promoted by canara bank, andra bank and SIDBI, in august 1992 to operate in south India. It paid up capital of Rs 10 cores is contributed in the ratio of 60:20:20 by its three promoters. It can have its operations throughout India due to the lifting up of restriction by RBI.

3. Sketch the characteristic features of factoring

The characteristic of factoring are as follows.

1. Bailment contract.

 The nature of the factoring contract is similar to that of a bailment contract. Factoring is a specialized actively where by a firm converts its receivable into cash by selling them to a factoring organization.

2. Form of factoring

 Factoring takes the form of a typical invoice factoring since it covers only those receivable which are not supported by negotiable instrument, such as bill of exchange etc.

3. Assignment of debts.

 Under factoring, there is assignment of debt in favor of the factor. This is the basic requirement for working of factoring service.

4. Fiduciary position of factor.

 The position of the factor is fiduciary in nature, since it arises from the relationship with the client firm.

5. Professional management.

 Factoring firms are professionally competent, with skilled persons to handle credit sales realization for different client in different trade for better credit management.

4. What are the salient features of cross- border factoring?

 The important features of this type of factoring is-

 1. It is similar to export factoring, where important factor is engaged by the export factor at the debtors end.

 2. It is also called „International Factoring‟ or the two factor system of factoring.

 3. The parties involved are the exporter, the importer, and the export factor and the import factor.

 4. There are two separate inter-linked agreements, between the exporter and the export factor on the one hand, and the export factor and the import factor on the other.

 5. The export and the import factors belong to a formal chain of factors, with well defined rules governing the conduct of business.

5. What are the advantages and disadvantages of factoring?

 Advantages

 1. Cost saving

It also helps in reduction of administrative cost and burden, facilitating cost saving.

 2. Leverage benefit

 It helps import the scope of operating leverage.

 3. Enhanced return

 Factoring is considered attractive to users as it helps enhance return.

 4. Liquidity

 It helps to avoid increased debts in case of without recourse factoring.

 Disadvantages

1. Engaging a factor may be reflective of the inefficiency of the management of the firm‟s receivable.

 2. Factoring may be redundant if a firm maintain a nationwide network of branches.

 3. Difficulties arising from the financial evaluation of clients.

4. A competitive cost of factoring has to be determined before taking a decision about engaging a factor.

6. Discuss the benefit of forfaiting

 Following are the important benefit of forfaiting is:-

 1. Profitable and liquid

 It is very advantageous because he not only get immediate income in the form of discount charges, but also, can sell them in the secondary market or to any investor for cash

 2. Simple and flexible

 It is also beneficial to the exporter. All the benefit that are available to a client under factoring are automatically available under forfeiting also.

 3. Avoids export credit risk

 The exporter is completely free from many export credit risks that may arise due to the possibility of interest rate fluctuation or exchange rates fluctuation or any political upheaval that may effect collection of bills.

 4. Avoid export credit insurance

 It is very costly and at the same time it involves very cumbersome procedures.

 5. Cent percent finance

 The export is able to convert his deferred transaction into cash transaction through a forfaitor. He is able to get 100 percent finance against export receivables‟.

7. Mention the three key element of factoring

 There are three key elements of factoring:-

 1. Selection of accounts.

 2. Collection of accounts

 3. Granting advance against receivable

1. Selection of accounts.

 The factor selects accounts of a supplier to be bought on a continuous basis based on customer‟s age, time of credit, quantum of amount etc. Normally the factor and the seller or supplier agree 1) on the credit limit for their customer, 2) the collection period and,3) rebate to be charged.

2. Collection of accounts

 The supplier or seller informs each customer that the factor has purchased the debt and the customer should pay only to the factor.

3. Granting advance against receivable

 The factor generally advances a portion of the value of assigned debt. The balance amount is paid on maturity. By providing funds to the supplier, the factor enables him to resume production.

8. What is international factoring? Who are the parties‟ involved in it?

 International factoring is the services of a factor in a domestic business are simply extended on the basis of the invoice prepared by the exporter. International factoring is facilitated with the help of export factors and import factors.

 In an international factoring transaction, there are four parties namely

 1. The exporter who is taking the place of a client in a domestic transaction.

 2. The importer who is taking the role of a customer in a domestic transaction.

 3. Export factor.

 4. Import factor.

 The exporter and the factor enter into an agreement for export factoring may take any one of the following types:-

1. Two factor system

 There are two factors under this system- one in the export‟s country and other in the importer‟s country. When the exporter wants to do business with some importer or importers, he approaches the factor in his country and informs him of his business proposal.

2. Single factor system

 Export factor himself will do all the work. So it is called single factor system. The import factor is called upon to assist the export factor only during the times of difficulties in realizing debt.

3. Direct export system

 Under this system, there is a factoring agreement directly between the exporter and this export factor and no other party is involved.

4. Direct import factor system

 The agreement between the exporter and the import factor in the importer‟s country.

9. Explain the recommendation of Kalyansundaram committee.

 Kalyansundaram committee was appointed in 1989 by RBI to study the feasibility of introducing factoring service in India. Accordingly in 1990 the recommendation of the committee were accepted, these are:-

 There is more scope for introducing factoring in India, especially through banks.

 Exporters can enjoy more benefits by factoring services.

 The growth of factoring will be so fast that within 2 or 3 years, it will be a viable business.

 Export factors can provide various other services also.

 All the industries as well as service can avail factoring service.

 Bank can take up factoring business due to their excellent network of branches.

10. Distinguish between factoring and forfaiting.

 Factoring is always used as a tool for short term financing where as forfaiting is for medium term financing at a fixed rate of interest.

 Factoring is generally employed to finance both the domestic and export business. But forfaiting is invariably employed in export business only.

 The central there of factoring is the purchase of the invoice of the client where it is only the purchase of the export bill under forfaiting.

 Forfaiting is done without recourse to the client where as it may or may not be so under factoring.

 The bills under forfaiting may be held by the forfaiting till the due date or they can be sold in the secondary market or to any investor for cash. Such a possibility does not exist under factoring.