SHRIMATI INDIRA GANDHI COLLEGE

(Nationally Accredited at 'A' Grade (3rd cycle) By NAAC)

TIRUCHIRAPPALLI-2

DEPARTMENT OF MANAGEMENT STUDIES

(MBA – AICTE Approved)

II MBA

STUDY MATERIAL

MERCHANT BANKING

P16MBA4EF6

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ELECTIVE COURSE - VI: MERCHANT BANKING

Objectives: To help students to learn the various concepts in merchant banking and its role in appraisal of projects. To help the students to know about insurance industry

Unit I

Introduction – An Over view of Indian Financial System – Merchant Banking in India – Recent Developments and Challenges ahead – Institutional Structure – Functions of Merchant Banking - Legal and Regulatory Frameworks – Relevant Provisions of Companies Act- SERA-SEBI guidelines- FEMA, etc. - Relation with Stock Exchanges, OTCEI and NSE.

Unit II

Role of Merchant Banker in Appraisal of Projects, Designing Capital Structure and Instruments – Issue Pricing – Pricing – Preparation of Prospectus Selection of Bankers, Advertising Consultants, etc. - Role of Registrars – Underwriting Arrangements - Dealing with Bankers to the Issue, Underwriters, Registrars, and Brokers – Offer for Sale – Book – Building – Green Shoe Option – E-IPO Private Placement – Bought out Deals – Placement with FIs, MFs, FIIs, etc.

Unit III

Mergers and Acquisitions – Portfolio Management Services – Credit Syndication – Credit Rating – Mutual Funds - Business Valuation

UNIT-IV

Mutual Funds - Origin, Types of Mutual Funds, Importance, Mutual Funds Industry in India – SEBI's directives for Mutual Funds, Private Mutual Funds, Asst Management company – Unit Trust of India – Evaluation of Performance of Mutual Funds – Money Market Mutual Funds – RBI Guidelines – Venture Capital: Meaning, Origin, Importance, Methods, India Scenario.

UNIT-V

Insurance – Meaning, Types, Insurance Industry in India and related reforms – Other Financial Services – Credit Cards – Credit Rating: Regulatory framework – Credit Rating Agencies – Rating Process and Methodology – Rating symbols/Grades – Pension Plan

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UNIT I

MERCHANT BANKING

INTRODUCTION

The evolution of the financial system in India is nothing but the reflections of its political and economic history. The evolution process has been influenced by the factors of urbanization of society, advent or large scale industrialization, introduction of railways and telegraphic communications in the 19th century, nationalization of financial institutions in 20th century and implementation of information technology on the eve of the 21st century.

A merchant banker is a key intermediary in the financial market. He facilitates the issuers of securities (companies) to raise capital from the financial market by selling the securities. He offers a package of services related to the capital raising activity. That is the reason why merchant banking is often identified with capital issue activities of companies. As a matter of fact, SEBI definition of the term ‘merchant banker’ emphasizes the aspect of issue management.

AN OVERVIEW OF INDIAN FINANCIAL SYSTEM

Financial system is a system to canalize the funds from the surplus units to the deficit units. Deficit units are a case where current expenditure exceeds their current income. There are other entities whose current income exceeds current expenditure which is called as Surplus units.

An efficient financial system not only encourages savings and investments, it also efficiently allocates resources in different investment avenues and thus accelerates the rate of economic development. The financial system of a country plays a crucial role of allocating scarce capital resources to productive uses. Its efficient functioning is of critical importance to the economy.

Financial System

- It is a system for the efficient management and creation of finance.

According to Robinson, “Financial system provides a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth”.

According to Van Horne, "Financial system is defined as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users – either for investment in real assets or for consumption".

Thus the financial system mainly stands on three factors:

Money is the unit of exchange or medium of payment. It represents the value of financial transactions in qualitative terms.

Credit on the other hand, is a debt or loan which is to be returned normally with interest.

Finance is monetary **Wealth** of the state, an institution or a person. Comprising these factors in a systematic order forms a financial system.

Objectives of Financial System/Service

- Accelerating the growth of economic development.
- Encouraging rapid industrialization
- Acting as an agent to various economic factors such as industry, agricultural sector, Government etc.
- Accelerating rural development
- Providing necessary financial support to industry
- Financing housing and small scale industries
- Development of backward areas, infrastructure and livelihood
- Imposing price control in need
- Functions of financial system are distributed from
- Functions of financial system are distributed from creation of money to efficient
- Management. It is the sum total of the functions of the various intermediaries.

The functions of financial system can be classified into two broad categories:

1) Controlling functions

2) Promotional functions.

Structure of Indian Financial System

Financial system is a system of arranging different types of funds required for the Business.

It deals about the following:

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1) Financial Institutions

2) Financial Markets

3) Financial Instruments

4) Financial Services

Financial Institutions

The Commercial Banks form the structure of financial institutions in India. They can be classified as under:

- ❖ Central Bank
- ❖ Banking and Non-Banking Companies
- ❖ Financial Institutions
- ❖ Non-Banking Financial Intermediaries
- ❖ Co-operative Banks
- ❖ Regional Rural Banks **Financial Markets**

(a) Capital Market: It is the market for long term funds i.e., raising capital for Companies through issue of shares and debentures. The Capital market can further divided into

(a) Primary Market and (b) Secondary Market

Classification of Capital Market

(i) Primary Market: It is the market for primary needs of the company. The Company sells its shares at the time of promotion and the investors directly buy the shares from the company through application.

(ii) Secondary Market: It is the market for secondary needs of the company. The sale and purchase of securities i.e., shares and debentures will take place through the recognized stock exchanges.

(b) **Money Market:** It is a market for short term funds. Money market provides working capital.

(c) **Foreign Money Market:** It is a market for foreign exchange which is bought and sold. In India the foreign market is controlled by Reserve Bank of India. Foreign Exchange Management Act (FEMA) deals with foreign exchange.

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(d) **Government Securities Market:** It is a market for Government securities like Treasury Bills and Bonds. Treasury Bills are bills issued for meeting the short term revenue expenditure of the Government.

Financial Instruments

Financial instruments include both instruments and products. Instruments include cheques, drafts, letter of credit, travellers' cheques, commercial papers, GDR's, Bonds etc.

Products may be in the form of Credit Cards, Debit Cards etc.

Classification of Financial Instruments

(a) Negotiable Instruments: A negotiable instrument is an instrument that is transferable from one person to another. Negotiable instrument may be a bearer instrument or an order instrument. A negotiable instrument may be promissory notes, bills of exchange or cheques etc.

(b) Commercial Paper: A commercial paper is one which is issued by leading financial institution which can be taken by any borrower and discounted with commercial banks.

(c) Bill of Lading: It is a document signed by the carrier, acknowledging shipment of the goods and Containing the terms and conditions of carriage.

(d) Letter of Credit: It is a letter by the importer bank guaranteeing the credit worthiness of the importer.

(e) Travellers' Cheque: It is a cheque issued by banks to the traveling public which can be cashed at ease.

Financial Services

Financial service, as a part of financial system provides different types of finance through various credit instruments, financial products and services. It enables the user to obtain any asset on credit according to his convenience and at a reasonable interest rate.

The following are the few components of financial services/system:

- Asset Liability Management
- Leasing and Hire Purchase
- Housing Finance

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- ❖ Portfolio Management
- ❖ Credit Card and Credit Rating
- ❖ Book Building and Mutual fund
- ❖ Factoring and Forfeiting

The Progress of any economy mainly depends on the efficient financial system of the country. Indian economy is no exception of this. This importance of the financial sector reforms affirms an effective means for solving the problems of economic, financial and social in India and elsewhere in the developing nations of the world.

MERCHANT BANKING IN INDIA

In India, the merchant banking sector has grown at a faster pace in the last two decades with the growth of the capital market and the money market. However, there have been ups and downs in the fortunes of this industry in the past. Over the years, the number of players in the merchant banking industry came down and currently we find only a few large firms surviving in the industry.

The first merchant banking activity in India started in 1969 by the Grind lays Bank by opening a merchant banking division. Initially they were issue mangers looking after the issue of shares and raising capital for the company. But subsequently they expanded their activities such as working capital management; syndication of project finance, global loans, mergers, capital restructuring, etc., initially the merchant banker in India was in the form of management of public issue and providing financial consultancy for foreign banks.

In 1973, SBI started the merchant banking and it was followed by ICICI. SBI capital market was set up in August 1986 as a full-fledged merchant banker. Between 1974 and 1985, the merchant banker has promoted lot of companies. However they were brought under the control of SEBI in 1992.

Merchant banks were brought under the ambit of SEBI regulations and this lead to a disciplined growth of the industry. New checks and balances have been introduced in the functioning of merchant banks in India. Collaborative arrangements with the foreign merchant banks were also common.

According to SEBI, “a merchant banker is one who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to the securities as manager, advisor or rendering corporate advisory services in relation to such issue management”.

Investment Banking Vs. Merchant Banking

The term ‘merchant banking’ and ‘investment banking’ are often used interchangeable in the financial literature. However, we can make out a subtle distinction between these two. The term ‘Investment Banking’ has the US origin whereas the term ‘merchant banking’ is in vogue in countries such as the UK and India.

The following list shows the selected investment banks, both domestic and global

DOMESTIC	GLOBAL
ICICI Securities	Goldman Sachs
Kotak Mahindra Capital Company	Morgan Stanley
Enam Financials	JP Morgan Chase
Karvy Investor Services	Rothschild
SBI Capital Markets	HSBC
DSP Merill Lynch	Credit Suisse
Keynore Corporate Services	Blackstone
ABN Amro	UBS
	Deutsche Bank
	City Group
	Barclays

RECENT DEVELOPMENTS AND CHALLENGES AHEAD

The recent developments in Merchant banking are due to certain contributory factors in India. They are the Merchant Banking was at its best during 1985-1992 being when there were many new issues. It is expected that 2010 that it is going to be party time for merchant banks, as many new issue are coming up. The foreign investors both in the form of portfolio investment and through foreign direct investments are venturing in Indian Economy.

It is increasing the scope of merchant bankers in many ways. Disinvestment in the government sector in the country gives a big scope to the merchant banks to function as consultants. New financial instruments are introduced in the market time and again. This basically provides more and more opportunity to the merchant banks. The mergers and corporate restructuring along with MOU and MOA are giving immense opportunity to the merchant bankers for consultancy jobs.

The challenges faced by merchant bankers in India

- SEBI guideline has restricted their operations to Issue Management and Portfolio Management to some extent. So, the scope of work is limited.
- In efficiency of the clients are often blamed on to the merchant banks, so they are into trouble without any fault of their own.
- The net worth requirement is very high in categories I and II specially, so many professionally experienced person/ organizations cannot come into the picture. Poor New issues market in India is drying up the business of the merchant bankers.

Thus the merchant bankers are those financial intermediary involved with the activity of transferring capital funds to those borrowers who are interested in borrowing. The activities of the merchant banking in India is very vast in the nature of

- The management of the customer's securities
- The management of the portfolio
- The management of projects and counselling as well as appraisal
- The management of underwriting of shares and debentures
- The circumvention of the syndication of loans
- Management of the interest and dividend etc.

INSTITUTIONAL STRUCTURE

In tracing the history of the merchant banking in India, the structure of merchant bankers appeared as follows at one point of time:

1. Merchant banking divisions of commercial banks, both Indian and Foreign.
2. Merchant banking divisions of financial institutions (e.g. IDBI, IFCI, etc.)

3. Merchant banking companies promoted by stock broking firms. (e.g. JM Financial, DSP)

4. Merchant banking services of NBFCs

However, the above structure has undergone a transformation now. The merchant banking divisions of the commercial banks exist now as independent subsidiary companies of the parent firms. For example, the SBI Capital Markets Ltd is the subsidiary of SBI. The merchant banking activities of the NBFCs almost cease to exist.

FUNCTIONS OF MERCHANT BANK

A merchant banker is not merely an issue manager. The scope of his activities extends beyond issue management. He undertakes new responsibilities such as syndication of project financing, global fund raising, designing new financial instruments and deal making in corporate takeovers. From dealing in shares for major industrial houses to takeovers, the merchant bankers have come a long way in the spectrum of services that are offered. Their operations have considerably widened and have become more specialized.

The following are the functions of merchant bankers in India:

- Corporate Counselling
- Project Counselling
- Pre-investment Studies
- Capital Restructuring
- Credit Syndication and Project Finance
- Issue management and Underwriting
- Portfolio Management
- Working Capital Finance
- Acceptance Credit and Bill Discounting
- Mergers, Amalgamation and Takeovers
- Venture Capital
- Lease Financing
- Foreign Currency Finance
- Fixed Deposit Broking
- Mutual Funds

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- Relief to Sick Industries
- Project Appraisal

Corporate Counselling: Corporate counselling is the beginning of the merchant banking services. Every industrial unit either new or existing needs it. The scope of corporate counselling is very vast. It covers a wide range of merchant banking activities and includes the services such as project counselling, project management, loan syndication, working capital management, capital re-structuring, public issue management, fixed deposit, lease financing, etc.

Project Counselling: Project counselling has originated from corporate counselling. It relates to project finance and includes preparation of project reports, cost of the project and also arranging the financing pattern. The projects are appraised on the basis of the location, marketing and technical and financial viability of the project.

LEGAL AND REGULATORY FRAMEWORK

An application should be submitted to SEBI in Form A of the SEBI (Merchant Bankers) Regulations, 1992. SEBI shall consider the application and on being satisfied issue a certificate of registration in Form B of the SEBI (Merchant Bankers) Regulations, 1992.

The registration fee payable to SEBI is Rs.5 lakhs which should be paid within 15 days of date of receipt of intimation regarding grant of certificate. The validity period of certificate of registration is Three years from the date of issue.

Renewal, three months before the expiry period, an application should be submitted to SEBI in Form A of the SEBI (Merchant Bankers) Regulations, 1992. SEBI shall consider the application and on being satisfied renew certificate of registration for a further period of 3 years. The renewal fee payable to SEBI is Rs.2.5 lakhs which should be paid within 15 days of date of receipt of intimation regarding renewal of certificate. The person whose registration is not current shall not carry on the activity as merchant banker from the date of expiry of validity period.

Categories of Merchant Bankers

Originally, as per SEBI regulations, merchant bankers were required to get authorization to act as an issue manager, underwriter or advisor. This authorization was granted by SEBI based on the net worth limits, professional competence, experience in the business, general reputation and the past performance record.

The categories for which registration may be granted are given below:

- ❖ Category I – To carry on the activity of issue management and to act as adviser, consultant, manager, underwriter, portfolio manager
- ❖ Category II – To act as adviser, consultant, co-manager, underwriter, portfolio manager
- ❖ Category III – To act as underwriter, adviser or consultant to an issue
- ❖ Category IV – To act only as adviser or consultant to an issue

Accordingly, four categories of merchant bankers should full fill the capital requirement as under:

- ❖ Category I Capital adequacy of Rs.5 crores
- ❖ Category II Capital adequacy of Rs.50 lakhs
- ❖ Category III Capital adequacy of Rs.20 lakhs
- ❖ Category IV No capital adequacy requirement

The functions rendered by these four categories were also stipulated by SEBI. Category I merchant banker could act as an issue manager, underwriter, advisor, consultant and portfolio manager. Although the advisory or consultancy function could be performed by all the four categories, it will not possible for Categories III and IV merchant bankers to act as an issue manager or portfolio manager.

RELEVANT PROVISIONS OF COMPANIES ACT

The Companies Act, 1956 sets out the code of conduct for companies with regard to issue, allotment and transfers of securities. It provides for disclosure to be made in the prospectus about the project, means of financing, particulars of company management and the perceptions of management with regard to risk factors. The legal aspects concerning dividends, rights and bonus issues are covered in the Companies Act.

- ❖ Company means a company formed and registered under this Act or an existing company as defined in clause (ii);
- ❖ Existing Company means a company formed and registered under any of the previous companies laws specified below:

Any Act or Acts relating to companies in force before the Indian Companies Act,

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1866 (10 of 1866) and repealed by the Act;

- ❖ The Indian Companies Act, 1866
- ❖ The Indian Companies Act, 1882
- ❖ The Indian Companies Act, 1913
- ❖ The Registration of Transferred Companies Ordinance 1942

Private company means a company which has a minimum paid-up capital of one lakhs rupees or such higher paid-up capital as may be prescribed, and by its articles.

a) restricts the right to transfer its shares, if any;

b) Limits the number of its members to fifty not including

c) Persons who are in the employment of the company, and

d) persons who, having been formerly in the employment of the company, were members

Of the company while in that employment and have continued to be members after the employment ceased; and

e) Prohibits any invitation to the public to subscribe for any shares in, or debentures of,

the company;

f) prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member; **Public company** means a company which is not a private company; has a minimum paid-up capital of five lakhs rupees or such higher paid-up capital, may be prescribed is a private company which is a subsidiary of a company which is not a private company.

The various provisions and regulations of Companies Act, 1956 which govern the merchant bankers:

- Prospectus (Sec. 55 to 68A)
- Allotment (Sec. 55 to 75)
- Commissions and discounts (Sec. 76 & 77)

- Issue of shares at premium and at discount (Sec. 78 & 79)
- Issue and redemption of preference shares (Sec. 80 & 80A)
- Further issues of capital (Sec. 81)
- Nature, numbering and certificate of shares (Sec. 82 to 84)
- Kinds of share capital and prohibition on issue of any other kind of shares (Sec. 85 & 86)

SCRA (Securities Contracts (Regulations) Act)

The Securities Contract (Regulation) Act, 1956 provides for regulation of securities trading and control of stock exchanges. Recognition and supervision of stock exchanges and laying down the criteria for listing of securities are some of the salient features of the SCRA. The government and the SEBI are empowered by the SCRA to issue appropriate orders for ensuring the smooth flow of transactions in stock exchanges.

The Securities Contracts (Regulations) Act was passed in 1956 by Parliament and it came into force in February 1957. An act to prevent undesirable transactions in securities by regulating the business of dealing therein, by providing for certain other matters connected therewith.

1. This Act may be called the Securities Contracts (Regulation) Act, 1956.
2. It extends to the whole of India.
3. It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

SEBI GUIDELINES

The SEBI Act, 1992 established SEBI as market regulator with all statutory powers. SEBI was established with the objective of protecting the interest of investors and for regulation and development of securities market in India. It has the powers to regulate all the market intermediaries. The SEBI grants registration to the market intermediaries and has powers to inspect, monitor and take penal actions on them in case of violations of any provisions of the Act or rules, Issues of securities, stock exchanges and other market intermediaries are subject to regulatory power of SEBI.

Merchant banking in India is governed by SEBI (Merchant Bankers) Regulations 1992. It provides for registration of merchant bankers, general obligations and responsibilities of merchant bankers, procedures for inspection and procedures for action in case of defaults.

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Besides these, the code of conduct for merchant bankers is also specified. To become a merchant banker the following are the pre-requisites:

- The applicant must be corporate body.
- The applicant should not carry on a business other than the securities market business.
- He should have the necessary infrastructure in terms of office space and experienced man-power.
- The associate company or the group company should not have been a registered merchant banker.
- The applicant should not have been involved in security scams.
- The minimum net worth of the applicant firm should be Rs.50million

Obligations and Responsibilities of Merchant Bankers

In the conduct of his business, a merchant banker is supposed to observe certain codes of conduct. SEBI has issued some guidelines for regulating the merchant banking activities and the code of conduct for the merchant banks is specified in the Schedule III of the SEBI (Merchant Bankers) Regulations 1992.

1. High standards:
2. Due diligence:
3. Dealing with competing merchant bankers:
4. No tall claims:
5. Cost-effective service:
6. Confidentially:
7. Disclosure of information:
8. Avoid market manipulative practices:
9. Restrain on advisory role:

All public issues shall be managed by a merchant banker who acts as the lead merchant banker or the lead manager to the issue. The number of such lead managers is linked to the size of the public issue as given below. The regulations of SEBI specify certain responsibilities of the lead merchant banker. In a public issue, the responsibilities relate to the disclosure of information in the offer documents, allotment of securities and refund of application money.

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SEBI has pronounced the following guidelines for Merchant Bankers:

1. Submission of Offer Document
2. Dispatch of issue material
3. Underwriting
4. Compliance Obligations
5) Redressed of investor grievances
6) The concerned lead merchant banker
7) Issue of No objection Certificate (NOC)
8) Registration of Merchant Bankers
9) Renewal of Registration
10) Impositions of Penalty Points

FEMA (Foreign Exchange Management Act)

The Foreign Exchange Management Act (FEMA) is a 1999 Indian Law "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India".

FEMA was passed in the winter session of Parliament in 1999, replacing the Foreign Exchange Regulation Act (FERA). This act seeks to make offenses related to foreign exchange civil offenses. It extends to the whole of India, replacing FERA, which had become incompatible with the pro-liberalization policies of the Government of India. It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organization (WTO). It is another matter that the enactment of FEMA also brought with it the Prevention of Money Laundering Act of 2002, which came into effect from 1 July 2005.

Unlike other laws where everything is permitted unless specifically prohibited, under this act everything was prohibited unless specifically permitted. Hence the tenor and tone of the Act was very drastic. It required imprisonment even for minor offences. Under FERA a person was presumed guilty unless he proved himself innocent, whereas under other laws a person is presumed innocent unless he is proven guilty.

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The main objective behind the Foreign Exchange Management Act (1999) is to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments. It was also formulated to promote the orderly development and maintenance of foreign exchange market in India. FEMA is applicable to all parts of India. The act is also applicable to all branches, offices and agencies outside India owned or controlled by a person who is a resident of India.

The FEMA head-office, also known as Enforcement Directorate is situated in New Delhi and is headed by a Director. The Directorate is further divided into 5 zonal offices in Delhi, Mumbai, Kolkata, Chennai and Jalandhar and each office is headed by a Deputy Director. Each zone is further divided into 7 sub-zonal offices headed by the Assistant Directors and 5 field units headed by Chief Enforcement Officers.

Switch from FERA

FERA, in place since 1974, did not succeed in restricting activities such as the expansion of translational corporations (TNCs). The concessions made to FERA in 1991-1993 showed that FERA was on the verge of becoming redundant. After the amendment of FERA in 1993, it was decided that the act would become the FEMA. This was done in order to relax the controls on foreign exchange in India, as a result of economic liberalization. FEMA served to make transactions for external trade (exports and imports) easier – transactions involving current account for external trade no longer required RBI's permission. The deals in Foreign Exchange were to be 'managed' instead of 'regulated'. The switch to FEMA shows the change on the part of the government in terms of foreign capital.

Some Highlights of FEMA

FEMA is applicable in all over India and even branches, offices and agencies located outside India, if it belongs to a person who is a resident of India.

- It prohibits foreign exchange dealing undertaken other than an authorized person;
- It also makes it clear that if any person residing in India received any Fore payment (without there being a corresponding inward remittance from abroad) the concerned person shall be deemed to have received they payment from an unauthorized person.

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- There are 7 types of current account transactions, which are totally prohibited, and therefore no transaction can be undertaken relating to them. These include transaction relating to lotteries, football pools, banned magazines and a few others.
- FEMA and the related rules give full freedom to Resident of India (ROI) to hold or own or transfer any foreign security or immovable property situated outside India.
- Similar freedom is also given to a resident who inherits such security or immovable property from an ROI.
- An ROI is permitted to hold shares, securities and properties acquired by him while he was a Resident or inherited such properties from a Resident.

RELATION WITH STOCK EXCHANGES AND OTCEI

A good example of a financial market is a **stock exchange**. A company can raise money by selling shares to investors and its existing shares can be bought or sold.

We have two leading stock exchanges – the BSE and the NSE that have nationwide terminals in almost 400 towns. The turnover of these two stock exchanges constitutes 99.9% of the total turnover. Now, the concept of regional stock exchanges has lost the significance. We had 22 stock exchanges in India and out of these, 4 have been derecognized by SEBI and at present we have only 18 recognized stock exchanges. All these stock exchanges have been corporatized and demutualized as the SEBI norms on demutualization.

Stock exchanges provide the trading platform for the stock trading. Members of stock exchange (stock brokers) transact business for client investors. Depositories enable the safe keeping of investors' securities in an electronic form. Merchant bankers serve as issue managers in public issue of securities. Bankers, underwriters and the Registrars to the issue are the intermediaries who play an active role in the public issue process. Portfolio managers manage the portfolio of securities for clients. Though the mutual funds, FIIs and venture capital funds are mentioned as intermediaries, they are also classified as 'investors' too.

Capital Market Segments

The capital market has two main segments namely, the primary market and secondary market. In the primary market, new capital issues of public limited companies and the debt issues of the government takes place. A secondary market, on the other hand, deals with securities

already issued. In a primary market, capital can be raised through a public issue or through private placement.

Secondary market is the stock market wherein the listed securities are traded in stock exchange. The Securities Contract Regulation Act (SCRA) governs the function of stock exchanges in the country. The regulations relate to recognition of stock exchanges, membership in stock exchanges and the listing of securities. In India, we have regional stock exchanges and national stock exchanges. Now that the stock exchanges have been permitted to setup trading terminals throughout the country, the concept of regional stock exchanges has lost its importance.

The Bombay Stock Exchange (BSE) dating back to 1875 is one of the oldest stock exchanges in the world and still it continues to be active. The National Stock Exchange of India Ltd (NSE) started in 1994 has emerged as stock exchange of repute with technologically superior trading systems. The BSE and the NSE are the two apex stock exchanges in the country. The inter connected Stock Exchange of India (ICSE) is a stock exchange promoted by the regional stock exchanges and it is yet to make headway in the business of stock trading. Now, by using information and communication technology, the investors can have access to select stock exchanges through mobile devices too.

Stock Exchanges:

- It is the market for exchange of stocks.
- Stocks‟ refers to the old securities i.e., those which have been already issued and listed on a stock exchange.
- These securities are purchased and sold continuously among investors without the involvement of companies.
- Stock exchange provides not only free transferability of shares but also makes continuous evaluation of securities traded in the market. It is also called a Secondary Market for securities.
- It is considered to be sine qua non for the primary market. In fact, the success of the issues taking place in the primary market depends much on the soundness and the depth of the secondary market.

According to Section 2(3) of the Securities Contract Regulation Act 1956 – "The stock exchange has been defined as anybody of individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities".

The Securities that are traded at the Stock Exchanges

- Shares, scrip's, stock, bonds, debentures, debentures stocks or other marketable securities of a like nature in or of any incorporated company or other body corporate
- Government securities; and
- Rights or interests in securities

Objectives of Stock Exchanges

1. Assisting in buying and selling of securities
2. Regulating the business of buying and selling or dealing in securities.

Functions of Stock Exchanges

The stock market occupies a pivotal position in the financial system. It performs several economic functions and renders invaluable services to the investors, companies, and to the economy as a whole. They may be summarized as follows:

1) Liquidity and Marketability of Securities:

2) Safety of Funds:

3) Supply of Long Term Funds:

4) Flow of Capital to Profitable Ventures:

5) Motivation for Improved Performance:

6) Promotion of Investment:

7) Reflection of Business Cycle:

8) Marketing of New Issues:

9) Miscellaneous Services

Traditional Structure of Stock Exchanges

The stock exchanges in India can be classified into two broad groups on the basis of their legal structure. They are;

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Three stock exchanges which are functioning as association of person’s viz., BSE, ASE and Madhya Pradesh Stock Exchange

Twenty stock exchanges which have been set up as companies, either limited by guarantees or by shares.

Names of Few Exchanges:

1) Bangalore Stock Exchange
2) Bhubaneswar Stock exchange
3) Calcutta Stock Exchange
4) Cochin Stock Exchange
5) Coimbatore Stock Exchange
6) Delhi Stock Exchange
7) Gauhati Stock Exchange
8) Hyderabad Stock Exchange
9) Interconnected Stock Exchange
10) Jaipur Stock Exchange
11) Ludhiana Stock Exchange
12) Madras Stock Exchange
13) Magadha Stock Exchange
14) Mangalore Stock Exchange
15) National Stock Exchange
16) Pune Stock Exchange
17) OTCEI

Demutualization of Stock Exchanges

1) The transition process of an exchange from a “mutually-owned” association to a company “owned by Shareholders” is called demutualization.

2) Demutualization is transforming the legal structure, of an exchange from a mutual form to a business corporation form.

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3) In a mutual exchange, the three functions of ownership, management and trading are intervened into a single group. It means that the broker members of the exchange are owners as well as traders on the exchange and further they themselves manage the exchange.

These three functions are segregated from one another after demutualization.

The demutualized stock exchanges in India are;

1. The National Stock Exchange (NSE)
2. over the Counter Exchange of India (OTCEI)

Methods of Trading in a Stock Exchange

The stock exchange operation at follow level is highly technical in nature. Non-members are not permitted to enter into the stock market. Hence, various stages have to be completed in executing a transaction at a stock exchange. The steps involved in the methods of trading have been given below:

- ❖ Choice of Broker
- ❖ Placement of Order
- ❖ Execution of Orders
- ❖ Preparation of Contract Notes
- ❖ Settlement of Transactions

At present, the settlement can be made by any one of the following methods:

- Spot Delivery Settlement: The delivery of securities and payment for these are affected on the date of the contract itself or on the next day.
- Hand Delivery Settlement: The delivery of securities and payment are affected within the time stipulated in the agreement or within 14 days from the date of the contract whichever is earlier.
- Clearing Settlement: The transactions are cleared and settled through the clearing house. Usually those securities which are frequently traded and are usually in demand are cleared through the clearing house.

- Special Delivery Settlement: The delivery of securities and payment may take place at any time exceeding 14 days following the date of the contract as specified in the contract and permitted by the governing board.

NSE (National Stock Exchange of India)

· It is the screen based trading established to counter the influence of Bombay Stock Exchange and to reduce the influence of certain powerful intermediaries in the stock market.

· Both securities of companies and debt instruments are traded here. The success of this stock exchange is quite evident that within a few years of its promotion the volume and the value of transactions have surpassed the Bombay Stock Exchange.

· Apart from this, the prices of securities prevailing in this market have its influence on the Bombay Stock Exchange.

Features of NSE

❖ The NSE employs a fully automated screen based trading system. Investors can trade from 400 cities on a real time basis.

❖ It has three segments: 1) Capital Market Segment, 2) Whole-sale Debt Market Segment and 3) Derivatives Market

1. The capital market segments covers equities, convertible debentures and retail trade in debt instruments like non- convertible debentures.

2. The wholesale debt market segment is a market for high value transactions in government securities, public sector bonds, commercial papers and other debt instruments.

3. Derivatives Market includes (a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security; (b) a contract which derives its value from the prices, or index of prices, of underlying securities.

❖ The NSE has no trading floor as is prevalent in the traditional stock exchanges.

❖ The market operates with all participants stationed at their offices and making use of their computer terminals, to receive market information to enter orders and to execute trade.

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- ❖ The trading members in the capital market segment are connected to the central computer in Bombay through a satellite link –up using VSATs (Very small aperture Terminals).
- ❖ The trading members in the whole sale debt market segment are linked, through high speed lines, to the central computer Mumbai.

The NSE has opted for an order driven system. The system provides enormous flexibility to trading members. A trading member can place various conditions on the order in terms of price, time or size. When an order is placed by a trading member, an order confirmation slip is generated.

OTCEI (OVER THE COUNTER EXCHANGE OF INDIA)

It is a Stock Exchange without a proper trading floor. All stock exchanges have a specific place for trading their securities through counters. But, OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange. This stock exchange is recognized under the Securities Contract (Regulation) Act and so all the stocks listed in this exchange enjoy the same benefits as other listed securities enjoy.

OTCEI has been incorporated under Section 25 of the companies Act. As a result of which the word 'Limited' need not be used since it is promoted for a common case of promoting the interest of small and medium companies. This privilege has been given to the company by the Central government.

This company was promoted by a group of financial institutions owned by Government of India, consisting of UTI, ICICI, IDBI, SBI Capital Market, IFCI, LIC, GIC and CAN BANK financial Services.

Features of OTCEI

1) Use of Modern Technology: It is an electronically operated stock exchange.

2) Restrictions for other stocks: Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stock listed in OTCEI will not be listed in other stock exchanges.

3) Minimum issued capital requirements: Minimum issued equity capital should be Rs.30 lakhs, out of which minimum public offer should be Rs.20 lakhs.

4) Restrictions for large companies: No company with the issued equity share capital of more than Rs.25 crores is permitted for listing.

5) Base Capital requirement for members: Members will be required to maintain a minimum base capital of Rs.4 lakhs to trade on the permitted or on listed segment.

6) All India network: The network of counters links OTCEI members, located in different parts of the country.

7) Satellite facility: The satellite required for OTCEI for its operations is jointly held with Press Trust of India

8) Computerization of transactions: Computers at each counter enable the dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunication links.

Objectives of OTCEI

- Assisting and guiding small companies to raise funds from the capital market in a costeffective manner
- providing a convenient and an efficient avenue of capital market investments for small investors
- Strengthening investors' confidence in the financial market by offering them the two-way best prices to them
- Ensuring transparency, redressing investors' complaints and unifying the country's securities market to cover even those places which do not have a stock exchange
- Acting as a launch pad to an IPO
- Providing liquidity advantage to the securities traded
- Promoting organized trading in Unlisted Securities
- Providing a source of valuation for securities traded

Securities Traded on the OTCEI

1. Listed Equity (exclusive):

2. Listed Debt:

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3. Gilts:

4. Permitted Securities:

5. Listed Mutual Funds:

To counter the influence of Bombay Stock Exchange and reduce the influence of certain powerful intermediaries in the stock market, a new stock market was promoted in which both securities of companies and debt instruments are traded, namely the National Stock Exchanges. NSE takes into account the screen based trading and so it is the most advanced. The success of this stock exchange is quite evident that within a few years of its promotion the volume and the value of transactions have surpassed the BSE.

UNIT – II

ISSUE MANAGEMENT

ROLE OF MERCHANT BANKING IN APPRAISAL OF PROJECTS

Merchant Banking, as a commercial activity, took shape in India through the management of Public Issues of capital and Loan Syndication. It was originated in

1969 with the setting up of the Merchant Banking Division by ANZ Grind lays Bank.

The main service offered at that time to the corporate enterprises by the merchant banks included the management of public issues and some aspects of financial consultancy.

The early and mid-seventies witnessed a boom in the growth of merchant banking organizations in the country with various commercial banks, financial institutions, and broker‘s firms entering into the field of merchant banking. Reform measures were initiated in the capital market from 1992, starting with the conferring of statutory powers on the Securities and Exchange Board of India (SEBI) and the repeal of Capital Issues Control Act and the abolition of the office of the Controller of Capital Issues.

Merchant Bankers and Capital Issues Management

Merchant Banker has been defined under the Securities & Exchange Board of India (Merchant Bankers) Rules, 1992 as any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory service in relation to such issue management.

The capital issue management comprises of the effective management of market related factors. They are:

- Transition to rolling settlement on the equity market
- Impact on different classes of market users
- Obtaining a liquid bond market
- Impact of reforms of 1990s
- Law and taxation
- Taxation of capital
- Legal reforms
- Political economy of financial sector reforms
- Market design, market inefficiencies, and trading profits

Issue Management

The management of issues for raising funds through various types of instruments by companies is known as issue management. The function of capital issues management in India is carried out by merchant bankers. The Merchant Bankers have the requisite skill and competence to carry out capital issues management. The funds are raised by companies to finance new projects, expansion / modernization/ diversification of existing units etc.

The definition of merchant banker as contained in SEBI (Merchant Banker) Rules and Regulations, 1992 clearly brings out the significance of Issue Management as, "Any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities as manager, consultant, advisor or rendering corporate advisory services in relation to such issue management".

Merchants of Public Issue Management

Classification of Securities Issue

- Public Issue
- Right Issue
- Private Placement

Merchant Bankers Functions

The different functions of merchant bankers towards the capital issues management are as follows:

1) Designing Capital Structure
2) Capital Market Instruments
3) Issue Pricing
4) Book Building
5) Preparation of Prospectus
6) Selection of Bankers
7) Advertising Consultants
8) Role of Registrar
9) Bankers to the Issue
10) Underwriters to the Issue
11) Brokers to the Issue

DESIGNING CAPITAL STRUCTURE

The term capital structure refers to the proportionate claims of debt and equity in the total long-term capitalization of a company.

According to Weston and Brigham, "Capital structure is the permanent financing of the firm, represented primarily by long-term-debt, preferred stock and common equity, but excluding all short-term credit. Common equity includes common stock, capital surplus and accumulated retained earnings".

Decisions on Capital Structure: The decisions regarding the use of different type of capital funds in the overall long term capitalization of a firm are known as capital structure decisions.

Any decisions on Capital Structure are based on different principles.

a) Cost Principle
b) Control Principle
c) Return Principle
d) Flexibility Principle
e) Timing Principle

Factors affecting Capital Structure Decisions: The major developments taking place in the economy affect the capital structure of firms. In order words, the way the economy a country is managed determines the way the capital structure of a firm will be determined.

Factors that are active in the economy are:

1. Business Activity:
2. Stock Market:
3. Taxation:
4. Regulations:
5. Credit Policy:
6. Financial Institutions:

CAPITAL MARKET INSTRUMENTS

Financial instruments that are used for raising capital resources in the capital market are known as Capital Market Instruments. The changes that are sweeping across the Indian capital market especially in the recent past are something phenomenal. It has been experiencing metamorphic in the last decade, thanks to a host of measures of liberalization, globalization, and privatization that have been initiated by the Government. Pronounced changes have occurred in the realm of industrial policy such as Licensing policy, financial services, Interest rates, etc. The competition has become very intense and real in both industrial sector and financial services industry.

As a result of these changes, the financial services industry has come to introduce a number of instruments with a view to facilitate borrowing and lending of money in the capital market by the participants.

Types of Capital Market Instruments: The various capital market instruments used by corporate entities for raising resources are as follows:

1. Equity Shares
2. Non-voting Equity shares
3. Preference Shares
4. Cumulative Convertible Preference Shares
5. Company Fixed Deposits

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6. Warrants

7. Debentures and Bonds

Equity Shares: Equity shares, also known as ordinary shares are the shares held by the owners of a corporate entity. Since equity shareholders face greater risks and have no specified preferential rights, they are given larger share in profits through higher dividends than those given to preference shareholders, provided the company's performance is excellent.

Non-voting Equity Shares: Consequent to the recommendations of the Abid Hussain Committee and subsequent to the amendment to the Companies Act, corporate managements are permitted to mobilize additional capital without diluting the interest of existing shareholders with the help of a new instrument called non-voting equity shares. Such shares will be entitled to all the benefits except the right to vote in general meetings.

Preference Shares: Shares that carry preferential rights in comparison with ordinary shares are called 'Preference Shares'. The preferential rights are the rights regarding payment of dividend and the distribution of the assets of the company in the event of its winding up, in preference to equity shares.

Types of Preference Shares

- Cumulative preference shares:
- Non-cumulative preference shares:
- Participating preference shares:
- Redeemable preference shares:
- Fully convertible cumulative preference shares:
- Preference shares with warrants attached:

Company Fixed Deposits:

Fixed deposits are the attractive source of short-term capital both for the companies and investors as well. Corporate favor fixed deposits as an ideal form of working capital mobilization without going through the process of mortgaging assets. Investors find fixed deposits a simple avenue for investment in popular companies at attractively reasonable and safe interest rates.

Warrants:

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An option issued by a company whereby the buyer is granted the right to purchase a number of shares of its equity share capital at a given exercise price during a given period is called a 'warrant'. Although trading in warrants are in vogue in the U.S. Stock markets for more than 6 to 7 decades, they are being issued to meet a range of financial requirements by the Indian corporate.

Debentures and Bonds:

A document that either creates a debt or acknowledges it is known as a debenture. Accordingly, any document that fulfills either of these conditions is a debenture. A debenture, issued under the common seal of the company, usually takes the form of a certificate that acknowledges indebtedness of the company.

A document that shows on the face of it that a company has borrowed a sum of money from the holder thereof upon certain terms and conditions is called a debenture.

Kinds of Debentures: Innovative debt instruments that are issued by the public limited companies are described below:

1. Participating Debentures
2. Convertible Debentures
3. Debt-equity Swaps
4. Zero-coupon Convertible Notes
5. Secured Premium Notes (SPN) with detachable Warrants
6. Non-Convertible Debentures (NCDs) with detachable Equity Warrant
7. Zero-interest Fully Convertible Debentures (FCDs)
8. Secured Zero-interest Partly Convertible Debentures (PCDs) with detachable and separately tradable warrants
9. Fully Convertible Debentures (FCDs) with interest (optional)
10. Floating Rate Bonds (FRB)

ISSUE PRICING

A listed company can freely price equity shares/convertible securities through public/ rights issues. An unlisted company eligible to make a public issue and desirous of getting its securities listed on a recognized stock exchange can also freely price shares and convertible

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securities. The free pricing of equity shares by an infrastructure company 8is subject to the compliance with disclosure norms as specified by the SEBI from time to time. While freely pricing their initial public issue of share/convertibles, all banks require approval by the Reserve Bank of India (RBI).

Differential Pricing:

Listed/unlisted companies may issue shares/convertible securities to applicants in the firm allotment category (i.e. Allotment on a firm basis made to Indian and multilateral development finance institutions, Indian mutual funds, foreign institutional investors including non-resident Indians/overseas corporate bodies and permanent/regular employees of the issuing company) at a price different from the price at which the net offer to the public (i.e. the Indian public, excluding firm allotments/reservations/ promoters contribution) is made, provided the price at which the security is offered to the applicants in firm allotment category is higher than the price at which securities are offered to the public.

Price Band:

The issuer/issuing companies can mention a price band of 20 percent (cap in the price band should not exceed 20 percent of the floor price) in the offer document filed with the SEBI and the actual price can be determined at a later date before filing it with the ROCs (Registrar of Companies). If the Board of Directors (BOD) of the issuing company has been authorized to determine the offer price within a specified price band, a resolution would have to be passed by them to determine such a price.

Payments of Discounts/Commissions:

Any direct/indirect payment in the nature of discount/commission/allowance or otherwise cannot be made by the issuer company/promoters to any firm allotted in a public issue.

Denomination of Shares:

Public/rights issue of equity shares can be made in any denomination in accordance with Section 13(4) of the Companies Act and in compliance with norms specified by the SEBI from time to time. The companies that have already issued shares in the denominations of Rs.10 or Rs.100 may change their standard denomination by splitting/consolidating them.

BOOK BUILDING

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A method of marketing the shares of a company whereby the quantum and the price of the securities to be issued will be decided on the basis of the bids received from the prospective shareholders by the lead merchant bankers is known as Book-Building method.

Under the book-building method, share prices are determined on the basis of real demand for the shares at various price levels in the market. For discovering the price at which issue should be made, bids are invited from prospective investors from which the demand at various price levels is noted. The merchant bankers undertake full responsibility for the same.

The option of book-building is available to all body corporate, which are otherwise eligible to make an issue of capital to the public. The initial minimum size of issue through bookbuilding route was fixed at Rs.100 Cores. However, beginning from December 9, 1996 issues of any size will be allowed through the book-building route.

Book-building facility is available as an alternative to firm allotment.

Accordingly, a company can opt for book-building route for the sale of shares to the extent of the percentage of the issue that can be reserved for firm allotment as per the prevailing SEBI guidelines. It is therefore possible either to reserve securities for firm allotment or issue them through the book-building process.

The book-building process involves the following steps:

1) Appointment of Book-Runners
2) Drafting Prospectus
3) Circulating Draft Prospectus
4) Maintaining Offer Records
5) Intimation about Aggregate Orders
6) Bid Analysis
7) Mandatory Underwriting
8) Filling with ROC
9) Bank Accounts
10) Collection of Completed Applications
11) Allotment of Securities
12) Payment Schedule and Listing

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13) Under-subscription

Advantages of Book Building: Book-building process is of immense use in the following ways:

a. Reduction in the duration between allotment and listing

b. Reliable allotment procedure

c. Quick listing in stock exchanges possible

d. No price manipulation as the price is determined on the basis of the bids received

PREPARATION OF PROSPECTUS

Prospectus is defined a document through which public are solicited to subscribe to the share capital of a corporate entity. Its purpose is inviting the public for the subscription/purchase of any securities of a company. Prospectus for public offer

a) Regular Prospectus

b) Abridged Prospectus

c) Prospectus for Rights Issue

d) Disclosures in Prospectus

e) Disclosures in Abridged Prospectus and Letter of Offer

Regular Prospectus: The regular prospectus is presented in three parts:

PART I

a. General Information about the company e.g. Name and address of the registered office consent of the Central Government for the issue and names of regional stock exchanges etc.,

b. Capital Structure such as authorized, issued, subscribed and paid up capital etc.,

c. . Terms of the issue like mode of payment , rights of instruments holders etc.,

d. . Particulars of the issue like project cost , means of financing etc.,

e. . Company, Management and project like promoters for the project, location of the project etc.,

f. Disclosures of public issues made by the Company, giving information about type of issue, amount of issue, date of closure of issue, etc.,

g. Disclosure of Outstanding Litigation, Criminal Prosecution and Defaults

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h. Perception of risk factors in marketing the products, of raw materials etc.,

PART II

a. General Information
b. Financial Information like Auditor's Report, Chartered Accountant's Report etc.,
c. Statutory and Other Information

PART III

a. Declaration i.e., by the directors that all the relevant provisions of the companies Act, 1956 and guidelines issued by the Government have been complied with.

b. Application with prospectus **Abridged Prospectus** The concept of abridged prospectus was introduced by the Companies (amendment) Act of 1988 to make the public issue of shares an inexpensive proposition. A memorandum containing the salient features of a prospectus as prescribed is called as Abridged Prospectus.

SELECTION OF BANKERS

Merchant bankers assist in selecting the appropriate bankers based on the proposals or projects. Because the commercial bankers are merely financiers and their activities are appropriately arrayed around credit proposals, credit appraisal and loan sanctions. But merchant banking include services like project counseling , corporate counseling in areas of capital restructuring amalgamations, mergers, takeover etc., discounting and rediscounting of short term paper in money markets, managing, underwriting and supporting public issues in new issue market and acting as brokers and advisers on portfolio management in stock exchange.

ADVERTISING CONSULTANTS

Merchant bankers arrange a meeting with company representatives and advertising agents to finalize arrangements relating to date of opening and closing of issue, registration, of prospectus, launching publicity campaign and fixing date of board meeting to approve and sign prospectus and pass the necessary resolutions. Publicity campaign covers the preparation of all publicity material and brochures, prospectus, announcement, advertisement in the press, radio, TV, investors conference etc.

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The merchant bankers help choosing the media, determining the size and publications in which the advertisement should appear. The merchant Bankers role is limited to deciding the number of copies to be printed, checking accuracy of statements made and ensure that the size of the application form and prospectus conform to the standard prescribed by the stock exchange.

The Merchant banker has to ensure that the material is delivered to the stock exchange at least 21 days before the issue opens and to brokers to the issue, branches of brokers to the issue and underwriter in time. Securities issues are underwritten to ensure that in case of under subscription the issues are taken up by the underwriters.

SEBI has made underwriting mandatory for issues to the public. The underwriting arrangement should be filed with the stock exchange. Particulars of underwriting arrangement should be mentions in the prospectus. The various activities connected with pre issue management are a time bound program which has to be promptly attended to. The execution of the activities with clockwork efficiency would lead to a successful issue.

ROLE OF REGISTRARS

Role of Registrars to an Issue (and Share Transfer Agents): The registrars to an issue, as an intermediary in the primary market, carry on activities such as collecting application from the investors, keeping a proper record of applications and money received from investors or paid to the seller of securities and assisting companies in determining the basis of allotment of securities in consultation with stock exchanges, finalizing the allotment of securities and processing/dispatching allotment letters, refund orders, certificates and other related documents in respect of issue of capital.

The share transfer agents maintain the records of holders of securities or on behalf of companies, and deal with all matters connected with the transfer/redemption of its securities. To carry on their activities, they must be registered with the SEBI which can also renew the certificate of registration.

They are divided into two categories:

Category I – To carry on the activities as a registrar to an issue and share transfer agent; Category II – To carry on the activity either as a registrar or as a share transfer agent. The registration is granted by the SEBI on the basis of consideration of all relevant matters and, in particular, the necessary infrastructure, past experience and capital adequacy. It also takes into

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account the fact that any connected person has not been granted registration and any director/partner/principal officer has not been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.

Capital Adequacy Fee

- The capital adequacy requirement in terms of net worth (capital and free reserves) was Rs.6 lakhs and Rs.3 lakhs for Category I and Category II of registrars and share transfer agents respectively.
- However, the capital adequacy requirements are not applicable since November 1999 for a department/division of a body corporate maintaining the records of holders of securities issued by them and deal with all matters connected with transfer/ redemption of securities.
- The two categories of registrars and transfer agents had to pay an annual fee respectively of Rs.15, 000 and Rs.10,000 for initial registration a well as renewal.
- With effect from November 1999, while Category I is required to pay a registration fee of Rs.50,000 and a renewal fee of Rs.40,000 every three years, Category II has to pay Rs.30,000 and Rs.25,000 respectively.

General obligations and responsibilities code of conduct for register to an issue and share transfer agents: A registrar to an issue and share transfer agent should:

1) Maintain high standards of integrity in the conduct of its business.
2) Fulfill its obligations in a prompt, ethical and professional manner.
3) At all times exercise due diligence, ensure proper care and exercise independent professional judgment.
4) Exercise adequate care, caution and due diligence before dematerialization of securities by confirming and verifying that the securities to be dematerialized have been granted listing permission by the stock exchange(s).
5) Make reasonable efforts to avoid misinterpretation and ensure that the information provided to the investors is not misleading.

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6) Not reject the dematerialization/dematerialization requests on flimsy grounds.Such requests could be rejected only on valid and proper grounds and supported by relevant documents.

7) Avoid conflict of interest and make adequate disclosure of its interest.

8) Put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, should take reasonable steps to resolve the same in an equitable manner.

9) Make appropriate disclosure to the client of its source or potential areas of conflict of duties and interest which would impair its ability to render fair, objective and unbiased services.

10) Always Endeavour to render the best possible advice to the clients having regard to their needs.

Maintenance of Records: The registrars and share transfer agents have to maintain records relating to all applications received from investors in respect of an issue, all rejected applications together with reasons, basis of allotment of securities in consultation with the stock exchanges, terms and conditions of purchase of securities, allotment of securities, list of allotters and nonallotters, refund orders, and so on.

Inspection: The SEBI is authorized to undertake the inspection of the books of accounts, other records, and documents of the registrars and share transfer agents to ensure that they are being maintained in a proper manner and the provisions of the SEBI Act, rules, regulations and the provisions of the SCRA.

Action in Default: A registrar/share transfer agent who fails to comply with any condition subject to which registration is granted, or contravenes any of the provisions of the SEBI Act/SCRA, rules/regulations and stock exchange bye-laws, rules and regulations is liable to suspension or cancellation of registration.

BANKERS TO THE ISSUE

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investors in respect of issues of capital and refund of application money.

Registration: To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI. The SEBI grants registration on the basis of all the activities relating to banker to an issue in particular with reference to the requirements:

The applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge his activities,

a) The applicant/any of the directors of the applicant is not involved in any litigation connected with the securities market/has not been convicted of any economic offence;

b) The applicant is a scheduled bank and

c) Grant of a certificate is in the interest of the investors. A banker to an issue can apply for the renewal of his registration three months before the expiry of then certificate.

General Obligations and Responsibilities furnish Information

When required, a banker to an issue has to furnish to the SEBI the following information;

a. The number of issues for which he was engaged as a banker to an issue;

b. The number of application/details of the application money received,

c. The dates on which applications from investors were forwarded to the issuing company /registrar to an issue;

d. The dates/amount of refund to the investors.

Books of Account/Record/Documents

A banker to an issue is required to maintain books of accounts/records/documents for a minimum period of three years in respect of, inter-alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company/registrar to the issue and dates and amounts of refund money to investors.

Disciplinary action by the RBI

If the RBI takes any disciplinary action against a banker to an issue in relation to issue payment, the latter should immediately inform the SEBI. If the banker is prohibited from carrying on his activities as a result of the disciplinary action, the SEBI registration is automatically deemed as suspended/cancelled.

Inspection

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Such inspection is done by the RBI upon the request of the SEBI. The purpose of inspection is largely to ensure that the required books of accounts are maintained and to investigate into the complaints received from the investors against the bankers to an issue.

The foregoing rules and regulations have brought the bankers to an issue under the regulatory framework of the SEBI with a view to ensuring greater investor protection.

On the basis of the inspection report, the SEBI can direct the banker to an issue to take such measures as it may deem fit in the interest of the securities market and for due compliance with the provision of the SEBI Act.

UNDERWRITERS

Another important intermediary in the new issue/primary market is the underwriters to issues of capital who agree to take up securities which are not fully subscribed. They make a commitment to get the issue subscribed either by others or by themselves. Though underwriting is not mandatory after April 1995, its organization is an important element of the primary market. Underwriters are appointed by the issuing companies in consultation with the lead managers/merchant bankers to the issues. A statement to the effect that in the opinion of the lead manager, the underwriters' assets are adequate to meet their obligation should be incorporated in the prospectus.

Registration: To act as underwriter, a certificate of registration must be obtained from the SEBI. In granting the certificate of registration, the SEBI considers all matters relevant/relating to the underwriting and in particular.

Fee: Underwriters, had to, for grant or renewal of registration, pay a fee to the SEBI from the date of initial grant of certificate, Rs. 2 lakhs for the first and second years and Rs.1 lakhs for the third year. A fee of Rs.20000 was payable every year to keep the certificate in force or for its renewal. Since 1999, the registration fee has been raised to Rs.5 lakhs. To keep the registration in force, renewal fee of Rs.2 lakhs every three years from the fourth year from the date of initial registration is payable. Failure to pay the fee would result in the suspension of the certificate of registration.

Agreement with Clients: Every underwriter has to enter into an agreement with the issuing company. The agreement, among others, provides for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to be subscribe to the issue after being intimated by/on behalf of the issuer, the amount of commission/brokerage, and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations.

Inspection and Disciplinary Proceedings: The framework of the SEBI‘s right to undertake the inspection of the books of accounts, other records and documents of the underwriters, the procedure for inspection and obligations of the underwriters is broadly on the same pattern as applicable to the lead managers.

SEBI’s General Obligations and Responsibilities Code of Conduct for Underwriters:

1) Make all efforts to protect the interests of its clients.

2) Maintain high standards of integrity, dignity and fairness in the conduct of its business.

3) Ensure that it and its personnel will act in an ethical manner in all its dealings with a body corporate making an issue of securities (i.e. the issuer).

4) Endeavour to ensure all professional dealings are affected in a prompt, efficient and effective manner.

5) At all times render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.

6) Not make any statement, either oral or written, which would misrepresent (a) the services that the underwriter is capable of performing for its client, or has rendered to any other issuer company; (b) his underwriting commitment.

7) Avoid conflict of interest and make adequate disclosure of his interest.

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8) Put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, should take reasonable steps to resolve the same in any equitable manner.

9) Make appropriate disclosure to the client of its possible source or potential in areas of conflict of duties and interest while acting as underwriter.

10) Not discriminate amongst its clients, save and except on ethical and commercial considerations.

Action in Case of Default: The liability for action in case of default arising out of

i. non-compliance with any conditions subject to which registration was granted.

ii. Contravention of any provision of the SEBI Act/rules/regulations, by an underwriter involves the suspension/cancellation of registration, the effect of suspension/ cancellation is on the lines followed by the SEBI in case of lead managers.

BROKERS TO THE ISSUE

Brokers are the persons mainly concerned with the procurement of subscription to the issue from the prospective investors. The appointment of brokers is not compulsory and the companies are free to appoint any number of brokers. The managers to the issue and the official brokers organize the preliminary distribution of securities and procure direct subscriptions from as large or as wide a circle of investors as possible.

The permission granted by the stock exchange is also subject to other stipulations which are set out in the letter of consent. Brokerage may be paid within the limits and according to other conditions prescribed. The brokerage rate applicable to all types of public issue of industrial securities is fixed at 1.5 percent, whether the issue is underwritten or not. The mailing cost and other out-of-pocket expenses for canvassing of public issues have to be borne by the stock brokers and no payment on that account is made by the companies.

The issuing company is expected to pay brokerage within two months from the date of allotment and furnish to the broker, on request, the particulars of allotments made against applications bearing their stamp, without any charge. The Cheques relating to brokerage on new issues and underwriting commission, if any, should be made payable at par at all Centre where the recognized stock exchanges are situated. The rate of brokerage payable must be is enclosed in the prospectus.

- Banking
- Issuing and underwriting
- Corporate Finance
- Management Services
- Product Knowledge

Marketing the public issue arises because of the highly competitive nature of the capital market. Moreover, there is a plethora of companies, which knock at the doors of investors seeking to sell their securities. Above all the media bombards the modern investors with eye catching advertisement to sell their concepts to prospective investors.

OFFER FOR SALE

Where the marketing of securities takes place through intermediaries, such as issue houses, stockbrokers and others, it is a case of 'Offer for Sale Method'. Under this method, the sale of securities takes place in two stages:

1) In the first stage, the issuer company makes an en-block sale of securities to intermediaries such as the issue houses and share brokers at an agreed price.

2) Under the second stage, the securities are re-sold to ultimate investors at a market-related price. The difference between the purchase price and the issue price constitutes profit for the intermediaries. The intermediaries are responsible for meeting various expenses such as underwriting commission, prospectus cost, advertisement expenses, etc.

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The issue is also underwritten to ensure total subscription of the issue. The biggest advantage of this method is that it saves the issuing company the hassles involved in selling the shares to the public directly through prospectus. This method is, however, expensive for the investor as it involves the offer of securities by issue houses at very high prices.

GREEN SHOE OPTION

Definition of 'Green shoe Option': A provision contained in an underwriting agreement that gives the underwriter the right to sell investors more shares than originally planned by the issuer. This would normally be done if the demand for a security issue proves higher than expected. It is legally referred to as an over-allotment option.

A 'Green shoe option' can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations if demand surges.

Green shoe options typically allow underwriters to sell up to 15% more shares than the original number set by the issuer, if demand conditions warrant such action.

However, some issuers prefer not to include Green shoe options in their underwriting agreements under certain circumstances, such as if the issuer wants to fund a specific project with a fixed amount of cost and does not want more capital than it originally sought.

The term is derived from the fact that the Green Shoe Company was the first to issue this type of option. Before investing in an IPO, we go through the offer document of the company to know more about it. A listed company is legally bound to abide by commitments made in the document. Besides providing information about the company's competitive strengths, industry regulation, corporate structure, main objects, subsidiary details, risk factors, etc. the offer document also mentions a technical word called "Green shoe option".

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Origin of the Green shoe: The term "Green shoe" came from the Green Shoe Manufacturing Company (now called Stride Rite Corporation), founded in 1919. It was the first company to implement the Green shoe clause into their underwriting agreement.

Green Shoe Option in India: Green shoe options or over-allotment options were introduced by the Securities and Exchange Board of India (SEBI) in 2003 to stabilize the aftermarket price of shares issued in IPOs.

Green shoe Option in Action

It is very common for companies to offer the Green shoe option in their underwriting agreement. In 2009, most realty companies in India, who were planning to raise funds from the primary market, had opted for green shoe option in their IPOs to stem volatility in share prices following their listing on the exchanges.

Companies such as Sahara Prime City, DB Realty, Lodha Developers and Ambience had opted for the green shoe option, which helped them stabilize share prices in the event of extreme volatility or prices moving below offer price.

E-IPO

What is an e-IPO?: A company proposing to issue capital to public through the online system of the stock exchange for offer of securities can do so if it complies with the requirements under Chapter 11A of DIP Guidelines. The appointment of various intermediaries by the issuer includes a prerequisite that such members/registrars have the required facilities to accommodate such an online issue process.

Initial Public Offering (IPO):

Initial Public Offering (IPO), also referred to simply as a “Public Offering” is the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately owned companies looking to become publicly traded.

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In a IPO, the issuer may obtain the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), best offering price and time to bring it to market. The Securities and Exchange Board of India will consider this week wide-ranging reforms in its regulations for mutual funds and initial public offers (IPOs), including a 'safety net' guarantee and tax incentives for new investors.

Various proposals expected to be discussed and approved at SEBI's upcoming board meeting on August 16 also include introduction of e-IPO, which would allow investors to bid for IPO shares electronically and without any physical paperwork.

· The Securities and Exchange Board of India (SEBI) has decided to introduce electronic IPOs from January 1, 2013.

· "The facility to submit the application forms would be available in more than 1000 locations which are part of the nationwide broker network of the stock exchanges and where there is a presence of the brokers' terminals (broker centre)," said SEBI in a circular to market participants.

· In the first phase, around 400 broker centers would be covered by January 1, 2013 and the remaining centers would be covered by March 1, 2013.

· Accordingly, details of locations including name of the broker, contact details such as name of the contact person, postal address, telephone number and email address of the broker, where the application forms shall be collected, will be disclosed by the stock exchanges on their websites at least 15 days before the dates specified by SEBI for introduction of electronic IPO.

· SEBI also asked stock exchanges to ensure that the details disclosed on their websites are regularly updated.

PRIVATE PLACEMENT

A method of marketing of securities whereby the issuer makes the offer of sale to individuals and institutions privately without the issue of a prospectus is known as Private

Placement Method. This is the most popular method gaining momentum in recent times among the corporate enterprises.

Under this method, securities are offered directly to large buyers with the help of shares brokers. This method works in a manner similar to the Offer for Sale Method whereby securities are first sold to intermediaries such as issues houses, etc. They are in turn placed at higher prices to individuals and institutions. Institutional investors play a significant role in the realm of private placing. The expenses relating to placement are borne by such investors.

Advantages of Private Placement

- Less expensive as various types of costs associated with the issue are borne by the issue houses and other intermediaries.
- Less troublesome for the issuer as there is not much of stock exchange requirements connecting contents of prospectus and its publicity etc. to be complied with.
- Placement of securities suits the requirements of small companies.
- The method is also resorted to when the stock market is dull and the public response to the issue is doubtful.

Disadvantages of Private Placement

- Concentration of securities in a few hands.
- Creating artificial scarcity for the securities thus jacking up the prices temporarily and misleading general public.
- Depriving the common investors of an opportunity to subscribe to the issue, thus affecting their confidence levels.

BOUGHT-OUT DEALS

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A method of marketing of securities of a body corporate whereby the promoters of an unlisted company make an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor is known as 'bought-out deals'.

Characteristics of Bought out deals

- Parties: There are three parties involved in the bought-out deals. They are promoters of the company, sponsors and co-sponsors who are generally merchant bankers and investors.
- Outright Sale: Under this arrangement, there is an outright sale of a chunk of equity shares to a single sponsor or the lead sponsor.
- Syndicate: Sponsor forms syndicate with other merchant bankers for meeting the resource requirements and for distributing the risk.
- Sale Price: The s ale price is finalized through negotiations between the issuing company and the purchaser, the sale being influenced by such factors as project evaluation, promoter's image and reputation, current market sentiments, prospects of off-loading these shares at a future date, etc.
- Fund-based: Bought-out deals are in the nature of fund-based activity where the funds of the merchant bankers get locked in for at least the prescribed minimum period.
- Listing: The investor-sponsors make a profit, when at a future date, the shares get listed and higher prices prevail. Listing generally takes place at a time when the company is performing well in terms of higher profits and larger cash generations from projects.
- OTCEI: Sale of these shares at Over-the-Counter Exchange of India (OTCEI) or at a recognized stock exchanges, the time of listing these securities and offloading them simultaneously are being generally decided in advance.

Benefits of Bought-out Deals: Bought-out deals provide the following benefits:

1. Speedy sale
2. Freedom
3. Investor protection
4. Quality offer

PLACEMENT WITH FIs, MFs, FIIs

Listed companies have been allowed by SEBI to make preferential allotment to registered FIIs subject to certain conditions. A company desiring to make a preferential allotment should obtain the shareholders' consent. The allotment should be in accordance with ceilings of 10% of total issued capital for individual FII and 30% of all FIIs and nonresident Indian investors. The preferential allotment should be made at a price not less than the highest price during the last 26 weeks on all stock exchanges where the company securities are listed.

FIIs (Foreign Institutional Investors): Guidelines of Government of India

Government of India through Guidelines issued on September 14, 1992 has allowed reputed foreign Institutional Investors (FIIs) including pension funds, mutual funds, asset management companies, investment trusts, nominee companies and incorporated or institutional portfolio managers to invest in the India capital market subject to the condition that they register with the Securities and Exchange Board of India and obtain RBI approval under FERA.

The different forms in which the portfolio investment flows into the country are global depository receipts (GDR's), investment in primary and secondary market, offshore funds and government securities. At the end of March 2000, 506 FIIs were registered with SEBI. Their total cumulative investment in securities market was Rs.57038 crores as at March 2002. Of the FIIs only 205 were active and 10 % accounted for 70% of transactions. There is no restriction on amount of investment and there is no lock in period.

FII and SEBI Regulations, 1995: The regulations stipulate that foreign institutional investors have to be registered with SEBI and obtain a certificate from SEBI. For the purpose of grant of the certificate SEBI takes into account,

1. The applicant's track record, professional competence, financial soundness, experience, general reputation of fairness and integrity

2. Whether the applicant is regulated by appropriate foreign regulatory authority

3. Whether the applicant has been granted permission by RBI under Foreign Exchange Regulating Act for making investments in India as a foreign institutional investor and

4. Where the applicant is,

a. an institution established or incorporated outside India as a pension fund, mutual fund or investment trust ; or

b. an asset management company or nominee company or bank or institutional portfolio manager, established or incorporated outside India and proposing to make investments in India on behalf of broad based funds; or

5. A trustee or power of attorney holder established or incorporated outside India and proposing to make investments in India on behalf of broad based funds.

6. The certificate is granted in Form B subject to payment of prescribed fees which is valid for 5 Years and can be renewed thereafter.

OFF-SHORE ISSUES

Off Shore Finance: Merchant bankers help their clients in Long term foreign currency loan, Joint venture abroad, Financing exports and imports, foreign collaboration arrangements

Banks Providing Merchant Banking Services In India:

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- Commercial banks, Foreign banks like National Grind lays Bank, Citibank, HSBC bank etc.
- Development banks like ICICI, IFCI, and IDBI etc.
- SFC, SIDCs Private firms like JM Financial and Investment service,
- DSP Financial Consultants, CEAT Financial Services, Kotak Mahindra, VMC Project Technologies, Morgan Stanley, Jardie Fleming, Klienwort Benson etc.

ISSUE MARKETING

Merchant Banking and Marketing of New Issues: Following are the steps involved in the marketing of the issue of securities to be undertaken by the lead manager:

- Target Market
- Target Concentration
- Pricing
- Mobilizing Intermediaries
- Information Contents
- Launching Advertisement Campaign
- Brokers and Investors Conferences

A critical factor that could make or break the proposed public issue is its timing. The market conditions should be favorable. Otherwise, even issues from a company with an excellent track record, and whose shares are highly priced, might flop. Similarly, the number and frequency of issues should also be kept to a minimum to ensure success of the public issue.

ADVERTISING STRATEGIES

SEBI issued Guidelines in 1993 to ensure that the advertisement are truthful fair and clear and do not contain statements to mislead the investors to imitate their judgment.

All lead managers are expected to ensure that issuer companies strictly observe the code of advertisement set-out in the guidelines. For the purpose of these guidelines the

expression advertisement, means notices, brochures, pamphlets, circulars show cards, catalogues, hoardings, placards, posters, insertions in newspapers, pictures, films, radio/television program or through any electronic media and would also include the cover pages of the offer documents.

Code of Advertisements - Capital Issues

1. An issue advertisement shall be truthful fair and clear and shall not contain any statement which is untrue or misleading.

2. An issue advertisement shall be considered to be misleading, It contains

   a. Statements made about the performance or activities of the company in the absence of necessary explanatory or qualifying statements, which may give an exaggerated picture of the performance or activities than what it really is?

   b. An inaccurate portrayal of a past performance in a manner which implies that past gains or income will be repeated in the future.

3. As investors may not be well versed in legal or financial matter, care should be taken to ensure that the advertisement is set forth in a clear, concise and understandable language. Extensive use of technical, legal terminology or complex languages and the inclusion of excessive details which may distract the investor should be avoided.

4. An issue advertisement shall not contain statements which promise or guarantee an appreciation or rapid profits.

5. An issue advertisement shall not contain any inform or language that not contained in the offer documents.

6. All issue advertisement in newspapers, magazines, brochures, pamphlets containing highlights relating to any issue should also contain risk

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factors with the same print size. It should mention the names of lead Managers, Registers to the issue.

7. No corporate advertisement except product advertisements shall be issued between the date of opening and closing of subscription of any public issue. Such product advertisement shall not make any reference directly or indirectly on the performance of the company during the said period.

8. No advertisement shall be issued stating that the issue has been fully subscribed or oversubscribed during the period the issue is open for subscription, except to the effect that the issue is open or closed. No announcement regarding closure of the issue shall be made except on closing date. If the issue is fully subscribed before the last closing date as state in the prospectus, the announcement should be made only after the issue is fully subscribed and such announcement is made on the date on which the issue is to be closed.

9. No model, celebrities, fictional characters, landmarks or caricatures or the like shall be displayed on or form part of the offer documents or issue advertisements.

10. No slogans, expletives or non-factual and unsubstantiated titles should appear in the issue advertisement or offer documents.

11.If any advertisements carries any financial data it should also contain data for last three years and shall include particulars relating to sales, gross profits, net profit share capital reserves, earning per share, dividends and book values.

12. No incentives, apart from the permissible underwriting commission and brokerages, shall be offered through any advertisements to anyone associated with marketing the issue.

NRI MARKETING

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The term NRI includes the following categories of persons:

- ❖ Indian national holding Indian passports with non-resident status (INNR),
- ❖ Person of Indian origin, foreign nationals of Indian origin, living in foreign countries including such persons of Indian origin as is in the status of stateless, because no foreign country has as yet accepted them as their national and they are not Indian national either by birth or residence, (FNIO).
- ❖ The term NRI also includes companies, partnership firms, trusts, societies and other corporate bodies called OCBs where 60% of the equity is owned by the NRIs.

Avenues for Investment by NRIs

- ❖ NRIs can have three different types of bank accounts, buy securities in the primary and secondary markets, and do business on non-reparable basis as well as reparable basis.
- ❖ NRI‘s have also made in the past large investments in specific bonds.
- ❖ Development Bond in 1991, the Resurgent India Bond in 1998 and India Millennium Deposits in 2000.

Foreign Direct Investment under New Industrial Policy (1991)

a) Repatriable Basis

b) Non Repatriable Basis

Investment in New Issues (Primary Market)

1. Forty percent scheme - Indian companies engaged in industry and manufacturing, Hotel (3,4, and 5 star category), hospitals and diagnostic centers, shipping companies, development of computer software and oil exploration services are allowed by RBI to issue shares/debentures to NRIs with repatriation benefits to the extent of 40% of new issue.

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2. No permission for investment is required in cases where the company has obtained permission from RBI. This is generally granted in the green field project (e.g. Chambal Fertilizers, Mangalore Refineries). NRI has to obtain permission from RBI even if the sale is to be effected after 12 month. Blanket permission can be obtained before completing 12 months of each investment.

3. Generally RBI does not permit NRI investment at issue prices in case of

a. Right issues of existing companies (excluding existing NRI shareholders)

b. Public issues of an existing profit making company.

4. NRI can repatriate original investment, profit and dividend provided they are held for a minimum period of one year. On long term capital gains a rate of 10% is applicable.

5. If the investment is sold before one year the investment and all related receipts become non-Repatriable unless RBI permission is taken in advance with clearance from Income

6. Tax department, with long term capital gains (LTCG) provisions as applicable to resident assesses.

7. In the case of non-allotment or allotment of less than requested amount, refunds can be credited to NRE accounts.

8. In case of debentures, long term capital gains (LTCG) provisional apply after three years (in place of one year for equity issues). But the proceeds are fully repatriable. For investment and sale through secondary market blanket permission valid for 5 years is to be obtained through an NRE banker.

RBI permission stipulates that such investments be routed through any one bank branch to facilitate control/monitoring. There is a ceiling for NRI investment in each

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company. For an individual NRI it is one percent of paid up capital and five percent for all NRI‘s and it could be raised to 24 % for all NRI‘s wherever the company passes a special resolution at is annual general meeting. Repatriation of original investment, profits and dividends is allowed. The lock in period has been removed on 12.10.1994.

Investment in Money Market Mutual Funds (MMFs)

NRIs are permitted to invest on non – repatriation basis in MMFs floated by commercial banks and public/private sector financial institutions. The concerned bank/ institution should get authorization from RBI/SEBI. NRIs do not need separate permission. Purchase of Share by Private Arrangement NRIs/OCBs requires permission of RBI for purchasing shares of Indian companies by private arrangement.

POST ISSUE ACTIVITIES

Post-Issue: The public issue closes on the stipulated closing date. Subsequently, the BRLM and the issuing company finalize the price. The prospectus will be updated with the mention of the final price of the shares. The finalized prospectus will be issued to QIBs. After making allotment to the QIBs on the discretionary portion, basis of allotment for the retail investors will be finalized by the issuer, Registrar, BRLM, stock exchange and a public representative. The basis of allotment is communicated to the stock exchange.

After this, the refund orders are sent to the applicants. Arrangements for crediting the allotted shares are done with the depositories. The merchant banker who acts as the lead manager is responsible till this final stage of listing of shares.

- ❖ Finalization of Basis of Allotment: If the public issue is oversubscribed to the extent of greater than five times, a SEBI nominated public representative is required to participate in the finalization of Basis of allotment (BoA).
- ❖ Advertisement: An announcement in the newspaper has to be made regarding the basis of allotment, the number of applications received and the date of dispatch of share certificates and refund orders, etc.

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Law Relating To Issue Management: It is important that the lead managers take into account the regulations of the capital issue as prescribed by the various enactments mentioned below:

1) Provisions of the Companies Act, 1956
2) The Securities Contracts (Regulations) Act, 1957 regarding transactions in securities
3) The Securities Contracts (Regulation (Rules, 1957)

UNIT – III

MERGERS AND ACQUISITIONS

Mergers and Acquisitions (M&A) as forms of business combination are increasingly being used for undertaking restructuring of corporate enterprises the world over. In fact, the corporate world is in the grip of merger-mania (mega mergers and hostile takeovers). The merger wave which began in the U.S. first occurred during the period between 1890 and 1904. Of late, mergers happen in all the sectors of the economy, the prime driving force being the accomplishment of synergetic effect for both the acquiring and the acquirer companies. Mergers have started happening in India too.

Mergers

A type of business combination where two or more firms amalgamate into one single firm is known as a merger. In a merger, one or more companies may merge with an existing company or they may combine to form a new company. In India mergers and amalgamations are used interchangeably.

In the wider sense, merger includes consolidation, amalgamation, absorption and takeover. It signifies the transfer of all assets and liabilities of one or more existing companies to another existing or new company. The main purpose of merges is to achieve the advantage of fusion and synergy through expansion and diversification.

Steps IN M & A: Following are the steps involved in M&A

- Review of Objectives

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- Data for Analysis
- Analysis of Information
- Fixing Price\Finding Merger Value

Forms of Merger

Merger takes place in the following forms:

1. Merger through absorption
2. Merger through consolidation

Major Issues of M&A in India

Business combinations and re-structuring in the form of merger, etc. have been attempted to face the challenge of increasing competition and to achieve synergy in business operations.

The major issues of M&A are as follows:

- Depreciation
- R&D Expenditure
- Tax Exemption
- Carry Forward Losses

Related Connotations

There are terms that sound relative to merger/amalgamation. These include acquisition and takeover.

Acquisition: The term 'acquisition' is used to refer to the act of acquiring of ownership right in the property and assets of another company and thereby bringing about change in the management of the acquiring company. Acquisition could happen in any of the following ways:

1. Entering into an agreement with a person or persons holding controlling interest in the other company.
2. Subscribing new shares issued by the other company in the open market
3. Purchasing shares of the other company at a stock exchange

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4. Making an offer to buy the shares of other company, to the existing shareholders of that company.

Takeover: Another term associated with merger is ‘takeover’. In the case of a takeover, one company obtains control over management of another company. Under both acquisition and takeover, it is possible for a company to have effective control over another company even by holding minority ownership. For instance, the Monopolies and Restrictive Trade Practices (MRTP) Act prescribes that a minimum of 25 percent voting power must be acquired as to constitute a takeover. Similarly, section 372 of the Companies Act defines the limit of a company’s investment in the shares of another company as anything more than 10 percent of the subscribed capital so as to continue a takeover.

Where a distinction between acquisition and takeover is made, takeover usually takes the form of ‘hostile’ or ‘forced’ or ‘unwilling’ acquisition and acquisition happens at the instance and the willingness of the company management and the shareholders. It is for this reason that acquisition is generally referred to as ‘friendly’ takeover.

An example, of acquisition in Mahindra and Mahindra Ltd, a leading manufacturer of jeeps and tractors, acquiring equity stake of Allwyn Nissan Ltd. On the other hand, the acquisition of Shaw Wallace, Dunlop, Mather and Platt and Hindustan Dorr Oliver by Chabrias and Ashok Leyland by Hindujas, etc are the examples of ‘hostile takeovers’ that have happened in the post liberalization era of the Indian financial sector.

Hostile Takeover

Where in a merger one firm acquires another firm without the knowledge and consent of the management of the target firm, it takes the form of a ‘hostile takeover’. The acquiring firm makes and unilateral attempt to gain a controlling interest in the target firm, by purchasing shares of the later firm directly in the open (stock) market. An example of hostile takeover was the takeover of TMBL by Siva sankaran of the Sterling Group. Since this type of takeover is generally prejudicial to the interest of the stakeholders. SEBI has come out with relevant code of conduct for the purpose of disciplining the takeover practice in India.

Merger – Types

Mergers are of different types as mentioned below:

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1. Horizontal merger
2. Vertical merger
3. Diagonal merger
4. Forward merger
5. Reverse merger
6. Forward Triangular merger
7. Reverse Triangular merger
8. Conglomerate merger
9. Congeneric merger
10. Negotiated merger
11. Arranged merger
12. Agreed merger
13. Unopposed merger
14. Defended merger
15. Competitive merger
16. Tender offer
17. Diversification

Regulation of M&A under the SEBI Act

SEBI guidelines are aimed at protecting the interest of the shareholders especially from the hazards of hostile takeovers. Most of these guidelines are applicable to the acquiring company. The salient features of the guidelines are as follows:

1. Notification: Where acquisition involves 5 percent or more of the voting capital of a company and the stock exchange shall be notified immediately.

2. Acquisition limit: An individual or a company can continue acquiring up to 10 percent of the voting capital of the target company without making any offer to other shareholders.

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3. Offer to public: Where the shareholding of the acquiring company exceeds 10 percent in a target company, a minimum offer of 20 percent of the shares shall be made to the remaining shareholders through a public announcement by the target company.

4. Offer price: The price at which the offer is to be made shall be so fixed as equivalent to the average of the weekly high and low of the closing prices during the last six months preceding the date of announcement.

5. Disclosure: It is essential that the acquiring company discloses detailed information regarding the terms of the offer, identity of the offeror, details of the offeror's existing holdings in the Offeree Company, etc. to all the shareholders.

6. Offer document: Offer document should contain information on the offeror's financial information, his intention to continue the offeree company's business and to make major change and long-term commercial justification for the offer.

PORTFOLIO MANAGEMENT SERVICES

Preserving and growing capital is as hard as earning it. Knowing what one want is as important as achieving those goals. Assessing one‘s risk profile and aligning potential returns for the risk assumed from various investment options is the crucial task. In today‘s fluid environment, that has become a hard task to achieve. As the investor‘s net worth increases, financial complexity expands exponentially and the investment needs and options multiply. And equities offer one of the best options for investments. Mutual funds as an investment vehicle are structured to reduce risks as far as possible, as they cater to thousands of investors.

Portfolio and Management Services: A list of all those services and facilities that are provided by a portfolio manager to its clients, relating to the management and administration of portfolio of securities or the funds of the client, is referred to as portfolio management services. The term portfolio means the total holdings of securities belonging to any person.

Portfolio Manager: According to SEBI, Portfolio Manager means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be.

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Discretionary Portfolio Manager: According to SEBI, discretionary portfolio manager means a portfolio manager who exercises or may, under a contract relating to portfolio management, exercises any degree of discretion as to the investments or management of the portfolio of securities or the funds of the client, as the case may be.

Objectives of Portfolio Management

- Provide long term capital appreciation with lower volatility, compared to the broad equity markets.
- Takes long positions in the cash market and short positions in the index futures markets.
- Invests in the model portfolios thus downside the risk by selling index futures in the derivatives market.

Functions: The objective of portfolio management is to develop a portfolio that has a maximum return at whatever level of risk the investor deems appropriate.

a) Risk Diversification

b) Asset Allocation

c) Bets Estimation

d) Rebalancing Portfolios

CREDIT SYNDICATION

Credit syndication services are services rendered by the merchant bankers in the form of organizing and procuring the financial facilities form financial institutions, banks, or other lending agencies. Financing arranged on behalf of the client for meeting both fixed capital as well as working capital requirements is known as loan syndication service'

Credit Syndication Services: Merchant bankers provide various services towards syndication of loans. The services may be either loan sought for long term fixed capital or of working capital funds. They are discussed in detail.

Objectives: Arranging medium and long term funds for long term fixed capital and working capital fund needs.

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Scope: The scope of syndicated loan services as provided by merchant bankers include identifying the sources of finance, approaching these sources, applying for the credit, and sanction and disbursal of loans to the clients.

While carrying out the activities connected with credit syndication, the merchant banker ensure due compliance with the formalities of the financial institution, banks and regulatory authority. They are:

1) General Information
2) Promoter information
3) Company information
4) Project profile information
5) Project cost information
6) Project financing information
7) Project marketing information
8) Cash flow information

Making Application

The merchant banker files the duly filled-in application in a manner as desired by the term-lending institution. While presenting the application, it is incumbent on the part of the merchant banker to ensure that all the required formalities have been complied with. For instance, it is important that necessary sanction is obtained from the Government for the proposed project. Loans are syndicated by development financial institutions though the lead institution especially in the case of consortium finances or joint lending. Where loans are sought in huge amounts consortium approach to lending is followed.

Merchant banker provides advice in the preparation of project/feasibility report and the market survey report, and the financial projections relating to the project.

1. Technical Appraisal :
2. Ecological Appraisal
3. Financial Appraisal
4. Promoters Contribution
5. Economic Appraisal

6. Commercial Appraisal
7. Managerial Appraisal
8. Arrangement of Loan Sanction
9. Compliance for Loan Disbursement
10. Compliance with Memorandum and the Articles

(b) Statutory Compliance

In addition, compliance is also called for with regard to the provisions constrained in various enactments concerning the management and regulation of joint stock companies in India. Some of these enactments include Companies Act, 1956, Industries (Development and

Regulation) Act, 1951, Foreign Exchange Regulation Act, 1973, Securities Contracts

(Regulation) Act, 1956, The Foreign Trade (Development and Regulation) Act, 1992, and Income-Tax Act, 1961.

Documentation and Creation of Security

An important function of a merchant banker is to create an adequate documentation of security by working closely with the lead financial institution, so as to ensure quicker disbursement of loan. The type of documents to be prepared and executed by the merchant banker will be as per the requirements of the lead financial institution. Depending on the loan type, the merchant banker executes bridge loan document or interim loan document.

Pre–Disbursement Compliance

This function is aimed at merchant bankers assisting the borrowing unit in the withdrawal of the loan amount from the financial institution. This done with additional compliance of formalities of provision of information and documentation. Some of the pre-disbursement conditions that require compliance by the merchant banker are documentation.

CREDIT RATING

Credit rating is a mechanism by which the reliability and viability of a credit instrument is brought out. When a company borrows or when a businessman raises loan, the lenders are interested in knowing the credit worthiness of the borrower not only in the present condition but also in future. Hence, credit rating reveals the soundness of any credit instruments issued by

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various business concerns for the purpose of financing their business,. In credit rating, the investor is not only able to know the soundness of the credit instrument, but be is also able to analyze between different credit instruments and he can make a trade-off between risk and return.

Credit Rating of Individuals, Companies and Countries

(a) Individuals

(b) Companies

(c) Countries

Rating of Individuals: Individuals go for credit rating when they want to borrow from recognized institutions. In India, we have Onida Individual Credit Rating Agency (ONICRA) which gives credit rating for individuals.

Rating of Companies: As per the guidelines of SEBI and RBI, companies have to resort to credit rating when they:

(i) Accept public deposits

(ii) Issue credit instruments in domestic market

(iii) Issue credit instruments in overseas market.

Rating of Countries: Credit rating is resorted to by countries for borrowing in international market or for attracting foreign investments or for raising funds from the international institutions like IMF and IBRD.

Basis of Credit Rating

Various aspects are taken into account by a credit rating agency when a borrowing company applies for rating. They are:

1. Business Analysis
2. Evaluation of industrial risks
3. Market position of the company within the industry
4. Operating efficiency of the company
5. Legal position in terms of prospectus
6. Financial analysis based on accounting quality

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7. Statement of profits
8. Earnings protection
9. Cash flow and their adequacy
10. Financial flexibility
11. Track record of management
12. Capacity to overcome adverse situations
13. Goals philosophy and strategy
14. Labor turnover
15. Regulatory and competitive environment
16. Asset quality
17. Financial position-interest/tax sensitivity

Credit Rating Companies in India

- Credit rating companies were started in India during the late 1980s.
- Credit Rating Information Services of India Ltd (CRISIL) was started in 1988 as a subsidiary of ICICI. Information
- Credit Rating Services Ltd., (ICRA) was started in 1990, which is a subsidiary of IDBI.
- Credit Analysis and Research Ltd. (CARE) were started in 1993.

Types of Credit Rating

We have seen the various rating symbols for different categories of the debt instruments. We can also classify credit rating as types of credit rating which are based on different securities.

These are:

1. Equity rating
2. Bond rating
3. Promissory note rating4. Commercial paper rating
5. Sovereign rating.

Features of Credit Rating

1. Credit rating is an expression of opinion of the credit agency about the risk of a security. This opinion is subject to change over the life of the security.

2. Credit rating indicates relative grading of risk in a security. Risk quality is expressed on a comparative basis.

3. Credit rating is revealed through symbols such as ‘AAA’, ‘AA’, etc.

4. The ratings are instrument specific’. It can differ from various instruments of the same company.

5. Rating being the opinions or perceptions of the rating agency, there could be a difference in the ratings of the same instruments by different agencies.

6. Rating is reflecting the relative credit risk; it does not reflect other investment risks that arise due to changes in the market conditions.

7. Credit rating is not an investment recommendation. It indicates just one aspect of investment, namely, risk. Other aspects like yield, risk preference of investor, etc. are not considered.

8. Credit rating is not a one-time task that is over with the assignment of ratings.

It is a continuous process. The ratings assigned are subject to surveillance and if conditions change, the rating may be revived.

SEBI and Credit Rating

Credit rating agencies are also subject to regulations by the SEBI and the RBI. In evolving the code of conduct for the credit rating agencies, the International Organization of Securities Commissions (IOSCO) has also played an active role. Recently, the Association of Credit Rating Agencies of Asia (ACRAA) has come out with the ‘best practices’ manual for credit rating agencies.

SEBI (Credit Rating Agencies) Regulations came into effect from July 1999. It provides for registration of credit rating agencies operating in India. The procedure for registration and general obligations of the credit rating agencies and a code of conduct for them are prescribed in

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the Regulations. The code of conduct for credit rating agencies is disclosed in the Regulation 13 of SEBI.

Besides the SEBI regulatory provisions, the IOSCO's Code of Conduct Fundamentals for Credit Rating Agencies published in December 2004 is also relevant for the rating agencies of the member countries.

MUTUAL FUNDS

Mutual Fund: Concept and Rationale

What is mutual fund? A mutual fund is an institution that pools the savings of small investors for investment in capital market and money market securities. The mutual fund invests in diversified securities so as to reduce the investment risks. The portfolio is managed by the mutual fund and the returns from the investment are distributed to the mutual fund investors as dividends. Even a small amount can be invested in the units of mutual funds schemes. This enables the investors to derive the benefits of diversification which otherwise would have been possible with smaller investments.

Objectives: Mutual funds came into existence in order to attract the savings of lower and middle income group people and give them the benefit of corporate profits by distributing attractive dividends at the end of the year. Mutual funds cater the different types of customers who are interested in

(a) Fixed income or

(b) A higher return for investment or(c)
Who is growth oriented.

The SEBI (Mutual Funds) Regulation 1996 define a mutual fund as "a fund established in the form of a trust by a sponsor to raise monies by the trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with the regulation"

The Association of Mutual Funds in India (AMFI) defines a mutual fund as "a trust that pools the savings of a number of investors who share a common financial goal"

Mutual Funds set up in India: The structure of mutual fund operations in India envisages a three tier establishment namely:

1. A Sponsor institution to promote the fund

2. A team of Trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund

3. An Asset Management Company is to actually deal with the fund and sponsoring Institution.

4. The Company which sets up the Mutual Fund is called the sponsor. The SEBI has laid down certain criteria to be met by the sponsor.

5. These criteria mainly deal with adequate experience, good past tract record, net worth etc.

Trustees: Trustees are people with long experience and good integrity in their respective fields. They carry the crucial responsibility of safeguarding the interest of investors. For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies with the approval of the SEBI.

Asset Management Company (AMC): The AMC actually manages the funds of the various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. In fact, the success of any Mutual Fund depends upon the efficiency of this AMC. The AMC submits a quarterly report on the functioning of the mutual fund to the trustees who will guide and control the AMC.

TYPES OF MUTUAL FUNDS

Mutual funds offer a plethora of schemes to the investing public. There are close to 2000 schemes in India. An investor can be easily bewildered by the wider array of schemes in the market.

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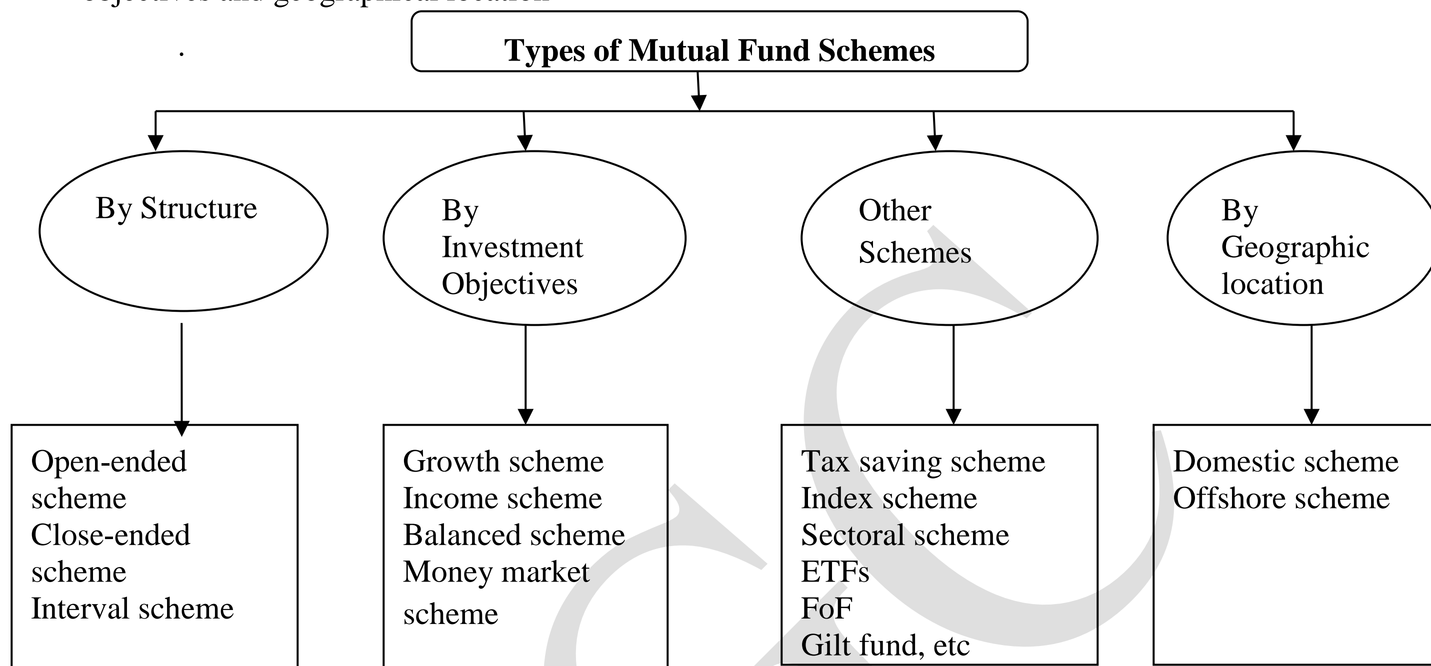
objectives and geographical location



The mutual fund schemes can be classified according to the term structure, investment

SEBI Guidelines for Mutual Funds

The SEBI has formulated guidelines and regulations of the mutual funds in India and it were introduced in December 1996. The objective of these regulations was to ordain the regulatory norms for the formation, operation and management of mutual funds in India. The regulations also lay down the broad guidelines on investment valuations, investment restrictions, advertisement code and code of conduct for mutual funds and asset management companies.

Registration of Mutual Fund

a. Every mutual fund shall be registered with SEBI through an application to be made by the sponsor in the prescribed perform, accompanied by a non-refundable application fee of Rs.25,000.

b. Every mutual fund shall pay Rs.25 lakhs towards registration fee and Rs.2,50,000 p.a. as service fees.

c. Registration will be granted by the Board on fulfillment of conditions such as the sponsor having a sound track-record of five years and the sponsor showing profits after providing depreciation, interest and tax for three out of the immediately preceding five years.

Regulation as to the Trust

1. A mutual fund shall be constituted in the form of a trust under the provision of Indian Registration Act, 1908 (U/s 16 of 1908) and the trust deed containing the provisions lay down by SEBI.

2. At least 50 percent of the trustees shall be independent trustees.

3. The trustees and the AMC, with the SEBI's prior approval, shall enter into an investment management agreement.

4. The trustees shall ensure that the AMC has been managing the schemes independently of other activities. They should also monitor securities transactions with brokers and avoid undue concentration of business with any single broker.

5. In the interest of unit holders, the trustees shall obtain the consent of the unit holders whenever SEBI requires decide to wind up or in the event of any change in the fundamental attributes of any scheme, etc.

6. The trustee shall call for the details of transactions in securities by the key personnel of the AMC.

BUSINESS VALUATION

The basic valuation methods of holdings by the Mutual funds should be done by keeping in view the following elements:

1. For listed securities – take last sale price quoted in the stock exchange dealing list

2. For OTCEI securities – take bid/ask price as may be relevant on case to case basis

3. Trustees may determine market value at a reasonable price as per current market at which the investors would buy at fairly reasonable rate.

4. For short term investments the basis of valuation should be the amortized cost.**Net Asset Value (NAV):** NAV is another parameter used to measure the operational efficiency of mutual funds. The intrinsic value of a unit under a particular scheme is referred to as the 'NAV' of the scheme. The value gives an idea of the amount that may

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be obtained by the unit holder on its sale to the mutual fund company. NAV of a unit is calculated as follows:

NAV per unit = (TMV – CL) ÷SU Where,

TMV = Total market value of investment portfolio + the written down value of fixed assets + the cost value of other current assets

CL = Current liabilities

SU = Number of outstanding units in that scheme

For the purpose of determining the NAV, the scheme of accounting practices are prescribed by the SEBI regulations of 1996 should be followed.

Calculation of NAV:

The NAV calculation should include the following elements for open end funds.

1. Investment at value recorded on first business day after trade transaction.
2. Changes in outstanding shares on first business day after trade transaction.
3. Dividend and distribution to shareholder ex-date.
4. Expenses (estimated and accrued to date of calculation)
5. Dividends receipts from investments ex-date
6. Interest and other income (estimated and accrued to date of calculation)
7. Other assets /organization costs.

Evaluating Mutual Funds:

In order that mutual fund managers act in a judicious manner so as to bring about ultimate beneficial consequences to the investing community, it is essential that the performance of such funds is evaluated. Such an appraisal would help the funds compare themselves with other funds, besides being a potential source of information to the present and prospective investors, especially the small investors.

From simple evaluation tools to sophisticated models, which take into consideration, the risk and uncertainty associated with the returns are available for evaluating the performance of mutual funds. Some of these tools are briefly explained below.

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Treynor Model: Jack Treynor evolved this model, which can be used to calculate the return per unit of risk. This is done by assuming that all investors averse to risk would like to maximize this value. The performance measure is calculated as follows:

$$PM = [Ari - Arf] \div \beta t$$

Where,

PM = The Treynor portfolio performance measure for the period

Ari = Average rate of return for portfolio 'i' during a period

Arf = Average rate of return on risk free investment during the period

βt = Slop of portfolio 'i' characteristic line which represents the portfolio relative volatility and it systematic risk.

A positive measure show a superior, risk adjusted performance of a fund

Sharpe Model: William F.Sharpe developed this model in 1966. It measures the total risk, not merely systematic risk (as in Treynor model). The relevant performance measure is computed as follows:

$$PM = [Ari - Arf] \div Nt$$

Where,

Nt = Standard deviation of rate of returns for the portfolio for the period.

A positive performance measure value is indicative of good performance.

UNIT-IV

MUTUAL FUNDS

Mutual Fund

According to Association of Mutual Funds in India (**AMFI**), "A Mutual fund is a trust that pools number of savings investors, who shares common financial goal'. From the aforesaid definition, we can understand the concept of Mutual fund and the key points as mentioned hereunder:-

- Mutual fund is a trust

- Mutual fund pools money from a group of investors called **Unit Holders**
- The investors share common financial goals
- Invest the money, collected from small investors into securities (shares, bonds etc.). It is called as **diversified investment**.
- Mutual Fund use professional expertise (investment management skills) on investments made.
- Asset classes of investments match the stated investment objectives of the scheme
- Incomes and Gains from the investments are passed on to the unit holders based on the proportion of the number of units they own

Origin

Even though Historians are uncertain of the origin of investment funds, some say that the closed-end investment companies launched at Netherlands in the year 1822 by the King WilliamI is the first mutual funds, whereas some others say that Dutch merchant named Adriaan van Ketwich, whose investment trust was created in the year 1774 might have given the idea to the king. Ketwich probably theorized that diversification would increase the appeal for investments to smaller investors with the minimal capital. The name of Ketwich's fund, Eendragt Maakt Magt, means "unity creates strength".

A further development of mutual funds was made in Switzerland in the year 1849, and subsequently it was followed in Scotland in the 1880s in the similar fashion. Consequent to the evolution of mutual fund rooted in Great Britain and France, the idea of pooling resources and spreading risk using closed-end investments, came to the United States in the year 1890s.

The first closed-end fund "Boston Personal Property Trust" was formed in U.S in the year 1893. The modern mutual fund evolution developed in the year 1970 in Philadelphia under the name Alexander Fund had special features of semi-annual issues and facility for investors to withdraw their investments on demand.

The Launching of the Modern Fund

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In the year 1924, the modern mutual fund was created in pursuance of the formulation of the Massachusetts Investors' Trust in Boston. Generation of the mutual fund firm namely "MFS Investment Management" went public in the year 1928". The custodian of the Massachusetts Investors' Trust was State Street Investors. However, State Street Investors started generating their own fund at the helm in the year 1924 with Richard Paine, Richard Saltonstall and Paul Cabot. It is also pertinent to note that Saltonstall was also associated with Scudder, Stevens and Clark. In view of the said setup the first no-load fund was launched in the year 1928. Instantaneously, the first new launch of Wellington Mutual Fund emerged to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

Regulation and Development of Mutual Funds

19 open-ended mutual funds and nearly 700 closed-end funds existed before the stock market crash of 1929. Due to that crash, closed-end funds were wiped out. Small open-end funds managed to survive. To protect the investors, Government regulators created the **Securities and Exchange Commission** (SEC). It paved way to enact the **Securities Exchange Act of 1934**. As a result, mutual funds must register with the SEC and to reveal it in its prospectus.

The mutual fund industry grew-up gradually during 1950s with 100 top open-end funds. And in addition to that, 50 new funds emerged during the decade. Hundreds of new funds were launched during the decade of 1960s, which had aggressive growth till the bear market condition of 1969. The first index fund concept was established in the year 1971 by William Fouse and John McQuown of Wells Fargo Bank. The mutual fund industry further flourished due to the impact of Low-cost index fund and the rise of no-load fund.

The assets and household ownership of mutual funds experienced rapid growth simultaneously in United States also. On account of increasing globalization of finance, expanding presence of large multinational financial groups and strong performance of equity and bond markets, the global growth of mutual funds boosted during 1990s.

Types of Mutual Fund

There are various tools for investing money such as bank deposits, metals, real estates, and stock market instruments. The scale of risk and return is based on the type of investments. Investors should tradeoff between risk and return. If they invest in bank deposits, the risk is very

lower and at the same time the return is also very lower than that of any other means of investment. The metals and real estate assets are not sold easily.

The expectation of investors is higher return with lower risk or Lower risk with optimum return within short period of time. It is possible only in stock market investments. But it is not possible to the common investor because he is not technically competent to understand the stock market operations. A common man can invest his money safely in stock market through the rescuer, Mutual funds.

Mutual funds are dynamic financial institutions which play a crucial role in an economy by mobilizing savings and investing them in the capital market. Savings pooled from small investors are invested through a fund manager to purchase a diversified portfolio of stocks or bonds. An investor can invest in mutual fund at lower cost with the advantage of diversification. Diversification means "spreading out money across many different types of investments". When one investment involves high risk, another might be lower. Diversification of investment holdings reduces the risk tremendously.

On the basis of their structure and objective, mutual funds can be classified into various types. Generally, there are two major types of Mutual Funds:-

Mutual Funds
- ✓ Open-end
- ✓ Closed-end

Mutual Funds **Open End Mutual Funds**

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at **Net Asset Value** (NAV) related prices, which are notified a daily. The key feature of open-end schemes is their liquidity.

Closed End Mutual Funds

A close-ended fund or scheme has a stipulated maturity period say for e.g. 5-7 years. The fund is open for subscription only during a specified period at the time of launching of the

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scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme through the stock exchanges, where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. Stock Exchange Board of India (**SEBI**) Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis. They are traded more like the general stocks.

The reasons to invest in this category are:

Prices are determined by market demands and thus, closed end funds trade at lower than the offer price more often.

The open end funds provide wide options for investors to choose from (a) stock funds and balanced funds which give full asset allocation benefit and (b) bond funds.

After the closure of the offer, buying and redemption of units by the investors directly from the Funds are not allowed. However, to protect the interests of the investors, SEBI provides investors with two avenues to liquidate their positions:

1. Closed-end Funds are listed on the stock exchanges where investors can buy/sell units from/to each other. The trading is generally done based on NAV at a discounted rate. The NAV of a closed-end fund is computed on a weekly basis (updated every Thursday).

2. Closed-end Funds may also offer "buy-back of units" to the unit holders. In this case, the corpus of the Fund and its outstanding units do get changed.

Mutual Fund Classifications

A scheme can also be classified as growth scheme, income scheme, or balanced scheme considering its investment objective. Such schemes may be open-ended or close-ended schemes.

Such schemes may be classified mainly as follows:

Equity Funds

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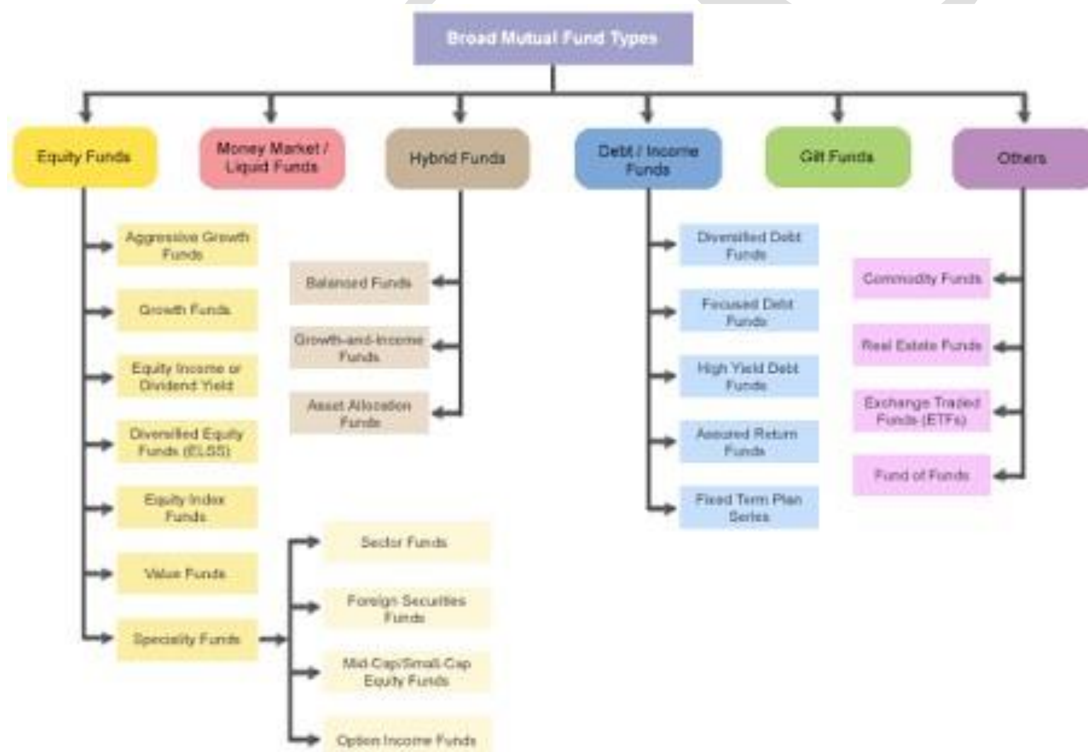
Equity funds provide higher returns and at the same time it is more risky while compared to any other fund. For long term investment purpose, an investor is advised to invest in equity. There are different types of equity funds under different level of risk as follows:

a. **Aggressive Growth Funds** – The maximization of capital appreciation is the mantra for fund managers. So they invest in highly grown-up companies' equities and less in speculative investments. Investment in speculative nature of equities may lead to higher risk.

b. **Growth Funds** – Here, the objective is to achieve an increase in value of investment through capital appreciation and not in the regular income. Fund manager selects the companies which are expected to earn above average in future for the investment of growth funds.



c. **Equity Income or Dividend Yield Funds** – These are for investors who are more concerned about regular returns from investments. Fund manager invests in those companies which declare high rate of dividends. Capital appreciation and risk level are less while compared to other equity funds.

d. Diversified Equity Funds – Fund manger invests this type of funds in the equities of all the companies and industries without any specified industry or sector. Due to this diversification of investment, the market risk is also diversified. Example **Equity Linked Savings Schemes** (ELSS). (ELSS investors can claim deduction from taxable income (up to Rs 1 lakhs) at the time of filing the income tax return).

e. Equity Index Funds – It is based on the performance of a specific stock market index. Equity index funds are two types namely broad indices (like S&P CNX Nifty, Sensex) and narrow indices (like BSEBANKEX or CNX Bank Index etc). Investments in Narrow indices index funds are less diversifiable; therefore it is more risky than that of broad indices index funds.

f. Value Funds – Fund manager invests in shares of companies which have strong financial performance but whose price-earnings ratio is low. Price-earnings ratio is the relationship between the Market Price per share and Earnings per share. These companies' book value of the shares is higher than the market price. The market price of these shares may rise in future. With this assumption the fund manager invests huge fund for long term time horizon. The cyclical industries like cement, steel, sugar etc., are the examples of value stocks.

g. Specialty Funds - Specialty funds are concentrated on particular industry or companies. Concentration is based on certain criteria for investments and those criteria must match with their portfolio. It is much riskier than other funds.

i. **Sector Funds:** The portfolio of sector funds comprises of only those companies that meet their criteria.

ii. **Foreign Securities Funds:** Fund manager invests in securities of one or more foreign companies. This fund gets the advantage of international diversification, but it has to face the foreign exchange rate risk and country risk.

iii. **Mid-Cap or Small-Cap Funds:** The Mutual Fund invests in securities of those companies whose market capitalization is lower. The market capitalization of Mid-

Cap companies is between ` 500 crore and ` 2500. In case of Small-Cap companies' market capitalization is lower than ` 500 crore. The market capitalization is the market price of the share multiplied by the number of outstanding shares of the company. The volatility of this type of companies' securities is very high but the liquidity is very low. Due to this high volatility and low liquidity the risk of this kind of companies' securities will be very high.

iv. **Option Income Funds:** Option income funds are those funds invested in high yielding companies. The options are used for hedging activity i.e., to reduce the risk or volatility. The risk can be controlled by way of proper utilization of options. It generates stable income for investors.

Money Market / Liquid Funds

Money market instruments are short-term interest bearing debt securities i.e., Treasury bills issued by Governments, (30 days, 60 days, 90 days etc., but maturing within one year), certificate of deposits issued by banks, commercial papers issued by companies etc.,. These securities are having high liquidity and safety. The investments in these funds are called money market/liquid funds. The risk of these funds is due to interest rate fluctuation.

Hybrid Funds

Hybrid funds comprise the portfolio of equities, debts and money market securities. The debt and equity are equal in proportion for the investment.

The types of hybrid funds in India are as follows:

a. Balanced Funds

The equal proportion of debt, equity, preference and convertible securities is the portfolio of balanced funds. It gives regular income and moderates capital appreciation to investors. The risk of capital is at the minimum level. This fund is suitable for traditional investors of those who prefer long term investment.

b. Growth-and-Income Funds

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The combination of the features of growth funds and income funds is referred as Growthand Income Funds. The capital appreciation as well as declaration of high dividend companies' securities is comprised in the portfolio of this fund.

c. Asset Allocation Funds

There are two types of investment avenues namely financial assets (equity, debt, money market instruments) and non-financial assets (real estate, gold, commodities). The fund manager may adopt the strategy of variable asset allocation. It allows change over from one asset to another at any time depending upon the market trends.

Debt / Income Funds

The investment of debt or income funds is purely only on the debt instruments issued by private companies, banks, financial institutions, governments and other entities. These funds are suitable to those investors who expect regular income and low risk. Debt instruments are graded by credit rating agencies. Grading indicates the risk of the debt securities. There are different types of debt funds based on investment objectives, which are as follows:-

a. Diversified Debt Funds

The portfolio of the fund comprises the debt securities of all companies belonging to all industries. The result of diversified investments in all sectors is risk reduction.

b. Focused Debt Funds

Debt funds that invest in debt securities issued by entities belonging to a particular sector or companies of the market are known as focused debt funds.

e. Fixed Term Plan Series

The funds' attracts the short-term investors and invests in short term debt securities. It is a closed-end scheme that offers a series of plans and issues units to investors at regular intervals.

But these plans are not listed on the stock exchanges.

Gilt Funds

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The portfolio of Gilt fund' is only the government securities of medium and long term matured bonds. It provides much safety to the investors with no credit risk. But it is exposed to interest rate risk.

Commodity Funds

The focus of investment of this fund is on different commodities, such as metals (like gold, silver, copper etc.,), food grains, oils, etc., or options and futures, contracts of commodities, commodity producing companies etc. The concentration of investment may be made on a specialized commodity or on a diversified commodity fund. Specialized commodity fund bears more risk than that of diversified commodity fund.

Real Estate Funds

Real estate investment provides higher capital appreciation and generates regular and higher income to the investors. Real estate investment includes not only in direct investment in real estate but also investments in securities of housing finance companies or lending to real estate developers.

Exchange Traded Funds (ETF)

Exchange Traded Funds are traded on stock exchanges like a single stock at index linked prices and it follows stock market indices. Investors of this fund get benefits of both closed-end fund and open-end mutual fund. It is very popular in London and New York stock exchanges. In India, it is introduced recently. This fund is more diversified and flexible of holding like a single share.

Fund of Funds

It means funds of a mutual fund invested in units of mutual fund schemes offered by other Asset Management Companies. No investments are made on financial (shares, bonds) or physical assets of the Fund of Funds. The investors of this fund get benefit of diversifying into different mutual fund schemes with a small amount of investment. And also, it facilitates diversification of risks.

Importance / Benefits of Mutual Funds

Mobilizing Small Savings

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Funds are mobilized by way of selling units. A unit is a proportional share of securities in the portfolio of a mutual fund. Small fund investors get benefits of portfolio investment with the small amount of their savings.

Investment Avenue

Mobilized funds are invested in various types of investment avenues. Investment avenues are Shares and Bonds of various Companies and Industries, Gold, Deposits, Govt. bonds, Money Market Instruments etc., Investors can get opportunity on the portfolio of assets proportionately.

Individual investors may not invest in all these investment avenues.

Professional Management

'Mutual Funds' utilizes professional experts and the experts manage the investment portfolios efficiently and profitably. Investors are free from taking risk of buying and selling shares.

Diversified Investment

Small investors can enjoy the benefit of portfolio investment through mutual funds.

Mutual funds have the advantage of diversified investment in various industry segments.

Liquidity

Mutual fund investors can buy and sell their units in the secondary market in case of close - ended mutual funds. In case of open-ended mutual funds, the investors can withdraw holdings any time at the Net Asset Value.

Less Risk

Mutual fund investment involves very less risk. Because, the fund is managed with the professional expertise, portfolio investment, diversification and the economies of scale in transaction cost.

Legal Protection

Securities Exchange Board of India (SEBI) is the regulatory body of securities market in India; it provides the regulations and guidelines for Mutual funds.

Tax Benefits

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Under the provisions of Income Tax Act, the investors of mutual fund can get tax shelter on the their investment in Mutual fund.

Minimum Transaction Costs

The transaction cost of buying and selling of mutual fund units is very less. This facilitates the investors to switch over from one scheme to another and they get benefit of flexible investment opportunities.

Economic Development

Mobilization of savings leads to investment. Mutual fund money is utilized for the investment in various industrial sectors. Industrial sector development leads to enhance the countries' economy.

Mutual Fund Vs Insurance

MUTUAL FUND	INSURANCE
Returns are higher	Lower returns, but risk too is low
Fund management is active	Ideal for long term investors
Lower distribution fees	Offer switching between asset classes without any load
Tax liabilities in some schemes	No Tax liability
Offers a range of products in debt and equity	Security is a big trigger for investing

MUTUAL FUNDS INDUSTRY IN INDIA

Mutual Fund in India was first started by **Unit Trust of India** (UTI) in the year 1964 in the form of investment trust. UTI initially started with open-ended mutual fund; the first unit scheme offered was the "US-64" and the face value of a single unit was ` 10, to attract the

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medium and low income group people. UTI enjoyed the monopoly of Mutual fund till 1987 and later the Government of India by amending the Banking Regulation Act, permitted commercial banks in the public sector to set up subsidiaries operating as trusts to perform the functions of mutual funds.

Before, the monopoly of the market had seen an ending phase; the Assets under Management (AUM) were ` 67 billion. The private sector entry to the fund family raised the AUM to ` 470 billion in March 1993 and at the end of April 2004; it reached the height of 1,540 billion.

Putting the AUM of the Indian Mutual Funds Industry into comparison, the total of it is less than the deposits of SBI alone and less than 11% of the total deposits held by the Indian banking industry. The main reason for its poor growth is that the mutual fund industry in India is new to the country. Hence, it is the prime responsibility of all mutual fund companies, to market correctly the product besides selling.

The growth of mutual fund industry in India is broadly put into four phases. The description of each phase is as under:

First Phase - 1964-87

In 1963, Unit Trust of India (UTI) was established by an Act of Parliament. It functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978, the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control from RBI. The first scheme launched by UTI was Unit Scheme 1964. The detailed notes about UTI are given separately in this unit.

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

Entry of Non-UTI Mutual Funds

SBI Mutual Fund was the first public sector mutual funds followed by Can bank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92), LIC (1989) and GIC (1990).

The end of 1993 marked ` 47, 004 crores as assets under management.

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

During 1993, a new era started in the Indian mutual fund industry due to the entry of private sector funds. The Mutual Fund Regulations came into existence under which all mutual funds were to be registered and governed except UTI. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993. In 1996, SEBI (Mutual Fund) Regulations were framed. During this phase, many foreign mutual funds were set up in India and the industry witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of ` 1, 21,805 crores out of which the assets of UTI alone were ` 44,541 crores

Fourth Phase - since February 2003

In February 2003, UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with AUM (Asset under Management) of ` 29,835 crores (as on January 2003). The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India does not come under the purview of the Mutual Fund Regulations. The second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It was registered under SEBI Mutual Fund Regulations Act 1996.

MAJOR MUTUAL FUND COMPANIES IN INDIA

ABN AMRO Mutual Fund

ABN AMRO Mutual Fund was setup on April 15, 2004 with ABN AMRO Trustee (India) Pvt. Ltd. as the Trustee Company. The AMC, ABN AMRO Asset Management (India) Ltd. was incorporated on November 4, 2003. Deutsche Bank AG is the custodian of ABN AMRO Mutual Fund

Birla Sun Life Mutual Fund

Birla Sun Life Mutual Fund is the joint venture of Aditya Birla Group and Sun Life Financial. Sun Life Financial is a global organization evolved in 1871 and is being represented in Canada, the US, the Philippines, Japan, Indonesia and Bermuda apart from India. Birla Sun Life Mutual Fund follows a conservative long-term approach to investment. Recently it crossed AUM of ` 10,000 crores.

Bank of Baroda Mutual Fund (BOB Mutual Fund)

Bank of Baroda Mutual Fund or BOB Mutual Fund was setup on October 30, 1992 under the sponsorship of Bank of Baroda. BOB Asset Management Company Limited is the AMC of BOB Mutual Fund and was incorporated on November 5, 1992. Deutsche Bank AG is the custodian.

HDFC Mutual Fund

HDFC Mutual Fund was setup on June 30, 2000 with two sponsorers namely Housing Development Finance Corporation Limited and Standard Life Investments Limited.

HSBC Mutual Fund

HSBC Mutual Fund was setup on May 27, 2002 with HSBC Securities and Capital Markets (India) Private Limited as the sponsor and Board of Trustees.

ING Vysya Mutual Fund

ING Vysya Mutual Fund was setup on February 11, 1999 with the same named Trustee Company. It is a joint venture of Vysya and ING. The AMC, ING Investment Management (India) Pvt. Ltd. was incorporated on April 6, 1998.

Prudential ICICI Mutual Fund

The mutual fund of ICICI is a joint venture with Prudential Plc. of America, one of the largest life insurance companies in the US of A. Prudential ICICI Mutual Fund was setup on 13th of October, 1993 with two sponsorers, Prudential Plc. and ICICI Ltd. The Trustee Company formed is Prudential ICICI Trust Ltd. and the AMC is Prudential ICICI Asset Management Company Limited incorporated on 22nd of June, 1993.

Mutual Fund

Sahara Mutual Fund was set up on July 18, 1996 with Sahara India Financial Corporation Ltd. as the sponsor. Sahara Asset Management Company Private Limited incorporated on August 31, 1995 works as the AMC of Sahara Mutual Fund. The paid-up capital of the AMC stands at ` 25.8 crore.

State Bank of India Mutual Fund

State Bank of India Mutual Fund is the first Bank sponsored Mutual Fund to launch offshore fund, the India Magnum Fund with a corpus of ` 225 cr. approximately. Today it is the largest Bank sponsored Mutual Fund in India. They have already launched 35 Schemes out of

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which 15 have already yielded handsome returns to investors. State Bank of India Mutual Fund has more than ` 5,500 Crores as AUM. Now it has an investor base of over 8 Lakhs spread over 18 schemes.

Tata Mutual Fund

Tata Mutual Fund (TMF) is a Trust under the Indian Trust Act, 1882. The sponsorers for Tata Mutual Fund are Tata Sons Ltd., and Tata Investment Corporation Ltd. The investment manager is Tata Asset Management Limited and its Tata Trustee Company Pvt. Limited. Tata Asset Management Limited's is one of the fastest in the country with more than ` 7,703 crores (as on April 30, 2005) of AUM.

Kotak Mahindra Mutual Fund

Kotak Mahindra Asset Management Company (KMAMC) is a subsidiary of KMBL. It is presently having more than 1, 99,818 investors in its various schemes. KMAMC started its operations in December 1998. Kotak Mahindra Mutual Fund offers schemes catering to investors with varying risk - return profiles. It was the first company to launch dedicated gilt scheme investing only in government securities.

Unit Trust of India Mutual Fund

UTI Asset Management Company Private Limited, established in Jan 14, 2003, manages the UTI Mutual Fund with the support of UTI Trustee Company Privete Limited. UTI Asset Management Company presently manages a corpus of over ` 20000 Crore. The sponsorers of UTI Mutual Fund are Bank of Baroda (BOB), Punjab National Bank (PNB), State Bank of India

(SBI), and Life Insurance Corporation of India (LIC). The schemes of UTI Mutual Fund are

Liquid Funds, Income Funds, Asset Management Funds, Index Funds, Equity Funds and Balance Funds.

Reliance Mutual Fund

Reliance Mutual Fund (RMF) was established as trust under Indian Trusts Act, 1882. The sponsor of RMF is Reliance Capital Limited and Reliance Capital Trustee Co. Limited is the Trustee. It was registered on June 30, 1995 as Reliance Capital Mutual Fund which was changed on March 11, 2004. Reliance Mutual Fund was formed for launching of various schemes under

which units are issued to the Public with a view to contribute to the capital market and to provide investors the opportunities to make investments in diversified securities.

Standard Chartered Mutual Fund

Standard Chartered Mutual Fund was set up on March 13, 2000 sponsored by Standard Chartered Bank. The Trustee is Standard Chartered Trustee Company Pvt. Ltd. Standard Chartered Asset Management Company Pvt. Ltd. is the AMC which was incorporated with SEBI on December 20, 1999.

Franklin Templeton India Mutual Fund

The group, Franklin Templeton Investments is a California (USA) based company with a global AUM of US$ 409.2 bn. (as of April 30, 2005). It is one of the largest financial services groups in the world. Investors can buy or sell the Mutual Fund through their financial advisor or through mail or through their website. They have Open end Diversified Equity schemes, Open end Sector Equity schemes, Open end Hybrid schemes, Open end Tax Saving schemes, Open end Income and Liquid schemes, Closed end Income schemes and Open end Fund of Funds schemes to offer.

Morgan Stanley Mutual Fund India

Morgan Stanley is a worldwide financial services company and its leading in the market in securities, investment management and credit services. Morgan Stanley Investment Management (MISM) was established in the year 1975. It provides customized asset management services and products to governments, corporations, pension funds and non-profit organisations. Its services are also extended to high net worth individuals and retail investors. In India it is known as Morgan Stanley Investment Management Private Limited (MSIM India) and its AMC is Morgan Stanley Mutual Fund (MSMF). This is the first close end diversified equity scheme serving the needs of Indian retail investors focusing on a long-term capital appreciation.

Escorts Mutual Fund

Escorts Mutual Fund was setup on April 15, 1996 with Exports Finance Limited as its sponsor. The Trustee Company is Escorts Investment Trust Limited. Its AMC was incorporated on December 1, 1995 with the name Escorts Asset Management Limited.

Alliance Capital Mutual Fund

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Alliance Capital Mutual Fund was setup on December 30, 1994 with Alliance Capital Management Corp. of Delaware (USA) as sponsorer. The Trustee is ACAM Trust Company Pvt. Ltd. and AMC, the Alliance Capital Asset Management India (Pvt) Ltd. with the corporate office in Mumbai.

Benchmark Mutual Fund

Benchmark Mutual Fund was setup on June 12, 2001 with Niche Financial Services Pvt. Ltd. as the sponsorer and Benchmark Trustee Company Pvt. Ltd. as the Trustee Company.

Incorporated on October 16, 2000 and headquartered in Mumbai, Benchmark Asset Management Company Pvt. Ltd. is the AMC.

Can bank Mutual Fund

Can bank Mutual Fund was setup on December 19, 1987 with Canara Bank acting as the sponsor. Can bank Investment Management Services Ltd. incorporated on March 2, 1993 is the AMC. The Corporate Office of the AMC is in Mumbai.

Chola Mutual Fund

Chola Mutual Fund under the sponsorship of Cholamandalam Investment & Finance Company Ltd. was setup on January 3, 1997. Cholamandalam Trustee Co. Ltd. is the Trustee Company and AMC is Cholamandalam AMC Limited.

LIC Mutual Fund

Life Insurance Corporation of India set up LIC Mutual Fund on 19th June 1989. It contributed ` 2 Crores towards the corpus of the Fund. LIC Mutual Fund was constituted as a Trust in accordance with the provisions of the Indian Trust Act, 1882.. The Company started its business on 29th April 1994. The Trustees of LIC Mutual Fund have appointed Jeevan Bima Sahayog Asset Management Company Ltd as the Investment Managers for LIC Mutual Fund.

GIC Mutual Fund

GIC Mutual Fund, sponsored by General Insurance Corporation of India (GIC), a Government of India undertaking and the four Public Sector General Insurance Companies, viz.

National Insurance Co. Ltd (NIC), The New India Assurance Co. Ltd. (NIA), The Oriental Insurance Co. Ltd (OIC) and United India Insurance Co. Ltd. (UII) and is constituted as a Trust in accordance with the provisions of the Indian Trusts Act, 1882.

The mutual funds are listed as follows:

A. Bank Sponsored

1. Joint Ventures – Predominantly Indian

Canara Robe co Asset Management Company Limited

SBI Funds Management Private Limited

2. Joint Ventures – Predominantly Foreign

Baroda Pioneer Asset Management Company Limited

3. Others

UTI Asset Management Company Ltd

B. Institutions

LIC Mutual Fund Asset Management Company Limited

C. Private Sector

1. Indian

- ✓ Axis Asset Management Company Ltd.
- ✓ Benchmark Asset Management Company Pvt. Ltd.
- ✓ DBS Cholamandalam Asset Management Ltd.
- ✓ Deutsche Asset Management (India) Pvt. Ltd.
- ✓ Edelweiss Asset Management Limited
- ✓ Escorts Asset Management Limited
- ✓ IDFC Asset Management Company Private Limited
- ✓ JM Financial Asset Management Private Limited
- ✓ Kotak Mahindra Asset Management Company Limited (KMAMCL)
- ✓ Quantum Asset Management Co. Private Ltd.

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- ✓ Reliance Capital Asset Management Ltd.
- ✓ Religare Asset Management Company Ltd.
- ✓ Sahara Asset Management Company Private Limited
- ✓ Tata Asset Management Limited
- ✓ Taurus Asset Management Company Limited

2. Foreign

- ✓ AIG Global Asset Management Company (India) Pvt. Ltd.
- ✓ FIL Fund Management Private Limited
- ✓ Fortis Investment Management (India) Pvt. Ltd.
- ✓ Franklin Templeton Asset Management (India) Private Limited
- ✓ Goldman Sachs Asset Management (India) Private Limited
- ✓ Mirae Asset Global Investments (India) Pvt. Ltd.

3. Joint Ventures – Predominantly Indian

- ✓ Birla Sun Life Asset Management Company Limited
- ✓ DSP Black Rock Investment Managers Private Limited
- ✓ HDFC Asset Management Company Limited
- ✓ ICICI Prudential Asset Mgmt. Company Limited
- ✓ Religare AEGON Asset Management Company Pvt. Ltd.
- ✓ Sundaram BNP Paribas Asset Management Company Limited

4. Joint Ventures – Predominantly Foreign

- ✓ Bharti AXA Investment Managers Private Limited
- ✓ HSBC Asset Management (India) Private Ltd.
- ✓ ING Investment Management (India) Pvt. Ltd.
- ✓ JPMorgan Asset Management India Pvt. Ltd.

- ✓ Morgan Stanley Investment Management Pvt.Ltd.
- ✓ Principal on Asset Management Co. Pvt. Ltd.
- ✓ Shinsei Asset Management (India) Pvt. Ltd.

Constitution and Management of Mutual Fund

A Mutual fund is formed as trust, which has sponsor, trustees, Asset Management Company (AMC) and custodian. Sponsor is like the promoters of a company. More than one sponsor establishes the trust. They take initiative for promoting the Mutual Fund. Trustee is the person/ firm/company/institutions who look after the assets of the mutual fund for the benefit of the unit holders. Normally, bankers, insurance companies are appointed as trustees, who supervise the assets of the mutual fund. Asset Liability Management Company (ALM) manages the 'funds' which is mobilized by mutual fund. ALM is expertise in the field of investment portfolio and approved by SEBI. They take care of Mutual funds' investments in various types of securities in a diversified manner. Custodian is the person/company who/which holds the securities of various schemes of the fund in his/its custody and who/which is registered with SEBI.

The trustees are vested with the general power of superintendence and direction over AMC. They monitor the performance and compliance of SEBI Regulations by the mutual fund. SEBI Regulations require that at least two thirds of the directors of trustee company or board of trustees must be independent i.e. they should not be associated with the sponsors. Also, 50% of the directors of AMC must be independent. The registration of mutual funds under SEBI is mandatory.

Sponsor

The sponsor is a body corporate which initiates the launching of a mutual fund. As per SEBI norms, it should have minimum 5 years of experience in the relevant field of financial services with good track record and its' contribution of capital must be 40% of the net worth of the Asset Management Company. It appoints trustees, an asset management company and custodians.

Trustees

Trustee is a manager of another's property. In mutual fund he holds the assets of mutual fund for the benefit of unit holders. The trust should be constituted under the provisions of Indian Trust Act.

Contents of Trust Deed

The trust deed shall contain such clauses as are mentioned in the third Schedule to the Indian trust Act and such other clauses which are necessary for safeguarding the interests of the unit holders.

- ✓ No trust deed shall contain a clause which has the effect of- limiting or extinguishing the obligations and liabilities of the trust in relation to any mutual fund or the unit holders; or

- ✓ Indemnifying the trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence or acts of commissions or omissions.

Approval of the Board for Appointment of Trustee

- ❖ No trustee shall initially or any time thereafter be appointed without prior approval of the Board.
- ❖ The existing trustees of any mutual fund may form a trustee company to act as a trustee with the prior approval of the Board.

Functions of the Trustees

- ✓ All assets of Mutual fund should be kept under the custody of trustee.
- ✓ It should provide information about the schemes to SEBI and Unit Holders.
- ✓ It can appoint an asset management company for floating of mutual fund schemes.
- ✓ It has rights to dismiss the AMC appointed by it.
- ✓ It has power to monitor and supervise the activities of AMC

Rights and Obligations of the Trustees

- ✓ The trustees and the asset management company shall with the prior approval of the Board enter into an investment management agreement.

- ✓ The trustees shall have a right to obtain from the asset management company such information as is considered necessary by the trustees.

- ✓ The trustees shall ensure that an asset management company has been diligent in empanelling the brokers, in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.
- ✓ The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme.

- ✓ The trustees shall be accountable for, and shall be the custodian of, the funds and property of the respective schemes and shall hold the same in trust for the benefit of the unit holders in accordance with these regulations and the provisions of trust deed.

- ✓ The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

- ✓ The trustees shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme in accordance with these regulations and the trust deed.

- ✓ The trustees shall quarterly review all transactions carried out between the mutual funds, Asset Management Company and its associates.

- ✓ The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy it that such contracts are executed in the interest of the unit holders.

Asset Management Company (AMC)

Asset Management company acts as investment manager and manages the affairs of Mutual Fund. It is appointed by the sponsor or the trustees. It should have a sound track record

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with a net worth of at least ` 100 crores. All schemes of the fund are operated by AMC and it is responsible for it. It may also operate as an underwriter with the approval of SEBI.

SEBI Regulations

The following rules and regulations of Securities Exchange of Board of India (SEBI) are related to the establishment and issue of schemes of Mutual Fund.

- ✓ Mutual fund shall be established in the form of trusts under the Indian Trust Act and managed by separately formed Asset Management Company.
- ✓ In the Board of directors of AMC must be 50% members are independent without the influence of sponsoring organization and they should have at least 10 years experience in the field of portfolio management.
- ✓ A minimum of ` 10 crores must have AMC as net worth
- ✓ An AMC can function for only one mutual fund and it is prohibited to work for another.
- ✓ AMCs are also allowed to do other fund based businesses such as providing investment management services to offshore funds, venture capital funds and insurance companies.
- ✓ Minimum issue of fund for closed-end scheme and open end scheme should be ` 20 crores and ` 50 crores respectively.
- ✓ The maximum period for subscription is 45 days in case of close-end schemes, but no such limitation in case of open – end scheme.
- ✓ The entire subscription has to be returned to the investors when the minimum amount or 60% of the target amount is not raised.
- ✓ There should be a separate and responsible fund manager for each scheme.

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- ✓ To protect the small investors, SEBI restrict the portfolio investment of Mutual Fund in a single company by 10% of Net Assets Value of a scheme.
- ✓ The issue expenses are restricted to 6% of raising funds under each scheme.
- ✓ A minimum of 90% of the profits must distribute to the unit holders in any given year.
- ✓ Accounting and Auditing of Mutual funds are mandatory and furnish the audited Annual statements to SEBI.
- ✓ SEBI has power to impose penalty on mutual funds for violation of SEBI guidelines.

New SEBI Guidelines for Mutual Funds

The Securities and Exchange Board of India (SEBI) has brought in sweeping changes for the mutual fund industry, the impact of which will be felt on the investor in more ways than one.

First, for New Fund Offers (NFOs)

They will **only be open for 15 days**. (ELSS funds though will continue to stay open for up to 90 days) It will save investors from a prolonged NFO period and being harangued by advisors and advertisements. The motivation behind the rule seems to be simple; investor can invest anytime, no need to wait for NFO period.

NFOs can only be invested at the Close of the NFO Period

Earlier, Mutual funds would keep an NFO open for 30 days, and the minute they received their first cheque, the money would be directly invested in the market; creating a skewed accounting for those that entered later since they get a fixed NFO price.

Dividends can now only be paid out of Actually Realized Gains

Impact: it will reduce both the quantum of dividends announced, and the measures used by MFs to gather investor money using dividend as an incentive to attract new investors.

Equity Mutual funds have been asked to play a **more active role in corporate governance** of the companies they invest in. This will help mutual funds become more active and not just that, they must reveal, in their annual reports from next year, what they did in each "vote". SEBI has now made it mandatory for funds to disclose whether they voted for or against

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moves (suggested by companies in which they have invested) such as mergers, demergers, corporate governance issues, appointment and removal of directors. MFs have to disclose it on their website as well as annual reports.

Equity Funds were allowed to charge 1% more as management fees if the funds were "no-load"; but since SEBI has banned entry loads, this extra 1% has also been removed.

SEBI has also asked Mutual Funds to reveal all commission paid to its sponsor or associate companies, employees and their relatives.

Regarding the Fund-of-Fund (FOF) – The market regulator has stated that information documents that Asset Management Companies (AMCs) have been entering into revenue sharing arrangements with offshore funds in respect of investments made on behalf of Fund of Fund schemes create conflict of interest. Henceforth, AMCs shall not enter into any revenue sharing arrangement with the underlying funds in any manner and shall not receive any revenue by whatever means/head from the underlying fund.

These guidelines set by the SEBI will lead to greater transparency for the common investor. SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. With these guide lines falling in place, it would create better trust and transparency and investable environment that would attract investors with greater faith and confidence.

UNIT TRUST OF INDIA AND MONEY MARKET MUTUAL FUNDS

Unit Trust of India

Establishment

The Unit Trust of India (UTI) was established by the government of India on 1st February, 1964 under the Unit Trust of India Act, 1963 (the bill was introduced by the then Finance Minister Sri.T.T.Krishnamachari).

Structure

The initial capital of UTI was ` 5 crores which was contributed by Reserve Bank of India (RBI), State Bank of India (SBI), Life Insurance Corporation of India (LIC), Scheduled banks and foreign banks. The management was entrusted to an independent Board of Trustees appointed by the Government.

Objectives

The basic objective of the UTI is to offer both small and large investors the means of acquiring shares in the widening prosperity resulting from the steady, industrial growth of the country.

There are two primary objectives of UTI,

- ✓ To promote and pool the small savings from the lower and middle income people who cannot have direct access to the stock exchange, and
- ✓ To give them an opportunity to share the benefits and fruits of prosperity resulting from rapid industrialization in India.

Functions

The main functions of UTI are as follows:

- ✓ To encourage savings of lower and middle-class people.
- ✓ To sell units to investors in different parts of the country.
- ✓ To convert the small savings into industrial finance.
- ✓ To give them an opportunity to share the benefits of industrialization in the country.
- ✓ To provide liquidity to units.

Recent Developments and Investment Policies of UTI

UTI Mutual Fund is managed by UTI Asset Management Company Private Limited (Estb: on Jan 14, 2003) appointed by the UTI Trustee Company Private Limited for managing the schemes of UTI Mutual Fund and the schemes transferred / migrated from UTI Mutual Fund. UTI Mutual Fund has come into existence with effect from 1st February 2003. UTI Asset

Management Company presently manages a corpus fund of over ` 34,500 Crores. UTI Mutual Fund has a track record of managing a variety of schemes catering to the needs of every class of citizenry. It has a nationwide network consisting 70 UTI Financial Centers (UFCs) and UTI International offices in London, Dubai and Bahrain.

Types of Funds

UTI funds are classified based on the following two aspects:-

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I. Maturity period

II. Investment objective

I. Based on Maturity

a. Open-Ended Fund/Scheme

An open-ended fund or scheme is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices, which are declared on a daily basis.

The key feature of open-ended schemes is its liquidity.

b. Close-Ended Fund/Scheme

A close-ended fund or scheme has a stipulated maturity period, say for example 5-7 years. The fund is open for subscription only during a specified period at the time of launching of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme through the stock exchanges where the units are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI Regulations stipulate that at least one of the two exit routes is provided to the investor i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

II. Investment Objective

a. Liquid Funds Category

UTI - Money Market Fund - It is an open-ended pure debt liquid plan, seeking to provide highest possible current income, by investing in a diversified portfolio of short-term money market securities.

UTI - Floating Rate Fund - It is to generate regular income through investment in a portfolio comprising substantially of floating rate debt / money market instruments and fixed rate debt / money market instruments.

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UTI - Liquid Fund Cash Plan - The scheme seeks to generate steady & reasonable income with low risk & high level of liquidity from a portfolio of money market securities & high quality debt.

b. Income Funds Category

UTI - G-Sec Fund - Investment Plan - It is an open-end Gilt-Fund with the objective to invest only in Central Government securities including call money, treasury bills and repos of varying maturities with a view to generate credit risk free return.

UTI - G-Sec Fund - Short Term Plan - It is an open-end Gilt-Fund with the objective to invest only in Central Government securities including call money, treasury bills and repos of varying maturities with a view to generate credit risk free return.

- ✓ UTI - GILT Advantage Fund -LTP - It is to generate credit risk-free return through investments in sovereign securities issued by the Central and / or a State Government LTP.
- ✓ UTI - Variable Investment Scheme - It is an open ended debt oriented fund with 100% investment in Debt/G-sec. Investment can be made in the name of the children upto the age of 15 years.
- ✓ UTI - Bond Advantage Fund - LTP - It aims to generate attractive returns consistent with capital preservation and liquidity.
- ✓ UTI - Monthly Income Scheme – It is an open-ended debt oriented fund investing a minimum of 90% in Debt and G-Sec and a maximum of 10% in equity instruments. The fund aims to distribute income periodically and it is best suited to the investors.
- ✓ UTI - Liquid Fund - Short Term Plan - The scheme seeks to generate steady & reasonable income with low risk & high level of liquidity from a portfolio of money market securities & high quality debt.
- ✓ UTI - MIS - Advantage Plan – It is to generate regular income through investments in fixed income securities and capital appreciation / dividend income through investment of a portion of net assets of the scheme in equity and equity related instruments so as to endeavor to make periodic income distribution to Unit holders.

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- ✓ UTI - Bond Fund – It is an open-end 100% pure debt fund, which invests in rated corporate debt papers and government securities with relatively low risk and easy liquidity.
- ✓ UTI - Capital Protection Oriented Scheme - The scheme will invest in a portfolio predominantly of fixed income securities that are maturing in line with duration of the respective plans. Each Plan will have a separate portfolio. The debt component of the portfolio structure shall have the highest investment grade rating. The equity components of the scheme will mainly focus on those companies / stocks that have potential to appreciate in the medium to long run.

c. Asset Allocation Funds Category

UTI - Variable Investment Scheme - The UTI Variable Investment Scheme is an openended scheme with dynamic allocation between equity and debt classes.

d. Index Funds Category

UTI - Master Index Fund - UTI MIF is an open-ended passive fund with the primary investment objective to invest in securities of companies comprising the BSE sensex in the same weight age as these companies have in BSE sensex.

UTI - Nifty Index Fund - UTI NIF is an open-ended passive fund with the objective to invest in securities of companies comprising of the S&P CNX Nifty in the same weight age as they have in S&P CNX Nifty.

UTI - Gold Exchange Traded Fund – Its objective is to endeavor to provide returns that, before expenses, closely track the performance and yield of Gold.

e. Equity Funds Category

UTI - Equity Tax Saving Plan - It is an open-ended equity fund investing a minimum of 80% in equity and equity related instruments. It aims at enabling members to avail tax rebate under Section 88 of the IT Act and provide them with the benefits of growth.

UTI - Master share unit Scheme – It is an open-end equity fund aiming to provide benefit of capital appreciation and income distribution through investment in equity.

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UTI – Master gain Unit Scheme - Master Gain is open-ended equity scheme with an objective of investing at least 80% of its funds in equity and equity related instrument with medium to high risk profile and up to 20% in debt and money market instruments with low to medium risk profile.

UTI - Opportunities Fund - This scheme seeks to generate capital appreciation and/or income distribution by investing the funds of the scheme in equity shares and equity-related instruments.

UTI - Software Fund – It is an open-ended fund which invests exclusively in the equities of the Software Sector companies. One of the growth sectors funds aiming to invest in equity shares of companies belonging to information technology sector to provide returns to investors through capital growth as well as through regular income distribution.

UTI - Banking Sector Fund - It is an open-ended equity fund with the objective to provide capital appreciation through investments in the stocks of the companies/institutions engaged in the banking and financial services activities.

UTI - Master Value Fund - It is an open-ended equity fund investing in stocks which are currently undervalued to their future earning potential and carry medium risk profile to provide 'Capital Appreciation'.

UTI - MNC Fund – It is an open-ended equity fund with the objective to invest predominantly in the equity shares of multinational companies in diverse sectors such as FMCG, Pharmaceutical, Engineering etc.

UTI - Mid Cap Fund – It is an open-ended equity fund with the objective to provide 'Capital appreciation' by investing primarily in mid cap stocks.

UTI - Infrastructure Fund – It is an open-ended equity fund with the objective to provide Capital appreciation through investing in the stocks of the companies engaged in the sectors like Metals, Building materials, oil and gas, power, chemicals, engineering etc. The fund will invest in the stocks of the companies which form part of Basic Industries.

UTI - Leadership Equity Fund - This scheme seeks to generate capital appreciation and/or income distribution by investing the funds of the scheme in stocks that are “Leaders” in their respective industries/sectors/sub-sector.

UTI - Contra Fund - The fund aims to provide long-term capital gain/dividend distribution through investments in listed equities and equity-related instruments. The Fund’s investment policies are based on insights from behavioral finance.

UTI - Wealth Builder Fund - The objective of the scheme is to achieve long term capital appreciation by investing predominantly in a diversified portfolio of equity and equity related instruments.

UTI - Long-Term Advantage Fund - The investment objective of the scheme is to provide medium to long term capital appreciation along with income tax benefit.

UTI - India Lifestyle Fund – Its aim is to provide long term capital gain and/or income distribution from a diversified portfolio of equity and equity related instruments of companies that are expected to benefit from changing Indian demographics, Indian lifestyles and rising consumption pattern.

f. Balanced Funds Category

I. UTI - Balanced Fund – It is an open-ended balance fund investing between 40% to 60% in equality related securities and the balance in debt (fixed income securities) with a view to generate regular income together with capital appreciation.

II. UTI - US 2002 – It is an Open-ended balance fund scheme aims at providing income distribution/ cumulation of income and capital appreciation over a long term from a prudent portfolio mix of equity and fixed income securities.

III. UTI - Mahila Unit Scheme – It is an open-ended scheme is designed with a minimum 70% investment in Debt/G-Securities and a maximum 30% investment in equity. The fund is designed to provide an enabler to adult female persons in pooling their own savings and/ or gifts into an investment vehicle so as to get periodic cash flow near to the time of any chosen festival/

occasion or to allow income/ gains redeployed in the scheme and repurchase units partially or fully as and when desired.

IV. UTI – Children's Career Plan (Balanced) - It is an open-ended debt oriented fund with investment in Debt/G-Securities of minimum 60% and a maximum of 40% in Equity. Investment can be made in the name of the children up to the age of 15 years so as to provide them, after they attain the age of 18 years, to receive scholarship to meet the cost of higher education and/or to help them in setting up a profession, practice or business or enabling them to set up a home or finance the cost of other social obligation.

V. UTI - CRTS - This is an open-end income oriented scheme. The scheme aims at catering to the investment needs of charitable, religious, educational trusts and similar institutions to provide them an investment vehicle to avail of tax exemption and also to have regular income.

VI. UTI - ULIP - This is an open-ended balanced fund with an objective of investing not more than 40% of the funds in equity and equity related instruments and balance in debt and money market instruments with low to medium risk profile. Investment by an individual in the scheme is eligible for exemption under section 88 of the IT Act 1961. In addition the scheme also offers Life Insurance and Accident Insurance cover.

VII. UTI - Retirement Benefit Pension Fund **-** It is an open-ended balanced fund with a maximum equity allocation of 40% and the balance in debt. This ensures to provide pension to investors particularly self-employed persons after they attain age of 58 years, in the form of periodical cash flow up to the extent of repurchase value of their holding through systematic withdrawal plan.

EVALUATION OF PERFORMANCE OF MUTUAL FUNDS

Performance Measures of Mutual Funds

Mutual Fund industry today, with about 34 players and more than five hundred schemes, is one of the most preferred investment avenues in India. However, with such a huge number of schemes to choose from, the retail investor faces problems in selecting funds. Factors such as investment strategy and management style are qualitative, but the 'funds performance record' is

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an important indicator too. Though past performance alone cannot be indicative of future performance, it is, frankly, the only quantitative way to judge how good a fund is at present.

Therefore, there is a need to correctly assess the past performance of different mutual funds. Worldwide, good mutual fund companies are known by their AMCs and this fame is directly linked to their superior stock selection skills. For mutual funds to grow, AMCs must be held accountable for their selection of stocks. In other words, there must be some performance indicator that will reveal the quality of stock selection of various AMCs.

Return alone should not be considered as the basis of measurement of the performance of a mutual fund scheme. It should also include the risk taken by the fund manager because different funds will have different levels of risk attached to them. Risk associated with a fund, in general, can be defined as variability or fluctuations in the returns generated by it. The higher the fluctuations in the returns of a fund are during a given period, the higher is the risk associated with it.

These fluctuations in the returns generated by a fund are resultant of two guiding forces. The first one is general market fluctuations, which affect all the securities, present in the market, called market risk or systematic risk and second is fluctuations due to specific securities present in the portfolio of the fund, called unsystematic risk. The **total risk** of a given fund is the sum of these two and is measured in terms of **standard deviation** of returns of the fund. Systematic risk, on the other hand, is measured in terms of **Beta**, which represents fluctuations in the NAV of the fund as against market. The more responsive the NAV of a mutual fund is to the changes in the market; higher will be its beta. Beta is calculated by relating the returns on a mutual fund with the returns in the market. While unsystematic risk can be diversified through investments in a number of instruments, systematic risk cannot be.

In order to determine the risk-adjusted returns of investment portfolios, several eminent authors have worked since 1960s to develop composite performance indices to evaluate a portfolio by comparing alternative portfolios within a particular risk class. The most important and widely used measures of performance are:

✓ The Trey nor Measure

✓ The Sharpe Measure

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✓ Jenson Model

✓ Fama Model

Money Market Mutual Funds

In April 1991, Money Market Mutual Funds (MMMFs) were introduced in India. They provide an additional short term investment avenue to investors and bring money market instruments within the reach of individuals.

A money market mutual fund is a fund that invests solely in money market instruments. Money market instruments are forms of debt that mature in less than one year and have high liquidity. Treasury bills make up the bulk of the money market instruments. Securities in the money market are relatively risk-free and most secure mutual fund investments. Its aim is to preserve principal while yielding a modest return. It is similar to a high-yield bank account but is not entirely risk free. Investor should concentrate on the rate of interest.

Types of Money Market Mutual Funds

a) Institutional Money Market Mutual Funds

These funds are held by governments, institutional investors and businesses etc. Huge sum of money is parked in institutional money funds.

b) Retail Money Market Mutual Funds

Retail money market funds are used for parking money temporarily. The investment portfolio of money market funds comprises of treasury bills, short term debts, tax free bonds etc.

Special Features of Money Market Mutual Funds

✓ Money market mutual funds are one of the safest instruments of investment for the retail low income investors. The assets in a money market fund are invested in safe and stable instruments of investment issued by governments, banks, corporations etc.

✓ Generally, money market instruments require huge amount of investments and it is beyond the capacity of an ordinary retail investor to invest such large sums. Money market funds allow retail investors the opportunity of investing in money market instrument and benefit from the price advantage.

✓ Money market mutual funds are usually rated by the rating agencies.

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RBI GUIDELINES

RBI Guidelines on MMMFs

The setting up of MMMFs would require the prior authorization of the Reserve Bank. Furthermore, the MMMFs to be set up by banks, their subsidiaries and public financial institutions would be required to comply with the guidelines and directives that may be issued by the RBI from time to time. Although the guidelines were issued in 1992-93, yet no institutions has so far come forward to establish a MMMF. The major hurdle has been the stringent limits for investments prescribed by the RBI. Moreover, the relative quietness on the money market front led to the absence of the “necessity” factor to establish MMMFs.

In November 1995, the RBI permitted the private sector mutual funds to set up MMMFs, with a view to provide greater liquidity and depth to the money market. While allowing the private sector MFs, the RBI also relaxed some of the earlier guidelines. The important relaxations were

1. Ceiling for raising resources and minimum size of ` 500 million withdrawn.

2. Minimum limit 25% while investing in T-bills and the Government of India papers of residual maturity up to 1 year withdrawn

3. Maximum limit of 30% while investing in call/notice money withdrawn

4. Maximum limit of 15% while investing in CPs withdrawn

5. Maximum limit of 20% while investing in Commercial bills withdrawn

6. Dividend / income on subscriptions by individual NRI in MMMFs can be repatriated, but not principal

7. Private sector MMMF should need the RBI and SEBI approval

In April 1992, the Reserve Bank announced the guidelines for Money Market Mutual Funds. The Reserve Bank had made several modifications in the scheme to make it more flexible and attractive to banks and financial institutions. These guidelines were subsequently incorporated into the revised SEBI regulations. In October 1997, MMMFs were permitted to invest in rated

corporate bonds and debentures with a residual maturity of up to one year, within the ceiling existing for Commercial Paper (CPs). The minimum lock-in period was also reduced gradually to 15 days, making the scheme more attractive to investors. MMMFs would come under the purview of SEBI regulations. Banks and Financial Institutions desirous of setting up MMMFs would however have to seek necessary clearance from RBI for undertaking this additional activity before approaching SEBI for registration.

Venture Capital

Introduction

Venture Capital is a form of "risk capital" which is invested in a project or a business where there is a substantial element of risk relating to the future creation of profits and cash flows. Risk capital is invested as shares (equity) rather than as a loan and the investor requires a higher "rate of return" to compensate him for his risk.

Concept

Venture capital provides seed capital or funding for expansion of companies in the form of share capital, to help unquoted companies grow and succeed. If an entrepreneur is looking to start-up, expand, buy-into a business, buy-out a business in which he works, turnaround or revitalize a company etc., venture capital could help do this. Obtaining venture capital is substantially different from raising a debt or a loan from a lender. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of the success or failure of a business.

Venture capital is invested in exchange for an equity stake in the business. As a shareholder, the venture capitalists' return is dependent on the growth and profitability of the business. This return is generally earned when the venture capitalist "exits" by selling its shareholding when the business is sold.

Origin

Venture capital funding is first originated in the UK in the late 18th century, when European entrepreneurs and merchant bankers were helping the growth of industry in USA, South Africa and India. This informal method of financing became an industry in the late 1970s and early 1980s when a number of venture capital firms were founded. There are now over 100

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active venture capital firms in the UK, which provideseveral billion pounds each year to unquoted companies mostly located in the UK. The venture capital funds are active in UK in the form of

- ✓ Clearing bank captive funds,
- ✓ Funds sponsored by savings and investment institutions and merchant bankers
- ✓ Business expansion scheme funds
- ✓ Corporate, academic and other private sector funds
- ✓ Semi-State bodies (both Central and Local Government).

Venture Capital and Development Capital

Venture capital is advanced for ventures using a new technology or new innovation. The venture capital company remains interested in the overall management of the project due to the high risk involved in the venture. Funds are made available throughout the project, commencing from commercial production to the successful marketing of products, to ensure continuous revenue earnings, enhanced worth of the investments and finally making available a proper exit route for liquating the investments.

Development capital is generally granted in the form of loans for setting up industrial units, and also for expansion and modernization. The lender takes special care in ensuring the end use of the credit and requires prompt payment of interest and repayment of the loan amount.

Types of Venture Capital Financing

There are three main groups into which venture capital investment can be divided. They are early stage, expansion, and buyout. Each of these groups is further divided into subgroups, as illustrated in the chart on the next page:

Early Stage

Early stage investing is divided into three subgroups: seed financing, startup financing, and 1st stage financing.

Seed Financing

This type of financing will be very early in the life of the business, usually pre-revenue and sometimes even before the product or service is created. It will also make it easier for the

entrepreneur to get loans after being financed this way. The entrepreneur will use seed money for market research and early product or service development.

Startup Financing

Startup financing is used by businesses to finish the development of their products and services. In some cases, it will also be used for marketing the products and services. This helps the company launch their operations.

1st Stage Financing

This is the last subgroup of financing in the early stage category, and would be used to continue operations of the company at a higher scale. Products (or services) would start to be produced in a large scale, and the initial funding would have been used by this time.

Expansion

Expansion investing is also broken up into three subgroups: 2nd stage financing, bridge financing, and 3rd stage financing.

2nd Stage Financing

This stage of financing is used by a business for initial expansion plans whether that involves products or services. The company usually will not be profitable even after receiving this type of financing.

Bridge Financing

Bridge financing is used as a short term investment that will maintain liquidity, especially if an inflow of cash is going to be received. One example could be if the company plans to have an IPO, bridge financing can be used to sustain the company for a short period of time that is till it receives money from the allot tees.

3rd Stage Financing

This type of financing is also called mezzanine financing, and is invested into a company that has achieved its breakeven point, and in some cases is achieving profitability. This type of financing will be used by a company for marketing, plant expansion, and new products or services.

Buyout

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The buyout stage of investing can be broken down into two subgroups: acquisition financing and leveraged buyouts (LBO).

Acquisition Financing

This type of financing is used to acquire either part of a company or the entire company. The original business making the acquisition would have expanded to the point where this strategy is feasible.

Leveraged Buyout (LBO)

This type of financing is otherwise known as a management buyout. The management group of the company will acquire an equity stake in a company and potentially buyout certain assets of the company. The company acquisition will be primarily financed through debt. Management teams or companies themselves use this strategy when they do not want to commit capital to the deal.

Venture Capital Firms - Fund Sources

There are several sources for raising funds by Venture capital firms. To obtain their funds, venture capital firms have to reveal a good track record and the prospect of producing returns greater than can be achieved through fixed interest or quoted equity investments. Most UK venture capital firms raise their funds for investment from external sources, mainly institutional investors, such as pension funds and insurance companies.

Venture capital firms' investment preferences may be affected by the source of their funds. Many funds raised from external sources are structured as Limited Partnerships and usually have a fixed life of 10 years. Within this period the funds invest the money committed to them and by the end of the 10th year they will have to return the investors' original money, plus any additional returns made. This generally requires the investments to be sold, or to be in the form of quoted shares, before the end of the fund.

Venture Capital - Investment Process

The investment process, from reviewing the business plan to actually investing in a proposition, can take a venture capitalist any period from one month to one year but typically it takes between 3 and 6 months. There are always exceptions to the rule and deals can be done in

extremely short time frames. Much depends on the quality of information provided and made available.

The key stage of the investment process is the initial evaluation of a business plan. Most approaches to venture capitalists are rejected at this stage. In considering the business plan, the venture capitalist will consider several principal aspects such as:

- ✓ Is the product or service commercially viable?
- ✓ Does the company have potential for sustained growth?
- ✓ Does the management have the ability to exploit this otential and control the company through the growth phases?
- ✓ Does the possible reward justify the risk?
- ✓ Does the potential financial return on the investment meet their investment criteria?

In structuring its investment, the venture capitalist may use one or more of the following types of share capital:

Ordinary Shares

These are equity shares that are entitled to all income and capital after the rights of all other classes of capital and creditors have been satisfied. Ordinary shares holders have voting rights. In a venture capital deal these are the shares typically held by the management and family shareholders rather than the venture capital firm.

Preferred Ordinary Shares

These are equity shares with special rights. For example, they may be entitled to a fixed dividend or share of the profits. Preferred ordinary shares holders have voting rights.

Preference Shares

These are non-equity shares. They rank ahead of all classes of ordinary shares for both income and capital. Their income rights are defined and they are usually entitled to a fixed dividend. The shares may be redeemable on fixed dates or they may be irredeemable. Sometimes they may be redeemable at a fixed premium (eg. at 120% of cost). They may be convertible into a class of ordinary shares.

Loan Capital

Venture capital loans typically are entitled to interest and are usually, though not necessarily, repayable. Loans may be secured on the company's assets or may be unsecured. A secured loan will rank ahead of unsecured loans and certain other creditors of the company. A loan may be convertible into equity shares. Alternatively, it may have a warrant attached which gives the loan holder the option to subscribe for new equity shares on terms fixed in the warrant. They typically carry a higher rate of interest than bank term loans and rank behind the bank for payment of interest and repayment of capital.

Venture capital investments are often accompanied by additional financing at the point of investment. This is nearly always the case where the business in which the investment is being made is relatively mature or well-established. In this case, it is appropriate for a business to have a financing structure that includes both equity and debt.

Other forms of finance provided in addition to venture capitalist equity include:

Clearing banks – They principally provide overdrafts and short to medium-term loans at fixed or, more usually, variable rates of interest.

Merchant banks – They organize the provision of medium to longer-term loans, usually for larger amounts than clearing banks. Later they can play an important role in the process of "going public" by advising on the terms and price of public issues and by arranging underwriting when necessary.

Finance houses - They provide various forms of installment credit, ranging from hire purchase to leasing; often asset based and usually for a fixed term and at fixed interest rates.

Factoring companies - They provide finance by buying trade debts at a discount, either on a recourse basis (you retain the credit risk on the debts) or on a non-recourse basis (the factoring company takes over the credit risk).

Government and European Commission sources - They provide financial aid to UK companies, ranging from project grants (related to jobs created and safeguarded) to enterprise loans in selective areas.

Mezzanine firms – They provide loan finance that is halfway between equity and secured debt. These facilities require either a second charge on the company's assets or are

unsecured. Because the risk is consequently higher than senior debt, the interest charged by the mezzanine debt provider will be higher than that by the principal lenders and sometimes a modest equity "up-side" will be required through options or warrants. It is generally most appropriate for larger transactions.

Venture Capital in India

Venture capital was originated in India very late. Bhatt Committee (Committee on Development of Small and Medium Entrepreneurs) in the year 1972 recommended the creation of venture capital. The committee urged the need for providing such capital to help new entrepreneurs and technologists in setting up industries.

Brief description of some of the venture capital funds of India is as follows:

Risk capital foundation: The Industrial Finance Corporation of India (IFCI) launched the first venture capital fund in the year 1975. The fund, 'Risk Capital Foundation' (RCF) aimed at supplementing promoters' equity with a view to encourage technologies and professionals to promote new industries.

Seed capital scheme: This venture capital fund was launched by IDBI in 1976, with the same objective in mind.

Venture capital schemes: Venture capital funding obtained official sponsorship with the announcement by the Central Government of the "Technology Policy Statement" in 1983. It prescribed guidelines for achieving technological self reliance through commercialization and exploitation of technologies. The ICICI, an all-India financial institution in the private sector set up a Venture Capital Scheme in 1986, to encourage new technocrats in the private sector to enter new fields of high technology with inherent high risk. The scheme aimed at allocating funds for providing assistance in the form of venture capital to economic activities having risk, but also high profit potential.

PACT: The ICICI undertook the administration of Program for Application of Commercial Technology (PACT) aided by USAID with an initial grant of US$ 10 million. The program aims at financing specific needs of the corporate sector industrial units along the lines of venture capital funding.

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Government fund: IDBI, as nodal agency, administers the venture capital fund created on April1, 1986, by the Central Government. The government started imposing a Research and Development (R & D) under the R & D Cess Act, 1986, levy on all payments made for the purchase of technology from abroad, including royalty payments, lump sum payments for foreign collaboration and payment for designs and drawings.

TDICI: In 1988, an ICICI sponsored company, viz, Technology Development and Information Company of India Ltd. (TDICI) was founded, and venture capital operations of ICICI were taken over by it with effect from July 1, 1988.

RCTFC: The Risk Capital Foundation (RCF) sponsored by IFCI was converted into Risk Capital and Technology Finance Corporation Ltd. (RCTFC) in the year 1988. It took over the activities of RCF in addition to the management of other financing technology development schemes and venture capital fund.

VECAUS: VECAUS–I, the UTI sponsored "Venture Capital Unit Scheme" was launched in the year 1989. Technology Development and Information Company of India Ltd. (TDICI) was appointed as its manager. In the year 1990, the corporation was also entrusted with the responsibility of managing another UTI sponsored venture fund named "VECAUS-II". In 1991, UTI launched VECAUS –III and RCTC was appointed as fund manager.

Other funds: The liberalized guidelines introduced by the government, in 1988 gave rise to the setting up of a number of venture capital funds, especially in the private sector.

Venture Leasing

A leasing arrangement in which the 'lessor' provides both the assets and the equity capital to the lessee is called venture leasing

Advantages

- ✓ Minimizes initial investments by startups
- ✓ Rentals can be tailored to the cash flow profile
- ✓ Equity participation can lower lease rentals
- ✓ Asset risk transferred to lessor

Disadvantages

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- ✓ May be difficult to offload equity stake
- ✓ Depreciation tax shield transferred to the lessor
- ✓ High agency costs to prevent misuse of asset
- ✓ Lower debt capacity for lessee.

UNIT - V

FINANCIAL SERVICES

Insurance

Introduction

Insurance is a contract whereby the insurer undertakes to compensate the insured for any loss suffered by the later in consideration of premium paid for certain period. There are different insurance companies such as LIC, GIC, United India, New India assurance etc., offering wide range of insurance options. They provide comprehensive coverage with affordable premium. An insured can choose the policy according to his needs and ability to pay periodical premium to cover the risk of insurance for the stipulated period. The periodical insurance premiums are calculated according to the total insurance amount specified or estimated value of the property/things insured.

Thus, Insurance provides financial protection against a loss arising out of happening of an uncertain event. Hence, insurance is used as an effective tool for **risk management**.

Definition

Insurance is a contract between two parties, whereby one party agrees to undertake the risk of another, in exchange for consideration known as **premium** and promises to pay a fixed sum of money to the other party on happening of an uncertain event (death) or after the expiry of a certain period/maturity period in case of life insurance or to indemnify the loss to the other party on happening of an uncertain event in case of general insurance. The party bearing the risk is known as the **'insurer'** or **'assurer'** and the party whose risk is covered is known as the **'insured'** or **'assured'**

Types of Insurance

Various types of insurances are as mentioned hereunder:

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Life insurance: Descendant's family receives insured amount in the case of death of the insured. In other case the insured himself gets the insured amount

Automobile/Motor insurance: Usually automobile insurances cover damages to the automobile and legal financial expenditure of the automobile driver/cleaner.

Workmen Compensation Insurance: It covers the employee for the loss of life or total/partial permanent disablement (loss of limb) or for occupational disease arising out of his employment during and in the course of his employment.

Health insurance: Health insurance covers the expenditure associated with treatment and medical expenditure including medicine.

Credit insurance: Borrowers often fail to repay the debts, loans and mortgages, due to certain unavoidable circumstances. Credit insurance can be of great help to the lenders during such crisis.

Property insurance: Property protection insurance provides protection from risks associated to theft, fire, floods etc. This type of insurance can be further classified into specialized forms as follows: -

- ✓ Fire insurance
- ✓ Earthquake insurance
- ✓ Flood insurance
- ✓ Home insurance
- ✓ Boiler insurance

At present insurance market is much vibrant than before and this has an impact on the rates of insurance premium.

Types of Insurance Companies

Insurance companies can be categorized into two main divisions which are classified as follows:

General Insurance Companies: They provide all types of insurance apart from life insurance i.e., fire insurance, marine insurance, vehicle insurance etc.,

Life Insurance Companies: The companies, dealing with life insurance, pension products and annuities are life insurance companies.

Types of Insurance Policies

Insurance provides compensation to a person for an anticipated loss to his life, business or an asset. Insurance is broadly classified into two parts covering different types of risks:

I. Life Insurance (Long-term)

II. General Insurance (Non-life Insurance).

I. Life Insurance

"A contract in which the insurer undertakes to a pay a certain sum of money to the insured, either on the expiry of a specified period, or on the death of the insured, in consideration of payment of 'premium' for a certain period of time, is known as 'life insurance".

It is otherwise called as **'Life Assurance'**. Generally, the tenure of Life insurance policy is long-term in nature; it may either be for a certain period or whole life period of the insured. Insurance against risk to one's life is covered under ordinary life assurance. Ordinary life assurance can be further classified into several types:

Types of Ordinary Life Assurance

1. Whole Life Assurance

In whole life assurance, insurance company collects premium from the insured for whole life or till the time of his retirement and pays claim to the family of the insured only after his death.

2. Endowment Assurance

In case of endowment assurance, the term of policy is defined for a specified period say about 15, 20, 25 or 30 years. The insurance company pays the claim to the family of the assured in the event of his death, within the policy's period or in an event of the assured surviving the

policy's period. In the event of the insured surviving beyond the coverage/specified period, the maturity value/sum assured along with bonus will be paid to the insured himself.

3. Assurances for Children

Child's Deferred Assurance

Under this policy, the insurance company pays the claim to the insured on the maturity date of the policy, which is calculated to coincide either with the date of child's eighteenth or twenty first birthday or attaining majority. The policy holder may either claim the payment on the date of maturity period or continue the insurance coverage. If the parent dies before the option date, the policy remains continued until the option date without paying premium for the remaining period. Suppose, the child dies before the option date, the parent gets back the premium plus bonus.

School fee policy

School fee policy can be availed by affecting an endowment policy on the life of the parent with the sum assured, payable in installments over the schooling period of their children.

4. Term Assurance

Term assurance is life insurance which provides coverage at a fixed rate of payments for a limited period of time in respect of the term offered by the assured. In case, the insured dies during the term, the death benefit will be paid to the beneficiary. If the insured survives after that period expires, either he has to pay additional premium for obtaining further coverage or he has to forgo coverage. It is the least expensive way to purchase a substantial death benefit on a coverage amount over a specific period of time.

5. Annuities

Annuity is a contract under which the insurer (insurance company) promises to pay the insured a series of payments until the insured's death. The insured make the premium payment in the mode of either lump sum or installments to the insurer. Generally, life annuity is chosen by a person having surplus wealth and wants to use this money after his retirement. **The annuities can be further classified into two types, which are as follows: -**

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a. **Immediate Annuity:** It means that the insured pays a lump sum amount (**purchase price**) to the insurer and in turn the insurer promises to pay him a specified sum on a monthly/quarterly/half-yearly/yearly basis.

b. **Deferred Annuity**: A deferred annuity can be purchased either by way of installments or by paying a single premium. The insured receives the annuity after the deferment period.

6) **Money Back Policy**

A money back policy is issued for a particular period, and the sum assured is paid through periodical payments to the insured, spread over this time period. In case of death of the insured within the term of the policy, full sum assured along with bonus accruing on it, is payable by the insurance company to the nominee of the deceased. Generally, Money back policy is preferred by the person, who requires periodical receipts.

II. General Insurance

General insurance is also known as non-life insurance. It is normally meant for a shortterm period of twelve months or less. In recent years, insurance companies are entering the longterm insurance agreements also and the period would not exceed five years. General insurance can be classified into the following categories:

Fire Insurance

Fire insurance provides protection against damage to property caused by accidents due to fire, lightening or explosion. Fire insurance also includes damage caused due to other perils like storm, tempest or flood, burst of pipes, earthquake, riot, civil commotion, malicious damage, explosion, impact (e.g. - aircraft).

Marine Insurance

Hull, cargo and freight are the three basic risk covering area for Marine insurance. Those risks areas are exposed to are collectively known as “Perils of the Sea”. These perils include theft, fire, collision etc.

✓ **Marine Cargo:** Marine cargo policy provides protection to the goods loaded in a ship against all perils between the departure and arrival to warehouse. Therefore, marine cargo covers carriage of goods by sea as well as transportation of goods by land.

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✓ **Marine Hull:** Marine hull policy provides protection against damage to ship caused due to the perils of the sea. In the event of any loss sustained due to collisions at sea, Marine hull policy covers only 3/4th liability of the hull owner (ship-owner) and the remaining 1/4th of the liability is looked after by associations formed by ship owners for the purpose.

Miscellaneous

Miscellaneous insurance covers all types of general insurance, except the fire and marine insurances. Some of the examples of general insurance are motor insurance, theft insurance, health insurance, personal accident insurance, money insurance, engineering insurance etc.

Insurance Industry in India

India has a deep-rooted history in the field of Insurance. In fact, the principles of insurance finds place, even in Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). Those writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pioneer to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts.

In 1818, the Oriental Life Insurance Company was established in Kolkata. It failed in the year 1834 due to the business of the Madras Equitable life insurance which was started in Madras from the year 1829. The Triton Insurance Company Ltd was formed in 1850 and it was the first general insurance sector in India. The British Insurance Act was enacted in 1870. The Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) insurance companies were started. In 1907, Indian Mercantile Insurance Limited was started, which was the first company to handle all forms of Indian insurance.

A new era began in the Indian insurance sector, by passing of the Life Insurance Act, 1912. The Indian Insurance Companies Act was passed in 1928. This Act empowered the Government of India to gather necessary information about the life insurance and non-life insurance organizations operating in the Indian financial markets. This Act was amended in 1938 with comprehensive provisions for effective control over the activities of insurers to protecting the interest of public. The Principal Agencies system was abolished in the Amendment Act of 1950. On 19th January, 1956 an ordinance was passed for nationalizing the Life Insurance Sector and the Life Insurance Corporation came into existence.

In 1972, with the passing of the General Insurance Business (Nationalization) Act, general insurance business was nationalized with effect from 1st January, 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commenced business on January 1st 1973.

Reforms in Indian Insurance Sector

In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. Following the recommendations of the Malhotra Committee Report, in the year 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premium, ensuring the financial security of the insurance market, to safeguard the interests of insurance policy holders and to initiate different policy measures to help sustain growth in the Indian insurance sector.

IRDA has notified 27 Regulations on various issues such as Registration of Insurers, Regulation on insurance agents, Solvency Margin, Re-insurance, Obligation of Insurers to Rural and Social sector, Investment and Accounting Procedure, Protection of policy holders' interest etc. IRDA brought out guidelines on **Initial Public Offers** (IPOs).

At present, the number of Insurance companies operating in India is 24 General insurance companies and 23 Life insurance companies. The growth rate of insurance sector is enormously increasing day-by-day. The contribution of Insurance services sector in the country's GDP is 7%. Insurance sector is strengthening the risk taking ability of the country and promoting for economic development by providing long- term funds for infrastructure development.

CREDIT CARDS

Credit Cards Origin

Credit is a method of selling goods or services without the buyer having cash in hand. The concept of the credit card is **"buying now, pay later"** and it is a way of offering credit to a consumer. Credit card carries an identifying number that speeds shopping transactions.

According to Encyclopedia Britannica, "the use of credit cards originated in the United States during the 1920s, when individual firms, such as oil companies and hotel chains, began issuing them to customers." In olden days, Credit cards were issued by merchants to their customers on credit sales. These cards were accepted only by the issuer himself not by any other person and the seller would not accept the others' card. Around 1938, companies started to accept each other's cards. Today, credit cards allow making purchases with countless third parties.

The Shape of Credit Cards

Long ago, credit cards were made from metal coins, metal plates, celluloid, metal, fiber, and paper. Now-a-days, credit cards are mostly made of plastic.

First Bank Credit Card

The Flatbush National Bank of Brooklyn, New York was the first bank started issuing credit cards in 1946. The card was invented by John Biggins in the program namely "Charge-It" conducted between bank customers and local merchants. Merchants deposited sales slips into the bank and the bank billed the customer who used the card.

Diners Club Credit Card

In 1950, the Diners Club issued their credit card in the United States. Diners' Club founder Frank McNamara invented the Diners Club credit card and introduced to his customers intended to pay restaurant bills. The card holder of diners club could eat without money at any restaurant which would collect money from Diners' Club. Diners' Club would settle the restaurants' bill first and later they collect the bill amount along with some charges from the customer (card holder). So, the Diners Club card was called as **charge card**. In 1958, the first credit card was issued by American Express. Later bank of America also issued America bank credit card which is popularly known as **Visa card.**

THE POPULARITY OF CREDIT CARDS

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During 1960s, more companies offered credit cards, advertising them as a time-saving device rather than a form of credit. American Express and Master Card became popular overnight.

Standard Credit Cards

Standard credit cards are otherwise called as "plain-vanilla" credit cards which offer no additions or rewards. This is a common kind of credit cards which allows the card holder to have a revolving balance up to a certain credit limit. Card holders can use the card according to his needs and they have to settle their account before the due date. If he fails to pay before the due date interest is charged on outstanding balances at the end of each month.

Premium Credit Cards

Many incentives and benefits are offered by premium credit cards e.g. Gold and Platinum cards which offer cash back, reward points, travel upgrades, and other rewards to cardholders. The card holder of premium cards are charged higher fees and the card is issued to the person who has prescribed higher income and credit score requirements.

Charge Cards

Charge card is a type of credit card that requires the cardholders to pay their balance in full at the end of each billing cycle instead of making payments on the balance over several months. Charge cards do not have spending limit and finance (interest rate) charge. Late payments are subject to a fee, charge restrictions, or card cancellation depending on the card agreement.

Limited Purpose Cards

Limited purpose credit cards can only be used at specific locations. Limited purpose cards are used like credit cards with a minimum payment and finance charge. Store credit cards and gas credit cards, petro card are examples of limited purpose credit cards.

Secured Credit Cards

Instead of assessing credit worthiness, some money is to be deposited to get a secured credit card. The credit limit on a secured credit card is limited up to the amount deposited. The credit limit may be extended in some cases. Cardholder must make monthly payments on their secured credit card balance.

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Prepaid Cards

Prepaid cards are similar to debit cards. The cardholder can use the card after payment of some money in advance. The spending limit is limited up to the amount paid in advance by the cardholder. If the cardholder wants more credit limit, he has to load more money into the card. Prepaid cards do not have finance charges or minimum payments since the balance is withdrawn from the deposit.

Business Credit Cards

A card which is designed specifically for business use is called as business credit card. It is an easy method for business people to maintain business and personal cash transactions separately. There are 12 major types of credit cards provided by banks and financial institutions in India. These cards provide a wide variety of financial benefits to holders. **Major India Credit**

Card Types

Following are various types of credit cards available in India:

- ✓ Premium Credit Cards
- ✓ Cash Back Credit Cards
- ✓ Gold Credit Cards
- ✓ Airline Credit Cards
- ✓ Silver Credit Cards
- ✓ Business Credit Cards
- ✓ Balance Transfer Credit Cards
- ✓ Co-branded Credit Cards
- ✓ Low Interest Credit Cards
- ✓ Lifetime Free Credit Cards
- ✓ Rewards

There are some additional credit cards that are available in India as well. Rewards credit cards available in India can be subdivided into six categories – Points, Hotels and Travels, Retail, Auto and Fuel.

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Premium Credit Cards

There are 33 various premium credit cards available in India:

- ✓ ABN AMRO Make My Trip Go Credit Card
- ✓ ABN AMRO Platinum Credit Card
- ✓ ABN AMRO Titanium One Credit Card
- ✓ American Express Kingfisher First Credit Card
- ✓ American Express Platinum Credit Card
- ✓ Axis Bank Visa Platinum Credit Card
- ✓ Bajaj Allianz Super Value Titanium Credit Card
- ✓ Citibank Platinum Credit Card
- ✓ Deutsche Bank Landmark Platinum Credit Card
- ✓ Deutsche Bank Miles & More Platinum Credit Card
- ✓ Deutsche Bank Miles & More Signature Credit Card
- ✓ Deutsche Bank Platinum Credit Card
- ✓ HDFC Bank Platinum Plus Credit Card
- ✓ HDFC Bank Platinum Plus Credit Card
- ✓ HDFC Bank Titanium Credit Card
- ✓ HDFC Bank Visa Signature Credit Card
- ✓ HSBC Platinum Credit Card
- ✓ ICICI Bank Ascent American Express Credit Card
- ✓ ICICI Bank Platinum Credit Card
- ✓ ICICI Bank Platinum Identity Credit Card
- ✓ ICICI Bank Platinum Premiere Credit Card
- ✓ ICICI Bank Thomas Cook Titanium Credit Card
- ✓ ICICI Bank Titanium Credit Card

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- ✓ ICICI Signature Credit Card
- ✓ Jet Airways Citibank Platinum Credit Card
- ✓ Kotak Mahindra League Platinum Credit Card
- ✓ Kotak Mahindra Royal Signature Credit Card
- ✓ SBI (State Bank of India) Platinum Credit Card
- ✓ Standard Chartered Emirates Platinum Credit Card
- ✓ Standard Chartered Emirates Titanium Credit Card
- ✓ Standard Chartered Platinum Credit Card
- ✓ Standard Chartered Super Value Titanium Credit Card
- ✓ Yare Barclaycard Platinum Credit Card

Features of Credit Card

Interest Rate

Interest rate is the prime feature of any credit card. Interest rate is directly influencing the payment for borrowing money on the credit card. In general, the interest rate is expressed as the annual percentage rate (APR).

Grace Period

The card issuers may provide a grace period to pay off the balance. The grace period is the amount of time given to the cardholder for the payment of his credit card balance in full to avoid interest charges. Credit card grace periods range is subject to the conditions of the card issuers.

Fees

Annual fee is normally charged by the card issuer. Over-limit fee is charged on the amount exceeding the credit limit of the card holder. Cash advance fee is charged when the card holder makes a cash advance on his credit card. Balance transfer fees are added when a cardholder transfers a balance to his credit card.

Credit Limits

Credit limit is the maximum spending amount of the cardholder by using his card. The cardholder may exceed his credit limit if he has opted ‘over-the-limit’ option. He is charged with the fee for over-the-limit when a transaction goes over the credit limit.

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Pros and Cons of Using Credit Card

Pros

Instant Cash

Credit card holders can get cash instantly whenever and wherever they need.

Convenience

Credit cards are convenient and time saving for cardholders from searching for an ATM or keeping cash on-hand.

Purchase Power and Ease of Purchase

The purchasing power of the credit card holder can increase due to allowing credit purchase by using credit cards. It makes easier to buy things. There is no need to carry bulk amount of cash with the card holder for purchase of goods. It is very useful and easy for e-ticket booking (Train, Air, bus, hotels, Theater, pilgrim dharsan etc.).

Protection of Purchases

The credit card statement can be a voucher for the purchase when the original receipt is lost. Some credit card company may offer insurance coverage on large purchases.

Create a Good Credit Worthiness

The credit worthiness of the cardholders is proved through making prompt payment. The creation of good credit worthiness is useful to the cardholder in certain circumstances like applying for loans, jobs etc.

Emergencies

Credit card helps to make some emergency payment for certain dues like motor vehicle installment due, rent, Hospital bill etc., and also it will be very helpful in emergency situations like car breaking down, flood, fire etc.

Credit Card Benefits

Credit cards offer some additional benefits like discounts from particular stores or companies, bonus such as free airline miles or travel discounts, and special insurances (like travel or life insurance.).

Cons

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High Interest Rates

Charging high cost of loan is the biggest drawback of credit cards. The interest rate for purchase, balance transfer, cash advance etc. is very high. These interest rates make the actual cost of any purchase higher because of the higher interest rate component. Getting money is easier by using credit card with high rate of interest.

Lavish Spending

Normally, the human tendency is to spend lavishly when they have more liquid cash. Credit cardholders are easily influenced to spend more money through some offers like lucrative discounts, cash back etc. which drive cardholders to increase their debt.

Heavy Penalty

Issuers of credit cards are charging heavy penalty for late payments made by the card holders. The issuer can take very serious action against the cardholders for default in repayment of debt with penalty.

CREDIT RATING

Meaning

Credit rating is an opinion of rating agency about a debt instrument. The opinion is expressed through symbols which indicate the degree of risk associated with repayment of principal and payment of interest on debt instrument. Credit rating agency gets fee for their services from corporate entities which approach for rating of their instruments. Credit rating is not mandatory to all corporate sectors except for certain instruments. The financial position of the corporations is reviewed frequently and the ratings are revised by the credit rating agency.

Origin

In 1841, the first mercantile credit agency was set up in New York to rate the ability of merchants to pay their financial obligations. Later on, it was taken over by Robert Dun. This agency published its first rating guide in 1859. The second agency was established by John Bradstreet in 1849 which was later merged with first agency to form Dun & Bradstreet in 1933. It became the owner of Moody's Investor's Service in 1962. Since 1970's, a number of credit rating agencies have been set up all over the world including countries like Malaysia, Thailand,

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Korea, Australia, Pakistan, Philippines etc. In India, CRISIL (Credit Rating and Information Services of India Ltd.) was setup in 1987 as the first rating agency.

Rating Indications

Rating symbols assigned to a security issue is an indicator of the following:

- ✓ the nature and terms of the particular security being issued;
- ✓ the ability and the creditworthiness of the issuer of a security to make payments in time;
- ✓ The probability that the issuer will make a default in payments.

Factors influencing Assigned Ratings

The ratings are assigned by the credit rating agency based on the following factors:

- ✓ The issuer's ability to meet the obligations of debt.
- ✓ The volume and composition of outstanding debt.
- ✓ The earning capacity of the company and its stability of 'future cash flows'.
- ✓ The interest coverage ratio i.e. it is the relationship between fixed interest and profit of the company (EBIT) whose ability to meet its fixed interest obligations.
- ✓ Current Ratio which is calculated to assess the liquidity position of the issuing firm.
- ✓ The value of assets pledged as collateral security
- ✓ Market demand for the products, competitors' market share, and distribution channels etc.
- ✓ Operational efficiency is judged by capacity utilization, prospects of expansion, modernization and diversification, availability of raw material etc.
- ✓ Track record of promoters, directors and expertise of staff.

Benefits of Credit Rating

The beneficiaries of Credit rating are investors, companies and intermediaries benefited in the following ways:-

Benefits to Investors

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Safety

Investors get an idea about the degree of financial strength of the issuer company through credit rating.

Risk and Returns

Credit rating indicates the degree of risk and possibility of returns on debt instruments. The indication (symbol) helps the investor to take decision for making investment on such instruments.

Investment Decisions

Credit rating symbol expresses the creditworthiness of the instruments as a layman can easily understand about the risk & return status of such instruments. Hence, he can take his own decision instead of seeking any advice from the stock brokers.

Investment Choice

Commonly, there are two different types of investors i.e., risk taker and risk averter. The level of risk taking is different for different investors. Hence, the investor can choose the securities for his investment based on his risk bearing capacity.

Easy Perception

All debt instruments are rated mandatorily. No analytical knowledge is required to make investment on debt instruments. Therefore, investors can make investment easily and quickly.

No Need of Issuing Company Details

Credit rating agencies conduct detailed investigation about the issuing companies' details like nature of business, financial position, liquidity and profitability position before evaluating the instruments issued by them. Therefore, investors need not bother about the company.

Monitoring System

The constant monitory system is followed by credit rating agencies after grading the instruments.

Benefits to the Company

Quick Mobility of Fund

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Highly rated instruments indicate the ability of the yield of the instruments. Normally, investors are interested to invest in this kind of instruments. Hence, the issuing company can mobilize fund quickly through the issue of such type of securities.

Lower Cost of Debt

The highly rated instruments are quoted with lower rate of interest. So, the company can get cheaper source of debt fund.

Reducing Issue Expenses

The rating itself is an advertisement for highly rated instruments. Hence, the issuing company has no need to spend for publicity of such instruments. Therefore, the issuing cost can be reduced to the issuing company.

Increasing Goodwill

The goodwill of the company would increase when their instruments get high rate. The high rated instruments build good image of the company in the eyes of stakeholders.

Motivation for Growth

The promoters of the company with highly rated instruments are motivated to expand their operations and move towards the growth path of the company.

Recognition

Credit rating is a way for getting opportunity to recognize the new companies or unknown companies.

Benefits to Intermediaries

The less effort is sufficient to approach the investors for the selection of instruments by the intermediaries in case of highly rated instruments.

Limitations of Credit Rating

Credit rating suffers from the following limitations:

Hidden Information

Investors can get loss when the company does not disclose the important information to the investigation team of credit rating agency.

Non-Consideration of External Factors

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The external factors like economic, political, environment and government policies which may affect the creditworthiness of the firm are not considered while evaluating the instruments.

Generally, the rating is based on historic data which may mislead the investors.

No Guarantee

Rating is simply an opinion about the capability of the company but it is not a certificate or guarantee of the credit rating agency.

Biased

The quality of the rating may be affected due to the personal bias of the investigating team.

Difference in Rating Grades

Investors get confused due to different rating scale for the same instrument given by different rating agencies.

The Regulatory Framework for Credit Rating Agencies

SEBI Regulations

The Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 empower SEBI to regulate CRAs operating in India. In fact, SEBI was one of the first few regulators, globally, to put in place an effective and comprehensive regulation for CRAs.

SEBI regulation for CRAs has been designed to ensure the following:

- ✓ Credible players enter this business (through stringent entry norms and eligibility criteria)

- ✓ CRAs operate in a manner that enables them to issue objective and fair opinions (through well-defined general obligations for CRAs)

- ✓ There is widespread investor access to ratings (through a clearly articulated rating dissemination process).

- ✓ The applicant should be registered as a company under the Companies Act, 1956 and possess a minimum network of ` 5 crore.

The following are some of the General Obligations specified in the CRA regulations. CRAs are amongst the very few market intermediaries for which such detailed operating guidelines have been prescribed under the regulations.

- ✓ Code of Conduct stipulated by SEBI
- ✓ Agreement with the client
- ✓ Monitoring of ratings
- ✓ Procedure for review of rating
- ✓ Internal procedures to be framed by the CRA
- ✓ Disclosure of Rating Definitions and Rationale by the CRA
- ✓ Submission of information to the Board
- ✓ Compliance with circulars etc., issued by the Board
- ✓ Appointment of Compliance Officer
- ✓ Maintenance of Books of Accounts records, etc.
- ✓ Confidentiality
- ✓ Rating process

These regulations cover issues with respect to confidentiality of information and disclosure with respect to the rationale of the rating being assigned. Several other provisions exist, like the regulator's right to inspect a CRA. An important feature of the regulation is that CRAs are prohibited from rating their promoters and associates.

SEBI Code of Conduct

SEBI's code of conduct for CRAs addresses some of the basic issues relating to conflicts of interest. The Code of Conduct is designed to ensure transparent and independent functioning of CRAs. Some of the salient provisions of the Code of Conduct are:

- ✓ A CRA shall make all efforts to protect the interests of investors.

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- ✓ A CRA shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.
- ✓ A CRA shall have in place a rating process that reflects consistent and international rating standards.
- ✓ A CRA shall keep track of all important changes relating to the client companies and shall develop efficient and responsive systems to yield timely and accurate ratings.
- ✓ A CRA shall disclose its rating methodology to clients, users and the public.

Regulating Authority

In India, the regulating authority of Credit Rating Agencies and financial instruments are SEBI, RBI and IRDA. The list of various financial instruments, and the relevant regulators, are given below:

Sl. No	Instrument	Regulator
1		Public / Rights/ Listed issue of bonds SEBI
2		IPO Grading SEBI
3		Capital protection oriented funds SEBI
4	Collective Investment Schemes of plantation companies	SEBI
5		Commercial Paper RBI
6	Bank loans	RBI (Basel II capital courses) computation for banks)
7	Security Receipts	RBI (For NAV declaration)
8	Securitized instruments (Pass Through Certificates)	RBI ((Basel II capital computation for banks)
9	Fixed Deposits by NBFCs & HFCs	RBI

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10	LPG/SKO Rating	Ministry of Petroleum and Natural Gas
11	Maritime Grading	Directorate General of Shipping (for some

Regulatory prescription of use of ratings for investment purposes

S. No	Product	Regulator
1	Banks' investments in unrated non-SLR portfolio	RBI
2	Investments by Insurance companies	IRDA
3	Provident Fund investments	Government of India

International Regulations

The International Organization of Securities Commission (IOSCO) has formulated a Code of Conduct Fundamentals for the working of CRAs. The IOSCO Code of Conduct broadly covers the following areas:

Quality and integrity of the rating process – This includes the measures to ensure quality of the rating process and monitoring and updating by the CRAs.

CRA's independence and avoidance of conflicts of interest – The procedures and policies to ensure the same.

CRA's responsibilities to the investing public and issuers – These address issues such as transparency and timeliness of ratings disclosure and the treatment of confidential information.

Disclosure of the code of conduct and communication with market participants – This requires CRAs to disclose to the public in accordance with the IOSCO Principles regarding the activities of Credit Rating Agencies

Credit Rating Agencies in India

The Indian credit rating agency has evolved over a period of time. Indian credit rating agencies include mainly CRISIL, ICRA, CARE, FITCH and Brickworks. CRISIL is the largest credit rating agency in India, with a market share of greater than 60%.

CRAs registered with SEBI

Name of the CRAs	Year of commencement of Operations
CRISIL	1988
ICRA	1991
CARE	1993
Fitch India	1996
Brickworks	2008

A. Credit Rating Information Services of India (CRISIL Ltd.)

CRISIL is the first rating agency in India. It was set-up in 1987 jointly by the erstwhile ICICI Ltd. and UTI. The other shareholders are Asian Development Bank (ADB), LIC, State Bank of India, HDFC etc. The head office of the company is located at Mumbai and it has established offices outside India also. The CRISIL Ltd. is the world's fourth largest rating agency. 'CRISIL' has rated over 4700 debt instruments issued by 2200 companies.

The activities of CRISIL Ltd. are as under

✓ To provide credit rating service in respect of Ratings of corporate debt issuances, Ratings of banks, non-banking finance companies, Ratings of borrowing programmes of governments and government bodies, Ratings of structured finance instruments and Ratings of micro-finance institutions

✓ To provide analytical tools for management of risk such as market risk, credit and operational risk and valuation services

✓ To undertake research on economy, industry and company performance and publish such reports

✓ To provide corporate as well as market advisory services to corporate and non-corporate clients.

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B. Investment Information and Credit Rating Agency of India Ltd. (ICRA)

ICRA was established in the year 1991 by the collaboration of financial institutions, investment companies, and banks. The company has formed the ICRA group together with its subsidiaries. The company offers products like short-term debt schemes, Issue-specific long-term rating and offers fund based as well as non-fund based facilities to its clients.

The objectives of the ICRA Ltd. are as follows:

✓ To rate rupee denominated debt instruments issued inter alia, by manufacturing companies, commercial banks, non-banking finance companies, financial institutions, public sector undertakings and local bodies, etc.

✓ To take-up assignments for credit assessment of companies/ undertakings intending to use the same for obtaining specific line of assistance from commercial banks, financial institutions, non-bank financial services companies.

✓ It provides services of general assessment. At the request of banks or any other potential users, it prepares, as per their requirements, general assessment reports. It does not assign any specific symbols in respect of such general assessments. It provides a report on various aspects of the functioning of companies such as operations, quality of management etc.

✓ To undertake research based study reports to address the unique needs and requirements of an individual client. The assignments include due diligence studies, equity assessment/valuation, industry analysis, and market study etc.

✓ To offer advisory services to banks, finance companies, manufacturing companies, government, regulatory authorities and local bodies in the following areas of strategic consulting, risk management and inputs for policy formulation

C. Credit Analysis and Research Limited (CARE)

CARE was incorporated in 1993. It was promoted by Industrial Development Bank of India (IDBI), Canara Bank, Unit Trust of India (UTI) and other financial and lending institutions. CARE has completed over 7,564 rating assignments since its inception in 1993.

The functions of CAREL are as under

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- ✓ To undertake credit rating of all types of debt instruments, both short term and long term.

- ✓ To make available information on any company, industry or sector required by a business enterprise.

- ✓ To undertake equity research study of listed or to be listed companies on the major stock exchanges

D. **FITCH Ratings**

Fitch Ratings is a global rating agency committed to provide the world's credit markets with independent and prospective credit opinions, research, and data. The headquarters of Fitch Ratings is in New York and London and it is a part of the Fitch Group.

E. **BRICKWORK Ratings**

Brickwork Ratings is a private credit rating agency. It was registered under SEBI in the year 2008. It was founded by bankers, credit rating professionals, former regulators as well as professors, was committed to promoting Financial Literacy.

Credit Rating Process

The rating process is designed to ensure that all ratings are based on the highest standards of independence and analytical rigor. From the initial meeting with the management to the assignment of the rating, the rating process normally takes three to four weeks. However, the rating agency has sometimes arrived at rating decisions in shorter time frames, to meet urgent requirements. The process of rating starts with a rating request from the issuer, and the signing of a rating agreement. Credit rating agency employs a multi-layered, decision-making process in assigning a rating.

The following picture depicts the CRISIL's Credit rating process:

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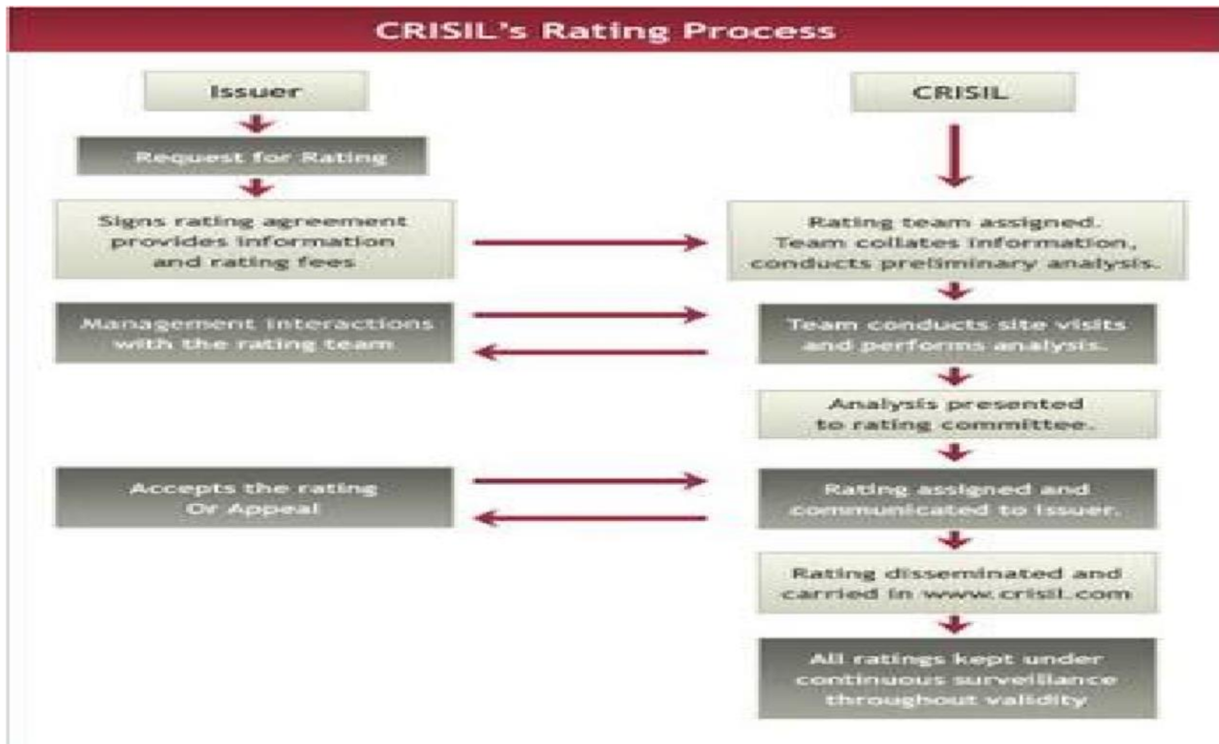

The process/ procedure followed by all the major credit rating agencies in the country are almost similar and usually comprises of the following steps.

1) Receipt of the Request

The issuing company approaches the credit rating agency to rate their instruments which are issued to the public. It is the starting point in the process of rating. The rating agency and Issuer Company enter into an agreement. The general terms and conditions of the agreement are as follows:

- ➢ To Keep confidential information about the issuing company
- ➢ Acceptance of the rating is in the hands of issuing company
- ➢ providing all information is essential on the part of issuing company

2) Assignment to Analytical Team

Credit rating agency entrusts the job to its expertise team for investigating the issuing company after entering into the agreement with them. Normally, the team consists of two members and it may vary depending upon jobs.

3) Obtaining Information

The issuing company must provide all the requisite information to the analytical team. The analytical team analyses the information relating to its financial statements, cash flow projections and other relevant information.

4) Team Visits and Interacts with Management

The analytical team must visit the issuing company for better understanding of the client's operations and interact with the company's executives.

5) Presentation of Findings

The analytical team presents the report on the issuing company to the internal committee of the credit rating agency.

6) Rating Committee Meeting

The rating committee conducts meeting with the analytical team to discuss about the assessment of all factors concerned to the issuer. After a deep discussion, the rating committee evaluates the issuing company and rates their instruments. The decision of the rating committee is final. The issuing company cannot be involved directly in the process of rating.

7) Communication of Decision

The issuing company gets the information from CRA about the rating grade assigned by them. The supported documents or explanations would be furnished to the issuing company. The issuing company may accept or reject the ratings. The rejected ratings are not disclosed by the Credit rating agency.

8) Broadcasting to the Public

The credit rating agency can broadcast the rating information through printed reports to the public after the acceptance of the issuer.

9) Continuous Surveillance

The Credit Rating Agency is continuously monitoring the issuing company till the validity period of the ratings.

Rating Methodology

The rating methodology is a detailed analysis of all the factors affecting the creditworthiness of an issuer company. The important factors are business, financial and industry

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characteristics, operational efficiency, management quality, competitive position of the issue, commitment to new projects etc.

The credit rating agency analyses the following factors for evaluating the instruments such as:

I. Business Risk Analysis

II. Financial Analysis

III. Management Risk Analysis

IV. Project Risk Analysis

V. External support

These are explained as under:

I. Business Risk Analysis

Business risk analysis involves the analysis of the industry risk, market position and operating efficiency of the company which has various factors that depicts in the following chart:

A. Industry risk

The rating agency evaluates the industry risk by considering the following factors:

a. Strength of the industry prospect,

b. Nature and basis of competition,

c. Demand and supply position,

d. Structure of industry,

e. Pattern of business cycle etc.

Business Risk Analysis		
Industry Risk	**Market Position**	**Operating Efficiency**

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✓ Macro Economic Factor ✓ Industry Structure ✓ Industry Demand Supply Scenario ✓ Industry Growth Prospectus ✓ Industry Profitability ✓ Market Size ✓ Extent of Competition ✓ Extent of Cyclicality ✓ Regulatory Environment	✓ Key Competitive Advantages ✓ Market Share Movements ✓ SWOT Analysis ✓ Brand Strength ✓ Product Profile ✓ Trend Analysis ✓ Pricing Power ✓ Distribution Network	✓ Cost Structure ✓ Technological Factors ✓ Access to Resource ✓ Labour Relations ✓ Capacity Utilisation ✓ Integration (forward & Backward) ✓ Flexible Production Capacities ✓ R & D Capabilities

B. Market Position

The credit rating agency determines the market position of the issuing company with reference to the following parameters:

i. Revenue Generation Addressed a. Market Size and Segments

b. Market Share and Trends

c. Entry Barriers and Capacity

d. Product Range and Customer Diversity

ii. Competitive Advantages

a. Brands, Product Quality

b. Strength of Distribution network and geographical Reach

c. Long Term contracts for Product off take / marketing arrangement

d. Ability to pass on Input Cost Increase

C. Operating Efficiency

Operating Efficiency can be measured by using the following aspects: i. Cost Structure

a. Technology used

b. Capacity Utilization

c. Regular up keep / modernization of facilities

ii. Input Structure

a. Access to resource, cost of key inputs

b. Level of Integration

c. Assured, Quality supply of Critical Utilizes

d. Labour Relations – Union

II. Financial Analysis

Financial risk analysis aims at determining the financial strength of the issuer company. The credit rating agency can use some accounting tools & techniques to analyze the financial risk which are depicted in the following picture.

Financial Risk Analysis			
Accounting Quality	**Financial Position**	**Cash Flow Adequacy**	**Financial Flexibility**

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✓ Accounting Polices ✓ Reporting Disclosures ✓ Analytical adjustments	✓ Capital Structure ✓ Profitability Analysis ✓ Debt Protection Ratios ✓ Off-Balance Sheet Obligations ✓ Sensitivity Analysis	✓ Sources of uses of Funds ✓ Cash accruals in relation to debt repayments ✓ Capital Expenditure Plans,	✓ Bank Limits ✓ Cash and marketable securities ✓ Access to Capital markets ✓ Relationship with bankers ✓ Contingency Plans ✓ Ability to Defer
	✓ Liquidity Short Term Factors ✓ Working Capital Management	funding profile	Capital Expenditure

A. Accounting Quality

✓ Qualification of Auditors

✓ Inventory Valuation Policies.

✓ Income recognition method

✓ Off Balance Sheet Items

A. Accounting Quality

- ✓ Qualification of Auditors
- ✓ Inventory Valuation Policies.
- ✓ Income recognition method
- ✓ Off Balance Sheet Items

B. Past and Future Financial Record

- ✓ Past performance
- ✓ Capital Structure (Debt – Equity)
- ✓ Debt Protection measure (Interest Coverage & Cash DSCR) & Liquidity
- ✓ Profitability Trends in Operating / Net Margins (indicating asset side Performance) – provide a tool to measure cash generation.
- ✓ Trends in Company's Funding mix Philosophy – Phasing of Capex Programmes.
- ✓ Future Performance Based on Industry Trends, Company's own operations and future plans.

C. Cash Flow Adequacy and Financial Flexibility

- ✓ Assess the adequacy and stability of cash Flow in relation to debt, working capital needs and capital expenditure requirement.
- ✓ Comparison of sources and uses of funds
- ✓ Ability to raise alternative financing eg. Equity, Quasi Equity, Loans from Promoters
- ✓ Financial support from group / promoters and its past track record
- ✓ Availability of un encumbered liquid assets

III. Management Risk Analysis

Rating of a debt instrument requires evaluation of the management strengths and weaknesses because company's performance is highly influenced by the management goals, plans, strategies etc., which can be analyzed through the following aspects:

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Management Risk Analysis			
Integrity	**Risk Appetite**	**Competence**	**Governance Practices**
❖ Adherence to Laws & Regulations ❖ Track Record of debt repayments ❖ Intra-group transactions ❖ Reputation in financial markets	❖ Financial Policy ❖ Growth Plans funding profile ❖ Unrelated diversification ❖ Attitude to Business risk ❖ Risk Management practices	❖ Track Record ❖ Consistency of performance ❖ Success of past strategies ❖ Succession plans ❖ Quality of Senior Management ❖ Experience in managing downturns ❖ Ability to attract/retain talent	❖ Equitable treatment of Shareholders ❖ Transparency & Disclosure ❖ Value creation to stakeholder ❖ Board Composition

IV. Project Risk Analysis

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The instrument issuing company's project should be evaluated to measure the risk of the project. It is very important for rating debt instrument. The following factors are considered to evaluate the project by the credit rating agency.

- ✓ Project Size
- ✓ Implementation risk
- ✓ Funding Risk
- ✓ Technology Risk
- ✓ Track Record in timely implementation
- ✓ Cost Overruns, contingency

V. External Factors

The credit rating agency has to analyses the external factors and its supports also. They are as follows:

External Factors		
Government Support	**Group Support**	**Parent Support**
Policy Role ❖ Strategic importance to the Government ❖ Critically of sector to economy **Implication of default / moral obligations** ❖ Political implications of default	**Economic rationale** ❖ Relevance of the entity to the group ❖ Percentage ownership by the group/promoters ❖ Economic incentive to the group **Moral Obligations** ❖ Extent of management control ❖ Shared name / common logo for the group of companies	**Economic Rationale** ❖ Strategic importance of the parent ❖ Extent of parent holding ❖ Economic incentive to parent **Moral Obligations** ❖ Strategic importance of the parent ❖ Shared Name

❖ Domino effect		❖ Domiciliary Status ❖ Management's stated posture
❖ Public perception of sovereign backing ❖ Stated posture of the government	❖ Commonality of resources ❖ Management's Stated Posture	

Rating Symbols and Definitions

Rating symbols are used in terms of alphabets.

Instruments for Rating

CRAs in India rate a large number of financial products:

1. Bonds/ debentures- [the main product]
2. Commercial paper
3. Structured finance products
4. Bank loans
5. Fixed deposits and bank certificate of deposits
6. Mutual fund debt schemes

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7. Initial Public Offers (IPOs)

CRISIL has revised the symbols and definitions of its long-term and short-term credit ratings on debt instruments, structured finance instruments, and debt mutual fund schemes. This is in compliance with a June 15, 2011, Securities and Exchange Board of India (SEBI) circular, "Standardization of Rating Symbols and Definitions," which mandates the use of common rating symbols and rating definitions by all credit rating agencies (CRAs). As per the circular, all CRAs are required to revise their rating symbols and definitions as recommended by SEBI. Accordingly, CRISIL has effected changes in rating symbols and definitions with effect from July 11, 2011. The rating symbols and definitions of the following class of instruments have been revised:

- ✓ Long-term debt instruments;
- ✓ Short-term debt instruments;
- ✓ Long-term structured finance instruments;
- ✓ Short-term structured finance instruments;
- ✓ Long-term mutual fund schemes; and ✓ Short-term mutual fund schemes.

CRISIL Long Term Debt Instruments Symbols and Definitions (Period >= 365 Days)

Long Term Rating Symbols	**Rating under Definitions Basel II**	**Risk Weight age under Basel II**
CRISIL AAA	Highest Safety	20 %
CRISIL AA	High Safety	30%
CRISIL A	Adequate Safety	50 %
CRISIL BBB	Moderate Safety	100%
CRISIL BB	Moderate Risk	150%
CRISIL B	High Risk	150%
CRISIL C	Very High Risk	150%
CRISIL D	Default	
Long-Term Debt Instruments		

Revised Rating symbol	Revised rating definition as stipulated by SEBI in its Circular No. CIR/MIRSD/4/2011 dated June 15, 2011
CRISIL AAA (Highest Safety)	Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
CRISIL AA (High Safety)	Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
CRISIL A (Adequate Safety)	Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
CRISIL BBB (Moderate Safety)	Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
CRISIL BB (Moderate Risk)	Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
CRISIL B	Instruments with this rating are considered to have high risk of default
(High Risk)	regarding timely servicing of financial obligations.
CRISIL C Very High Risk	Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
CRISIL D (Default)	Instruments with this rating are in default or are expected to be in default soon.

CRISIL Short Term Debt instruments Symbols (Period < 365 Days)

Rating Short Term Rating Symbol	Rating Definitions under Basel II
CRISIL A1	Very Strong Degree of Safety
CRISIL A2	Strong degree of safety

CRISIL A3	Moderate Degree of Safety
CRISIL A4	Minimum Degree of safety
CRISIL D	Default

SHORT-TERM DEBT INSTRUMENTS

Revised Rating symbol	Revised rating definition as stipulated by SEBI in its Circular No. CIR/MIRSD/4/2011 dated June 15, 2011
CRISIL A1	Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk.
CRISIL A2	Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk.
CRISIL A3	Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligations. Such instruments carry higher credit risk as compared to instruments rated
	in the two higher categories.
CRISIL A4	Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligations. Such instruments carry very high credit risk and are susceptible to default.
CRISIL D	Instruments with this rating are in default or expected to be in default on maturity.

PENSION PLAN

Retired persons require reasonable money continuously to lead a comfortable life till their death. A Retirement Plan provides financial assurance for the payment of certain sum of money periodically to the retired persons. In India, the government servants are receiving pension after retirement. There is no such pension to the private employees. Instead, there are various retirement plans available to private employees. Hence, the private employees can take private

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Retirement Plans to secure their future in terms of finance. The trend of opting for Retirement Plans is becoming increasingly popular in India.

Definition

According to the Supreme Court of India (1982), “Pension is a term applied to periodic money payments to a person, who retires at a certain age, considered age of disability; payments usually continue for the rest of the natural life of the recipient.”

Is Retirement Plan Essential?

There are several reasons for the popularity of Retirement Plans in India, these are as follows:-

Socio - Cultural Change

The trend of joint family system is slowly deteriorating and the nuclear family system is being followed especially in urban areas in India due to various reasons like employment, income, independency and reluctance etc. Due to socio-cultural changes, the retired persons are increasingly under pressure to arrange their own income after retirement. Now-a-days, the retired/old age persons also like to be more financially independent.

Increase in Cost of Living

At present, the cost of living is very high due to various economic reasons like inflation, food scarcity, population etc. The medical service is very expensive and causes heavy financial burden to the old age persons as the coverage of medical insurance is limited besides, the process of medical insurance claim being cumbersome. Therefore, the old age persons are increasingly looking at creating a sufficient and reasonable post-retirement income for the bare survival after retirement.

Longer span of life

The life span of human being has increased due to advanced medical facilities. Hence, a strong financial support is required to the retired persons due to the longevity.

Types of Retirement Plans

There are various retirement plans and schemes in India, both in the private and public sectors such as:-

Life Annuity Plan

Life annuity plan guarantees a person a specific amount of income until he survives. After the person's death, the originally invested amount is refunded to his nominee or legal heirs, in the absence of any nominee.

Guaranteed Period Annuity

In this plan, the person is guaranteed a specific income for a minimum number of years. If the person dies before that period, the nominees will continue to receive that income till the period is completed. If the person outlives that period, he or she can continue to receive the income till his death.

Annuity Certain

Under this retirement plan, a fixed amount of income is paid for a fixed number of years. The payments will stop at the end of the fixed period, even if the retiree lives beyond this fixed period.

Deferred Annuity

Under this plan, the person first saves from his income to create a corpus fund for a number of years. Thereafter, that fund is used for investing in a specific retirement plan that gives him an assured income till his life time.

Defined Benefit Pension Plan

Under this plan, the pension amount is known and assured, but it is not dependent on any external factor. The investor must contribute some amount periodically either by himself or through his employer or both. This amount is invested which earns some returns. But the investor can get assured sum irrespective of the kind of returns generated by the investment.

Their pension amounts were linked to their grade and last drawn salary.

Pros of Defined Benefit Plan

- Investor can get peace of mind because they know they will get assured and defined pension amount.
- Investors need not worry about monitoring the investments periodically.
- **Cons of Defined Benefit Pension Plans**

- There is no disadvantage to the employees whereas this plan is disadvantageous to the employee because they have to ensure that the funds contributed for the pension are invested in such a way that they generate adequate returns to cover future pension of the employee.

- If the returns are not enough to pay the pension, the employer has to provide the deficiency either from other sources or contributions of serving employees. (e.g., Government) **Defined Contribution Pension Plan**

The amount of contribution towards pension is fixed but the benefit amount is undetermined. This type of plan is called defined contribution pension scheme or plan. Here pension depends on the returns made on the investments. There are multiple options of investments such as equity (high risk and high returns), debt (low risk and moderate returns) or govt. securities (no risk and low returns). The Fund would grow into a large amount at the time of retirement through the investment (of both contribution and returns) over the years. Investors are permitted to withdraw only a part of pension fund as lump-sum. Remaining portion of fund would be invested in annuity and that would provide fixed amount every month.

Advantages of Defined Contribution Pension Plans

- The main advantage to the employees is that **the pension fund investment is marketlinked**. They can make excellent returns on the investments through proper selection of portfolio of investments.

- The advantage for the employer is that it doesn't have to worry about the management of the pension funds and the returns generated by them.

Disadvantages of Defined Contribution Pension Plans

- The disadvantage to the employees is that there is a chance of getting lower amount of pension due to improper selection of investment.

- Continuous monitoring is a burden to the employees.

New Pension System (NPS) for Non-Government Employees

The Structure of the scheme and entities involved are as follows:

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a. The New Pension System is administered by the **Pension Fund Regulatory Development Authority** (PFRDA).

b. A **Central Recordkeeping Agency (CRA)** maintains all the records (like account balances) related to the NPS. National Security Depository Limited (NSDL) has been selected as the nationwide CRA for the New Pension System.

c. There are six **Pension Fund Managers (PFMs)**. The PFM are responsible for investing funds and generating returns from them.

d. There are also entities called **Points of Presence (PoPs)**. The PoPs are responsible for the sales and marketing of the NPS. (These are similar to the distributors of mutual funds).

List of Pension Fund Managers (PFMs)

1. ICICI Prudential Life Insurance Company Limited
2. IDFC Asset Management Asset Management Company Limited
3. Kotak Mahindra Asset Management Company Limited
4. Reliance Capital Asset Management Company Limited
5. SBI Pension Funds Limited
6. UTI Retirement Solutions Limited

Features and Options of the Scheme

I. Permanent Retirement Account Number (PRAN)

Each investor in the New Pension Scheme (NPS) would be allotted a Permanent Retirement Account Number (PRAN). This would be a unique identification number that would be used to identify an investor irrespective of his PFM.

II. Investment Options Available to an Investor

Investors would get multiple options for investing their funds in the NPS. These options span the entire risk spectrum from risky to risk-free. There are three investment options

1. **Growth option:** A growth option would be an **equity based option**, wherein the investments would be primarily done in equities. This option has the potential to give the

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highest returns but it carries a higher risk. The **investment would be passive**. There wouldn't be any active buying and selling of stocks based on the fund manager's analysis. Instead, funds would be invested only in the 50 stocks comprising the NSE's NIFTY stock index. This option is most suitable for young people who are just starting their careers. This would also be suitable for middle-aged people who do not have many dependents.

2. **Moderate option**: The funds would be invested in **corporate debt and other fixed income instruments**. This option has the potential to give moderate returns but it carries a moderate risk. This option is most suitable for risk-averse young people and for midcareer people. This would also be suitable for some of the more adventurous (risk taking) people nearing retirement.

3. **Cautious option**: The most cautious option would be **government security based**. Here, investors' money would be invested in government securities. These securities are risk free and hence this option would give risk free returns. The returns are expected to be the lowest among all three options. This option is most suitable for employees approaching their retirement and risk-averse mid-career employees.

Investors would get an option to allocate their funds between these three options in any proportion they prefer. Thus, they can create a balance between the risky and risk-free options based on their own risk profile. If they do not want to allocate their funds, there is an **auto choice** feature. Here, investments would be allocated among the three options **depending on their age**. Thus, when they are young, more investment would be made in the equity based fund, and when they are old, more and more funds would be invested in the low risk government securities based fund.

- **Switching Options:** Investors could **periodically reallocate** their funds among the three options once in a year. Also, they could **switch the fund managers (PFMs) periodically**. That is, they would be able to move the management of their funds from one PFM to another. This process is expected to be simple, as all the records are centrally kept by the CRA and the Permanent Retirement Account Number (PRAN) would be investors' identification number across all Pension Fund Managers (PFM).

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- **Costs and Fees involved in the scheme** The management fee for NPS is less than 0.01% per annum.
- The annual record keeping fee for NPS would be just ` 280.
- Transaction fee is 6 for each transaction.

Define Contribution system:

The periodical payment is fixed**,** but the pension amount is not fixed. It totally depends on the returns on investment. This scheme is a defined contribution scheme, without the benefit not being defined.

Maturity withdrawals: Investor can get money only at the age of 60 years. Early withdrawals are not allowed except for marriage of sons/daughters and purchase of house. Investor can get only 60% of the corpus as lump sum and remaining 40% should be invested in an annuity (accumulated corpus), which is used to provide a fixed monthly amount.

Coexist with other schemes (EPF / EPS): New Pension System (NPS) would not replace any existing scheme like the Employee Provident Fund scheme or the Employee Pension Scheme.

Income tax exemption: The amount of contribution to NPS is exempted from income tax under section 80C and also the interest or profit earned on the investment in NPS would not be taxed in the year in which it is earned; but, the amount would be taxed at the time of withdrawal.

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