Financial Institutions and Markets

By

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Unit – 1 – Financial System

Meaning of Financial System

- A financial system is a system that allows the exchange of funds between financial market participants such as lenders, investors, and borrowers.
- Financial systems operate at national and global levels.
- A financial system is the set of global, regional, or firm-specific institutions and practices used to facilitate the exchange of funds.
- Financial systems can be organized using market principles, central planning, or a hybrid of both.
- A financial system is a combination of people, institutions, businesses, and processes that facilitate financial transactions.

Formal and Informal Financial Sector

In simple terms, formal finance is financing capital that has been sourced from banks and other formal financial intermediaries, whereas informal finance is the capital which has been sourced from friends, family, relatives or private moneylenders.

❖**Formal Financial Sector :** The financial sector is a section of the economy made up of firms and institutions that provide financial services to commercial and retail customers. This sector comprises a broad range of industries including banks, investment companies, insurance companies, and real estate firms.

❖**Informal Financial Sector :** Companies and individuals seeking higher return than interest on bank deposits are able to earn higher returns by placing funds in the informal financial sector. This sector thus acts as an alternative intermediary to banks and other formal institutions and also performs the functions of risk management and monitoring.

Components of the formal financial system

A financial system consists of individuals like borrowers and lenders and institutions like banks, stock exchanges, and insurance companies actively involved in the funds and assets transfer. It gives investors the ability to grow their wealth and assets, thus contributing to economic development.

There are several financial system components to ensure a smooth transition of funds between lenders, borrowers, and investors.

- ❖ Financial Institutions
- ❖ Financial Markets
- ❖ Tradable or Financial Instruments
- ❖ Financial Services
- ❖ Currency (Money)

1. **Financial Institutions** Financial institutions act as intermediaries between the lender and the borrower when providing financial services. These include:
   - ❖ Banks (Central, Retail, and Commercial)
   - ❖ Insurance Companies
   - ❖ Investment Companies
   - ❖ Brokerage Firms

2. Financial Markets

These are places where the exchange of assets occurs with borrowers and lenders, such as stocks, bonds, derivatives and commodities. Financial markets help businesses to grow and expand by allowing investors to contribute capital. Investors invest in company stock with the expectation of it producing a return in the future. As the business makes a profit, it can then pass on the surplus to the investors.

3. Financial Instruments

Tradable or financial instruments enable individuals to trade within the financial markets. These can include cash, shares of stock (representing ownership), bonds, options, and futures.

4. Financial Services

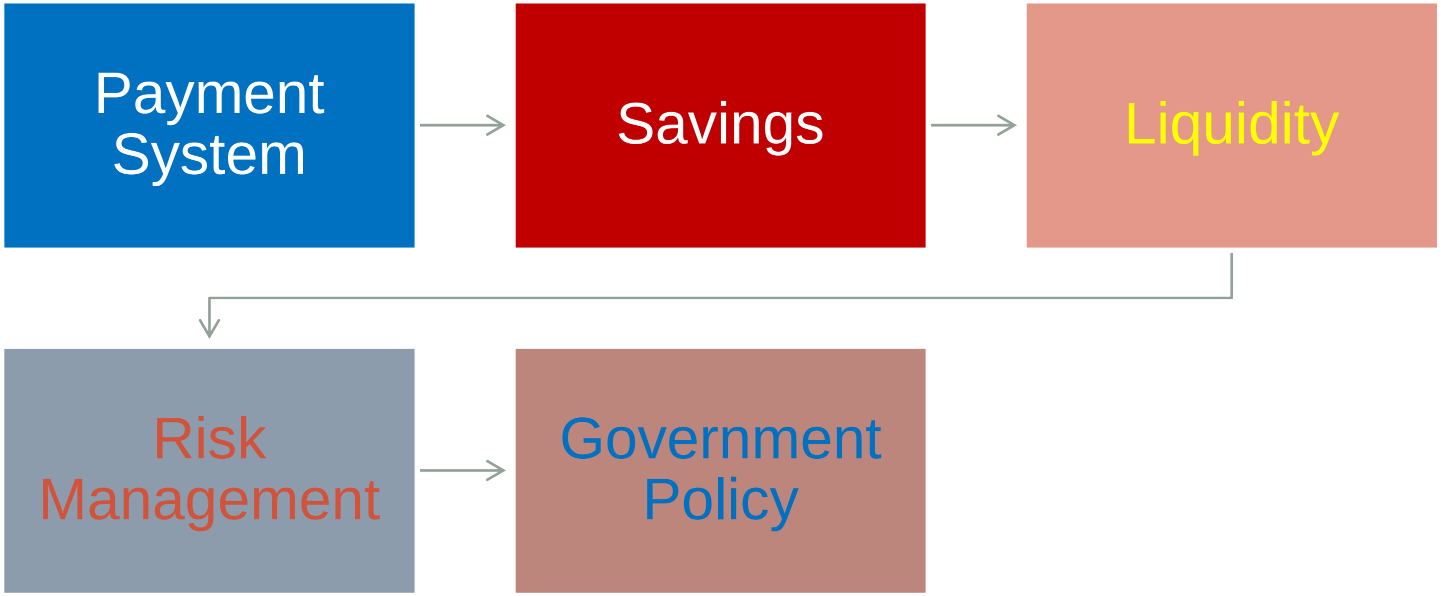
Financial services provide investors a way of managing assets and offer protection against systemic risk. These also ensure individuals have the appropriate amount of capital in the most efficient investments to promote growth. Banks, insurance companies, and investment services would be considered financial services.

5. Currency (Money)

A currency is a form of payment to exchange products, services, and investments and holds value to society.

❖ Functions of Financial Systems

A financial system allows its participants to prosper and reap the benefits. It also helps in borrowing and lending when needed. In simpler words, it will circulate the funds to different parts of an economy. Here are some of the financial system functions:



- ❖**Payment System** – An efficient payment system allows businesses and merchants to collect money in exchange for their products or services. Payments can be made with cash, checks, credit cards, and even crypto currency in certain instances.
- ❖**Savings** – Public savings allow individuals and businesses to invest in a range of investments and see them grow over time. Borrowers can use them to fund new projects and increase future cash flow, and investors get a return on investment in return.
- ❖**Liquidity** – The financial markets give investors the ability to reduce the systemic risk by providing liquidity. It thus allows for easy buying and selling of assets when needed.
- ❖**Risk Management** – It protects investors from various financial risks through insurances and other types of contracts.
- ❖**Government Policy** – Governments attempt to stabilize or regulate an economy by implementing specific policies to deal with inflation, unemployment, and interest rate.

- **Elements of a Financial System**
- The elements of a financial system make up several key parts of an economy.
- A financial system involves all of the businesses, regulations and systems that handle money in that economy.
- While financial systems may seem complicated, the elements of financial systems are regular parts of everyday life that, when working well, combine to create and facilitate large-scale economic impacts.
- The six elements of a financial system are lenders and borrowers, financial intermediaries, financial instruments, financial markets, money creation and price discovery.
- These financial-system components keep money flowing between people and businesses in an organized manner.

❖ Lenders and Borrowers

- ❖Lenders loan money to borrowers.
- ❖Although people can be lenders on a private basis, lenders in a financial system are typically financial institutions.
- ❖A homebuyer often finances the purchase of their home through a mortgage loan, making them a borrower.
- ❖Businesses also take out loans from financial institutions.
- ❖ One characteristic of a good financial system is regulation surrounding lending.

❖ Financial Intermediaries

- ❖Financial intermediaries act in between two financial institutions to make the entire financial system more stable.
- ❖Think of a financial intermediary as a "middle man."
- ❖Financial intermediaries rarely own the money they hold.
- ❖Rather, these businesses and organizations move funds from one part of the financial system to the next.
- ❖Banks are one example of a financial intermediary.

❖Financial Instruments

- ➢ A financial instrument is a contract for trading a financial asset.
- ➢Financial instruments are an important part of a financial system because they allow wealth to keep moving throughout the system.
- ➢Checks, bonds, certificates of deposit, stock trades and stock options contracts are all examples of financial instruments.

❖Financial Markets

- ❖A financial market is any marketplace, physical or virtual, where financial instruments can be traded between people and financial institutions.
- ❖The stock market is a financial market.
- ❖Other examples of financial markets include the real estate market, the bonds market, the commodities market and the foreign exchanges market.

❖Money Creation

❖Financial systems rely on money circulating throughout them.

❖A government may introduce new money to the market by printing it.

❖In the United States, the Federal Reserve makes decisions regarding the creation of money.

❖Different financial systems may have different forms of money creation, but there must be an adequate amount of money circulating to keep the system going.

❖In regards to crypto currency, money creation happens when a new type of currency is created.

❖ Price Discovery

- ❖Price discovery is the process of setting a price for goods, services, or even financial instruments.
- ❖Price discovery is based on a variety of factors, such as supply and demand.
- ❖Items that are unwanted or plentiful often have cheaper prices.
- ❖Although it may not always seem this way to consumers, price discovery is a collaborative effort between buyers and sellers.
- ❖Sellers must price their goods in order to make a profit, and buyers must be willing to pay that price.

➢ Nature and Role of Financial Intermediaries

- ❖Financial intermediaries serve as middlemen for financial transactions, generally between banks or funds.
- ❖A non-bank financial intermediary does not accept deposits from the general public.
- ❖The intermediary may provide factoring, leasing, insurance plans, or other financial services.
- ❖The overall economic stability of a country may be shown through the activities of financial intermediaries and the growth of the financial services industry.
- ❖Financial intermediaries move funds from parties with excess capital to parties needing funds.

- **Benefits of Financial Intermediaries**
- Through a financial intermediary, savers can pool their funds, enabling them to make large investments, which in turn benefits the entity in which they are investing.
- At the same time, financial intermediaries pool risk by spreading funds across a diverse range of investments and loans.
- Financial intermediaries also provide the benefit of reducing costs on several fronts.
- For instance, they have access to economies of scale to expertly evaluate the credit profile of potential borrowers and keep records and profiles cost-effectively.
- Last, they reduce the costs of the many financial transactions an individual investor would otherwise have to make if the financial intermediary did not exist.

Meaning of Financial Markets

- A Financial Market is referred to space, where selling and buying of financial assets and securities take place.
- It allocates limited resources in the nation's economy.
- It serves as an agent between the investors and collector by mobilizing capital between them.
- In a financial market, the stock market allows investors to purchase and trade publicly companies share.
- The issue of new stocks are first offered in the primary stock market, and stock securities trading happens in the secondary market.

Importance of Financial Market in an Economy

- ❖The markets make it easy for buyers and sellers to trade their financial holdings.
- ❖ The stock market is just one type of financial market.
- ❖Financial markets are made by buying and selling numerous types of financial instruments including equities, bonds, currencies, and derivatives.
- ❖Financial markets rely heavily on informational transparency to ensure that the markets set prices that are efficient and appropriate.
- ❖The market prices of securities may not be indicative of their intrinsic value because of macroeconomic forces like taxes.

The Role of Financial Markets

Financial markets have a crucial role in our economic system; they allow global commerce to transact smoothly and continuously, with no breaks, while reducing price shocks. Discover everything you need to know about financial markets.

- Capital markets
- Stock markets
- Money markets
- Forex markets
- Bond markets
- Commodities markets
- Derivatives markets

Types of Financial Markets

- **Over the Counter (OTC) Market:** They manage the public stock exchange, which is not listed on the NASDAQ, American Stock Exchange, or New York Stock Exchange. The OTC market deals with companies that are usually small, can be traded cheaply, and have less regulation.
- **Bond Market:** A financial market is a place where investors loan money on bonds as security for a set period of time at a predefined rate of interest. Bonds are issued by corporations, states, municipalities, and federal governments across the world.
- **Money Markets:** They trade high liquidity and short maturities and lend securities that mature in less than a year.
- **Derivatives Market:** They trade securities that derive their value from their primary asset. The derivative contract value is regulated by the market price of the primary item in the derivatives market, including futures, options, contracts-for-difference, forward contracts, and swaps.
- **Forex Market:** It is a financial market where investors trade in currencies. In the entire world, this is the most liquid financial market.

Functions of Financial Market

Mentioned below are the important functions of the financial market.

- ❖It mobilizes savings by trading it in the most productive methods.
- ❖It assists in deciding the securities price by interaction with the investors and depending on the demand and supply in the market.
- ❖It gives liquidity to bartered assets.
- ❖Less time-consuming and cost-effective as parties don’t have to spend extra time and money to find potential clients to deal with securities. It also decreases cost by giving valuable information about the securities traded in the financial market.

The Structure of the Financial System

- ❖The financial system consists of many institutions, instruments, and markets.
- ❖Financial institutions range from pawnshops and moneylenders to banks, pension funds, insurance companies, brokerage houses, investment trusts, and stock exchanges.
- ❖Financial instruments range from the common coins, currency notes, and checks; mortgages; corporate bills; bonds; and stocks; to the more exotic futures and swaps of high finance.
- ❖Markets for these instruments may be organized formally (as in stock or bond exchanges with centralized trading floors) or informally (as in over-the-counter or curb markets).
- ❖For analytical purposes, the system can be divided into users of financial services and providers.

Structure of the Indian Financial System

- The forces of change unleashed in the Indian economy over the last decade have transformed the opening environment across the entire spectrum of businesses.
- This coincided with rapid developments in technology that created both an opportunity and a challenge for businesses worldwide the opportunity to innovate in product offerings to customers and improve operating efficiency, and the challenge of keeping pace with change and gaining first-mover advantage.
- These two developments catalysed significant shifts in the structure of the Indian economy, perhaps the most visible and far-reaching of which was the increased share of the services sector in the economy.
- The liberalisation of the financial sector, which formed a key part of the overall liberalisation process, blurred the distinction between various financial intermediaries and promoted greater efficiency and competitiveness in the financial markets.
- The structure of the financial markets itself began to change with the growth of the debt capital markets and the entry of new market participants like mutual funds, disintermediation gradually set in.

Classification of the Financial System In India

The Indian financial system is broadly classified into two broad groups:

i. Organized sector and (ii) Unorganized sector.

The financial system is also divided into users of financial services and providers.

Financial institutions sell their services to households, businesses and government. They are the users of the financial services. The boundaries between these sectors are not always clear cut.

In the case of providers of financial services, although financial systems differ from country to country, there are many similarities.

(i) Central bank (ii) Banks (iii) Financial institutions (iv) Money and capital markets and (v) Informal financial enterprises.

Organized Indian Financial System

- The financial system is a critical element in a well-functioning economy.
- The organized financial system comprises of an impressive network of banks, other financial and investment institutions and a range of financial instruments, which together function in fairly developed capital and money markets.
- Short-term funds are mainly provided by the commercial and co-operative banking structure.
- Nine-tenth of such banking business is managed by twenty-eight leading banks which are in the public sector.
- With around two-third share in the total assets in the financial system, banks play an important role.

Organized Financial System Comprises

The organized financial system comprises the following sub-systems:

- ❖ Banking system
- ❖ Co-operative system
- ❖ Development Banking system
  - ➢ Public sector
  - ➢ Private sector
- ❖ Money markets and
- ❖ Financial companies/institutions.
- ❖ Microfinance institutions

Important Source of Surplus Funds in an Economy

The most important source of surplus funds in an economy tends to be the households, but sometimes business enterprises, governments (central, state or local) as well as foreigners also sometimes have excess funds and so they also lend them out. The most important borrower-spenders are various businesses and governments at different levels; however, at times the households and foreigners may also borrow to finance their spending.

The finance could be of two types:

- **Direct Finance:** In this case the borrower directly borrow funds from the lender in the financial markets by selling them securities (also called financial instruments), which are claim on the borrower's future income/assets or
- **Indirect Finance:** In this case the role of channelising the funds from the savers to borrowers is done through financial intermediaries (example commercial banks, such as HDFC Bank, Canara Bank etc.; and non-bank financial institutions such as LIC, IDBI, Mutual Funds etc.)

❖ It is important to understand that Securities are assets for person/firm who buys them but liabilities/debts (or IOUs) for individual/firm that sells (issues) them.

❖One may ask why it is important to channelise the funds from savers to borrowers.

❖The answer is as follows: the people who have surplus funds are generally not the people who have the idea about the profitable investment opportunities.

❖In the absence of financial markets the savers and borrowers would find it very hard to transfer funds from a person who has surplus funds but does not have the profitable opportunities to invest to one who and lacks adequate funds.

❖Financial markets, thus, are essential in promoting economic efficiency in any economy.

❖Financial markets significantly contribute to higher production, efficiency, and consumer well-being by enabling better purchase timing and maximizing their potential for societal economic welfare.

Types of Financial Intermediary

Financial intermediaries have a lot of variety across different countries. Typically the financial intermediaries can be:

- ❖ Commercial Banks; e.g. State Bank of India, HDFC Bank, ABN AMRO Bank, Citibank, HSBC Bank, etc.
- ❖ Development Banks, e.g. IDBI, ICICI, NABARD, SIDBI, etc.
- ❖ Financial adviser or broker;
- ❖ Insurance Companies; GIC, AIG, Tokio, Peerless etc.
- ❖ Life Insurance Companies; LIC, Allianz, AIG
- ❖ Mutual Funds; Standard Chartered Mutual Fund, Morgan Stanley Mutual Fund, SBI Mutual Fund etc.
- ❖ Pension Funds; e.g. CalPERS (California Public Employee Retirement System), EPF (Employees Provident Fund), PPF (Public Provident Fund)
- ❖ Building Societies; HDFC, HUDCO etc.
- ❖ Credit Unions;

Summary

❖We found that the financial system, among other things helps to provide liquidity and reduce risks.

❖Following this study explained the idea of financial intermediation and listed the main intermediaries.

❖Structural Reform of the Financial Sector Executive Summary The U.S. financial system is critical to the functioning of the economy as a whole and banks are central to the financial system.

❖In addition to providing substantial employment, finance serves three main purposes:

Credit provision

- ❖ Credit fuels economic activity by allowing businesses to invest beyond their cash on hand, households to purchase homes without saving the entire cost in advance, and governments to smooth out their spending by mitigating the cyclical pattern of tax revenues and to invest in infrastructure projects.
- ❖ Banks directly provide a substantial amount of credit in the U.S., but, unlike in almost any other economy, financial markets are the ultimate providers of most credit.

Liquidity provision.

- Businesses and households need to have protection against unexpected needs for cash.
- Banks are the main direct providers of liquidity, both through offering demand deposits that can be withdrawn any time and by offering lines of credit.
- Further, banks and their affiliates are at the core of the financial markets, offering to buy and sell securities and related products at need, in large volumes, with relatively modest transaction costs.
- This latter role is particularly important in the U.S., given the dominance of markets, but is often under-appreciated

Risk management services

- ❖Finance allows businesses and households to pool their risks from exposures to financial market and commodity price risks.
- ❖Much of this is provided by banks through derivatives transactions.
- ❖These have gotten a bad name due to excesses in the run-up to the financial crisis but the core derivatives activities provide valuable risk management services.
- ❖Many argue that the U.S. financial system grew overly large in the bubble period and is still too large today.
- ❖We agree that some of the activities that took place in the bubble period involved taking on excess amounts of risk, but it is extremely hard to determine the right size of the financial system based on well-grounded economic theories.

Financial Institutions and Markets

Unit - II

1. Financial Markets

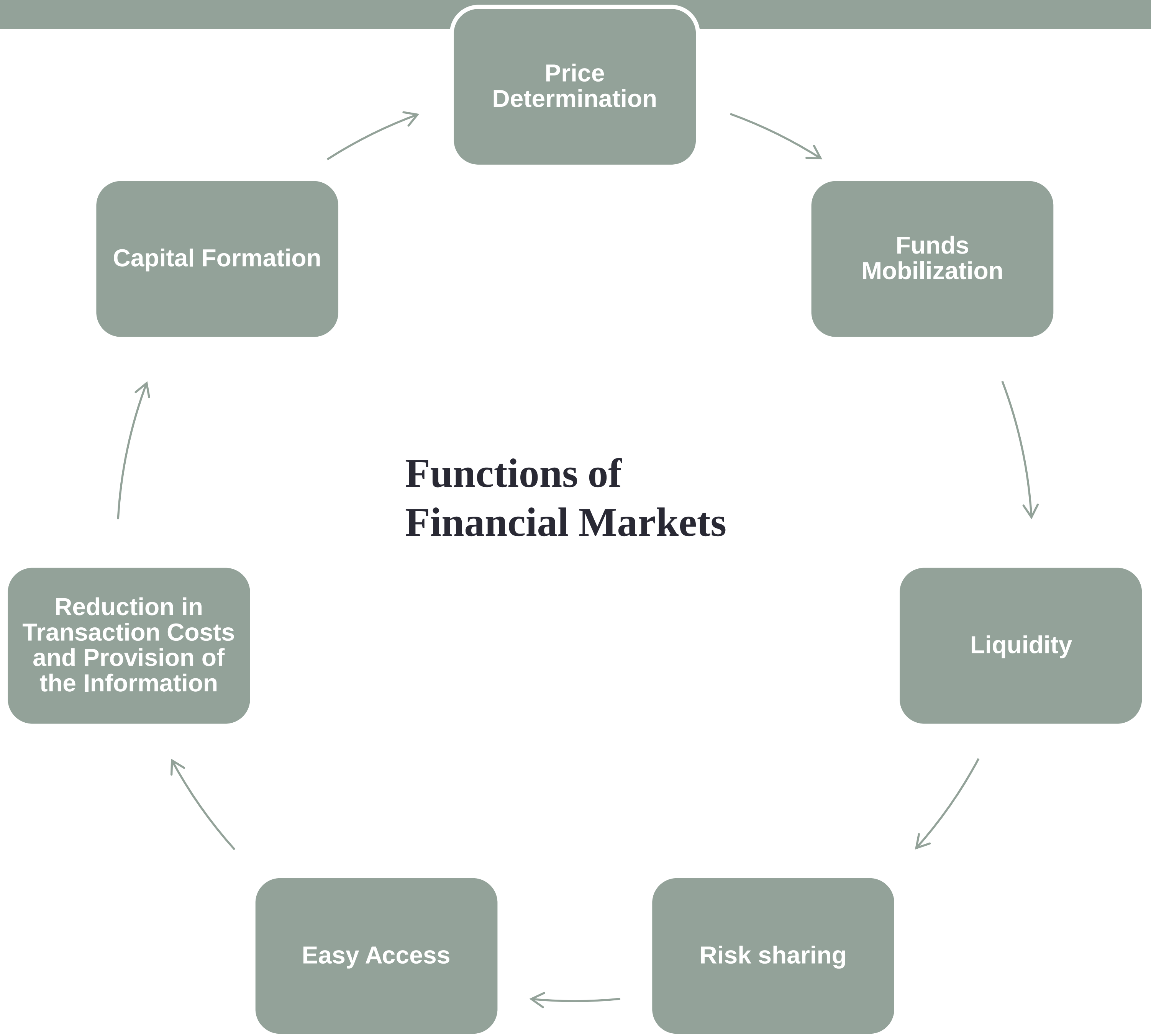
Financial Markets include any place or system that provides buyers and sellers the means to trade financial instruments, including bonds, equities, the various international currencies, and derivatives. Financial markets facilitate the interaction between those who need capital with those who have capital to invest.

2. The Money Markets

They provide a means for lenders and borrowers to satisfy their short-term financial needs

Randall Dodd

- ❖ Money markets were once seen as low-volatility segments of the financial system, providing safe, liquid investments for funds like banks and borrowers.
- ❖The global financial crisis highlighted the differences among different segments, with some exhibiting resilience while others were fragile.


Functions of
Financial Markets
Price Determination
Funds Mobilization
Liquidity
Risk sharing
Easy Access
Reduction in Transaction Costs and Provision of the Information
Capital Formation

I. Price Determination

❖The financial market performs the function of price discovery of the different financial instruments traded between the buyers and the sellers on the financial market.

❖The prices at which the financial instruments trade in the financial market are determined by the market forces, i.e., demand and supply.

❖So the financial market provides the vehicle by which the prices are set for both financial assists which are issued newly and for the existing stock of the financial assets.

II. Funds Mobilization

❖Along with determining the prices at which the financial instruments trade in the financial market, the required return out of the funds invested by the investor is also determined by participants in the financial market.

❖The motivation for persons seeking the funds is dependent on the required rate of return, which the investors demand.

III. Liquidity

The liquidity function of the financial market provides an opportunity for the investors to sell their financial instruments at their fair value prevailing in the market at any time during the working hours of the market.

IV. Risk sharing

The financial market performs the function of risk-sharing as the person who is undertaking the investments is different from the persons who are investing their fund in those investments. With the help of the financial market, the risk is transferred from the person who undertakes the investments to those who provide the funds for making those investments.

V. Easy Access

The industries require the investors to raise funds, and the investors require the industries to invest their money and earn the returns from them. So the financial market platform provides the potential buyer and seller easily, which helps them save their time and money in finding the potential buyer and seller.

VI. Reduction in Transaction Costs and Provision of the Information

The trader requires various types of information while doing the transaction of buying and selling the securities. For obtaining the same time and money is required. But the financial market helps provide every type of information to the traders without the requirement of spending any money by them. In this way, the financial market reduces the cost of the transactions.

VII. Capital Formation

Financial markets provide the channel through which the new investors' savings flow in the country, which aids in the country's capital formation.

4. Efficiency and Instruments

Efficiency of the Instrument Mortgage Instrument means any mortgage, deed of trust or deed to secure debt executed by a Credit Party in favor of the Administrative Agent, for the benefit of the Secured Parties, as the same may be amended, modified, extended, restated, replaced, or supplemented from time to time. Market efficiency refers to the degree to which market prices reflect all available, relevant information.

5. The Indian Money Markets

The money market allows the Reserve Bank of India (RBI) to implement monetary policy. It assists the government in financing its deficits through non-inflationary means. Treasury bills are issued by the government to raise funds for short-term loans. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers.

6. The Capital Market

❖ Capital markets are financial markets that bring buyers and sellers together to trade stocks, bonds, currencies, and other financial assets. Capital markets include the stock market and the bond market. They help people with ideas become entrepreneurs and help small businesses grow into big companies.

❖ A capital market is where individuals and firms borrow funds using shares, bonds, debentures, debt instruments, etc. The most common example is a stock exchange such as NASDAQ, trading shares from different companies amongst investors.

❖ Role of the Capital markets offer continuous availability of funds to finance companies, by linking companies, savers, and investors, facilitating transaction settlement, promoting saving habits, and channeling part of the savings into new and attractive investment opportunities.

Functions

Facilitates the movement of capital to be used more profitability and productively to boost the national income. Boosts economic growth. Mobilization of savings to finance long term investment. Facilitates trading of securities

The Primary markets and Secondary market

Primary Markets

❖ The primary market is where securities are created, while the secondary market is where those securities are traded by investors.

❖In the primary market, companies sell new stocks and bonds to the public for the first time, such as with an initial public offering (IPO).

❖A primary market is a source of new securities.

❖Often on an exchange, it's where companies, governments, and other groups go to obtain financing through debt-based or equity-based securities.

❖Primary markets are facilitated by underwriting groups consisting of investment banks that set a beginning price range for a given security and oversee its sale to investors.

Secondary market

❖For buying equities, the secondary market is commonly referred to as the "stock market."

❖The defining characteristic of the secondary market is that investors trade among themselves.

❖That is, in the secondary market, investors trade previously issued securities without the issuing companies' involvement.

❖For example, if you go to buy Amazon) stock, you are dealing only with another investor who owns shares in Amazon.

❖Amazon is not directly involved with the transaction.

The Derivative market

❖The derivatives market is the financial market for derivatives, financial instruments like futures contracts or options, which are derived from other forms of assets.

❖The market can be divided into two, that for exchange-traded derivatives and that for over-the-counter derivatives.

❖Derivatives market is the financial market for derivatives which are a group of products including futures and options whose value is derived from and/or is dependent on the value of a different underlying asset such as commodities, currency, securities etc.

❖Common examples of derivatives include futures contracts, options contracts, and credit default swaps.

❖Beyond these, there is a vast quantity of derivative contracts tailored to meet the needs of a diverse range of counterparties.

The debt market

❖The debt market, or bond market, is the arena in which investment in loans are bought and sold.

❖There is no single physical exchange for bonds. Transactions are mostly made between brokers or large institutions, or by individual investors.

The Financial Regulation

- Financial regulation refers to the rules and laws firms operating in the financial industry, such as banks, credit unions, insurance companies, financial brokers and asset managers must follow. However financial regulation is more than just having rules in place - it's also about the ongoing oversight and enforcement of these rules.
- The Central Bank of Ireland regulates and supervises over 10,000 financial service providers operating in Ireland. Since 2014, the responsibility for supervising banks is shared between the Central Bank of Ireland and the European Central Bank (ECB).
- Most of the laws governing the financial system are made by politicians in the House of the Oireachtas or the European Union. The Central Bank then oversees how these rules are complied with, sometimes issuing additional guidance. These rules have strengthened significantly since the financial crisis.

Financial Regulation Important

- ❖All of us depend on the financial system in one way or another. For example, savers rely on banks to have their money available when they need it. Businesses need to be able to borrow to maintain and develop their business. Consumers taking out a mortgage or insurance may need to get advice on the best product for them. In the case of insurance companies, policyholders rely on getting claims paid when something goes wrong.
- ❖Poorly regulated financial institutions have the potential to undermine the stability of the financial system, harm consumers and can damage the prospects for the economy. That's why strong financial regulation is important - to put rules in place to stop things from going wrong, and to safeguard the wider financial system and protect consumers if they do go wrong.

RBI Guidelines

- ❖ RBI Guidelines refer to guidelines, circulars, notifications, regulations, and decisions relating to taxation, monetary union, capital adequacy, income recognition, asset classification, liquidity, reserve requirements, special deposit cash ratio, capital asset requirements, and banking or monetary control.
- ❖ These guidelines are issued by competent authorities, including those related to small finance banks in the private sector.

SEBI Guidelines

- ❖ SEBI stands for Securities and Exchange Board of India. It is a statutory regulatory body that was established by the Government of India in 1992 for protecting the interests of investors investing in securities along with regulating the securities market. SEBI also regulates how the stock market and mutual funds function.
- ❖ Purpose of SEBI

The purpose for which SEBI was setup was to provide an environment that paves the way for mobilization and allocation of resources. It provides practices, framework and infrastructure to meet the growing demand.

It meets the needs of the following groups:

- ❖ Issuer: For issuers, SEBI provides a marketplace that can utilized for raising funds.
- ❖ Investors: It provides protection and supply of accurate information that is maintained on a regular basis.
- ❖ Intermediaries: It provides a competitive market for the intermediaries by arranging for proper infrastructure.

Financial Institutions

Unit : III

Financial Institutions

- A financial institution (FI) is a company engaged in the business of dealing with financial and monetary transactions such as deposits, loans, investments and currency exchange.
- Financial institutions encompass a broad range of business operations within the financial services sector including banks, trust companies, insurance companies, brokerage firms, and investment dealers.
- Virtually everyone living in a developed economy has an ongoing or at least periodic need for the services of financial institutions.

Understanding Financial Institutions (FIs)

- Financial institutions serve most people in some way, as financial operations are a critical part of any economy, with individuals and companies relying on financial institutions for transactions and investing.
- Governments consider it imperative to oversee and regulate banks and financial institutions because they do play such an integral part in the economy. Historically, bankruptcies of financial institutions can create panic.

Types of Financial Institutions

Financial institutions offer a wide range of products and services for individual and commercial clients. The specific services offered vary widely between different types of financial institutions.

a) Commercial Banks

b) Investment Banks

c) Insurance Companies

d) Brokerage Firms

Development financial institutions

- Development financial institutions provide long-term credit for capital-intensive investments spread over a long period and low yielding rates of return, such as urban infrastructure, mining and heavy industry, and irrigation systems.
- They act as critical intermediaries for channelling long-term finance required for infrastructure and realising higher economic growth.
- In India, after the 1991 reforms, major DFIs were converted into commercial banks. However, after these there were few institutions in the country which could take care of industrial or infrastructure development.
- Therefore, in order to plug the infrastructure deficit, the government has taken a positive step by making a proposal to re-establish the DFIs in India.

DFI: Background & Present Status

- Development banks are different from commercial banks, which mobilize short- to medium-term deposits and lend for similar maturities to avoid a maturity mismatch.
- In India, the first DFI was operationalized in 1948 with the setting up of the Industrial Finance Corporation (IFC).
- DFIs in India like Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI) and IFCI did play a significant role in aiding industrial development in the past with the best of the resources made available to them.
- However, after 1991 reforms, the concessional funding they were getting from Reserve Bank of India (RBI) and the government was no longer available in the subsequent years.
  - As a consequence, IDBI and ICICI had to convert themselves into universal banks.
- While these DFIs disappeared, a new set of institutions like IDFC (1997), IIFCL (2006) and more recently, National Investment and Infrastructure Fund (NIIF) (2015) emerged to focus on funding infrastructure.
- In budget 2021, with the initial capital base of Rs. 20,000 crore as committed by the government, the new DFI, assuming a leverage of around 7 times, can lend up to Rs. 1.4 trillion.

Banking and Non-Banking Financial Institutions

- There are two main types of financial institutions: banking and non-banking. Banking institutions include commercial banks, savings and loan associations, and credit unions.
- Non-banking financial institutions include insurance companies, pension funds, and hedge funds.

Banking Financial Institutions

- Banking financial institutions are in the business of taking deposits from the public and making loans. In addition, they provide other services such as investment banking, foreign exchange, and safe deposit boxes.
- These institutions are heavily regulated by governments to protect consumers and ensure that the banking system is stable.

Types of Banking Financial Institutions

- There are two types of banking financial institutions: depository and non-depository.
- Depository institutions include banks, savings and loans associations, credit unions, and mutual savings banks
- Non-depository institutions include finance companies, insurance companies, and pension funds

Non-Banking Financial Institutions?

Non-banking financial institutions (NBFCs) are companies that provide financial services such as lending, insurance, and investment banking but that are not regulated as banks. This means that they have a different set of rules and regulations to follow.

Types of Non-Banking Financial Institutions

There are a few different types of non-banking financial institutions, which include:

- Insurance companies: These companies sell insurance policies to individuals and businesses. The policies can provide coverage for things like car accidents, medical expenses, or property damage.
- Investment banks: These banks help companies raise money by issuing and selling securities. They also provide advice on mergers and acquisitions, and they trade stocks and bonds.
- Pension funds: These funds provide retirement income for workers. The money is invested in stocks, bonds, and other assets.
- Mutual funds: These funds pool money from investors and invest it in a portfolio of stocks, bonds, and other assets.
- Hedge funds: These funds are private investment partnerships that use a variety of investment strategies to make money.
- Private equity firms: These firms invest in private companies and help them grow. They may also take the companies public.
- Venture capital firms: These firms invest in early-stage companies with high growth potential.

Each of these non-banking financial institutions serves a different purpose, but they all work towards the ultimate goal of providing funding for businesses and individuals.

Management of NPAs by Banks in India

- ❖ Non-Performing Assets or NPA are like a cancer worm that has been destroying the banking system of India slowly and steadily.
- ❖ NPA are bad loans with banks or other financial institutions whose interests and or principal amounts are overdue for a long time.
- ❖ This time is usually 90 days or more. Like any other business, banks also must run on profits, but NPA eats into that margin for banks.

Types of NPA

- ❖ **Substandard NPA:** Those NPA that have remained overdue for a period of less than or equal to12 months.
- ❖ **Doubtful NPA:** Those NPA that have remained in the substandard category for a period of equal to or less than 12 months.
- ❖ **Loss Assets:** This occurs when the NPA has been recognized as a loss by the bank, or the internal or external auditor or on Reserve Bank of India (RBI) inspection but the loan has not been forgiven completely.

Provisioning Norms

- These are rules set by the RBI for all banks to set aside a certain amount for their bad assets or NPA. They vary according to the category of the NPA as follows:
- 10 percent of allowances for the total unpaid amount without making any budget for securities or other government guarantee cover.
- The NPA under substandard category would have another 10 per cent cover making it a total of 20 per cent on the outstanding amount.
- The provisional requirement for unsecured or doubtful NPA is 100 percent.

Factors contributing to NPAs

- Banks' lending to persons/corporations etc. who are not creditworthy and taking high risks.
- Banks are not diminishing their losses by understanding their bank's sufficiency on capital and loan loss reserves at a given time;
- Promoter of Companies redirecting their funds elsewhere;
- Banks trying to fund non-viable projects;
- In the initial part of the 1990s, Public Sector Banks started experiencing acute capital shortage and losses. The targets set for their operation did not project the utmost need for these corporate goals;
- The banks had very little autonomy to price their products; offer products to preferred sectors or spend money for their own profits. For example, Banks were forced to lend to priority sector namely agriculture due to political pressure;
- Deficient means to collect and distribute credit information amongst commercial banks; and
- Efficient recovery from evasive and overdue borrowers was impeded due to weaknesses in the existing process of debt recovery, ineffective legal provisions on and bankruptcy and problems in foreclosure the execution of court orders.

Mutual funds

- ❖Mutual fund investing is a scheme that is processed by gathering money from different people and is invested in a variety of assets. This kind of collected money is generally invested in marketable securities like shares, stock, and money-market instruments.
- ❖Nowadays, most individuals prefer investing in mutual funds to meet their specific financial goals. Therefore, mutual fund investments are emerging as the most preferred option for investment.
- ❖A team of research analysts, along with a professional fund manager, guides the investment decisions of the investors who have funded into a particular scheme.
- ❖ Further, the personal scheme charges expenses to the investor towards costs related to funding management, distribution expenses, etc.

Types of mutual fund schemes

- ❖Open-ended- In this scheme, the investor can buy and sell units freely and is open for investment at any point in time.
- ❖Close-ended- These units can be listed on the stock exchange, and investors can trade them. It is accessible only for a limited duration.
- ❖Interval scheme- This scheme is another version of close-ended; it can be reopened for a short time during the scheme's tenure, where the investors can sell back their units.

Mutual Funds Investors

- ❖A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt.
- ❖The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds.
- ❖Mutual funds let you pool your money with other investors to mutually buy stocks, bonds, and other investments. They're run by professional money managers who decide which securities to buy (stocks, bonds, etc.) and when to sell them.
- ❖You get exposure to all the investments in the fund and any income they generate.
- ❖In terms of MF penetration to the total population, India has just 2.5% of its total population invested in mutual funds.

Investment

- ❖The purpose behind investing is to gradually build your wealth over an extended period of time. This is done through the buying and holding of a portfolio of stocks, mutual funds, bonds and other investment instruments.
- ❖Generally, investments are held for a period of years or even decades. This enables the investors to take advantage of benefits like interest and dividends along the way.

Trading

- ❖On the contrary, trading deals with more frequent transactions like- buying and selling of stocks, commodities and other instruments.
- ❖The goal here is to make short term gains by buying at lower prices and selling at higher prices. This is done within a relatively short period of time.

Mutual Funds of Organization

- The structure of mutual funds in India is a three-tier one with few other significant components. The three-tier structure comprises the fund sponsor, trustees and the asset management company.
- Not only different banks or AMCs create or float mutual fund schemes. There are other entities involved that play a significant role in the structure of mutual funds. Moreover, the structure of mutual funds came into existence under SEBI Mutual Fund Regulations,1996. It plays the role of primary watchdog for all transactions. Thus, the inception of these regulations has revolutionized the structure of mutual funds, and all entities are regulated under it.
- Mutual fund is managed either trust company board of trustees. Board of trustees & trust are governed by provisions of Indian trust act. If trustee is a company, it is also subject Indian Company Act. Trustees appoint AMC in consultation with the sponsors & according to SEBI regulation.

TYPES OF MUTUAL FUND SCHEMES

- ❖Mutual funds come in many varieties, designed to meet different investor goals. Mutual funds can be broadly classified based on –
- ❖Organisation Structure – Open ended, Close ended, Interval
- ❖Management of Portfolio – Actively or Passively
- ❖Investment Objective – Growth, Income, Liquidity
- ❖Underlying Portfolio – Equity, Debt, Hybrid, Money market instruments, Multi Asset
- ❖Thematic / solution oriented – Tax saving, Retirement benefit, Child welfare, Arbitrage
- ❖Exchange Traded Funds
- ❖Overseas funds
- ❖Fund of funds

Role of Insurance

- ❖Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property.
- ❖ Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.

Provide safety and security:

- ❖Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss.
- ❖ For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

Generates financial resources:

Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilized for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

Life insurance encourages savings:

Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

Promotes economic growth:

Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

Medical support:

A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

Spreading of risk:

Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

Source of collecting funds:

Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation.

Role of Insurance in Economic Growth

- Insurance sector in India plays a dynamic role in the wellbeing of its economy. It substantially increases the opportunities for savings amongst the individuals, safeguards their future and helps the insurance sector form a massive pool of funds.
- With the help of these funds, the insurance sector highly contributes to the capital markets, thereby increasing large infrastructure developments in India.

The Indian Insurance Sector

- The Indian Insurance Sector is basically divided into two categories Life Insurance and Non-life Insurance. The Non-life Insurance sector is also termed as General Insurance.
- Both the Life Insurance and the Non-life Insurance is governed by the Insurance Regulatory and Development Authority of India (IRDAI).

The Past of Insurance Sector In India

- In the history of the Indian insurance sector, a decade back LIC was the only life insurance provider. Other public sector companies like the National Insurance, United India Insurance, Oriental Insurance and New India Assurance provided non-life insurance or say general insurance in India.
- However, with the introduction of new private sector companies, the insurance sector in India gained a momentum in the year 2000. Currently, 24 life insurance companies and 30 non-life insurance companies have been aggressive enough to rule the insurance sector in India.
- But, there are yet many more insurers who are awaiting IRDAI approvals to start both life insurance and non-life insurance sectors in India.

The Present of Insurance Sector In India

- So far as the industry goes, LIC, New India, National Insurance, United insurance and Oriental are the only government ruled entity that stands high both in the market share as well as their contribution to the Insurance sector in India.
- There are two specialized insurers – Agriculture Insurance Company Ltd catering to Crop Insurance and Export Credit Guarantee of India catering to Credit Insurance. Whereas, others are the private insurers (both life and general) who have done a joint venture with foreign insurance companies to start their insurance businesses in India.

The Role of Insurance Intermediaries:

- The importance of insurance in modern economies is unquestioned and has been recognized for centuries. Insurance "is practically a necessity to business activity and enterprise." But insurance also serves a broad public interest far beyond its role in business affairs and its protection of a large part of the country's wealth.
- It is the essential means by which the "disaster to an individual is shared by many, the disaster to a community shared by other communities; great catastrophes are thereby lessened, and, it may be, repaired."
- Insurance is an essential element in the operation of sophisticated national economies throughout the world today.
- Without insurance coverage, the private commercial sector would be unable to function.
- Insurance enables businesses to operate in a cost-effective manner by providing risk transfer mechanisms whereby risks associated with business activities are assumed by third parties.
- It allows businesses to take on credit that otherwise would be unavailable from banks and other credit-providers fearful of losing their capital without such protection, and it provides protection against the business risks of expanding into unfamiliar territory new locations, products or services which is critical for encouraging risk taking and creating and ensuring economic growth.

Insurance Regulatory Authority

- The Insurance Regulatory Authority is a statutory government agency established under the Insurance Act CAP 487 of the Laws of Kenya to regulate, supervise and develop the insurance industry. It is governed by a Board of Directors which is vested with the fiduciary responsibility overseeing operations of the Authority and ensuring that they are consistent with provisions of the Insurance Act.
- The Authority is the successor of the Office of the Commissioner of Insurance which came into existence with the enactment of the Insurance Act, CAP 487 in 1986. Prior to this, insurance regulation was based on the UK legislation under the Companies Act 1960.
- In executing our mandate, we adhere to the core principles of objectivity, accountability and transparency in promoting not only compliance with the Insurance Act and other legal requirements by insurance/reinsurance companies and intermediaries but also sound business practices. We therefore practice regulation and supervision that enables industry players to be innovative and entrepreneural. Bearing in mind industry differences in terms of size, extent and complexity, necessitating changes in operating and investment decisions helps cut down on compliance costs. Since in the long run, this has impacts on productivity and growth of the insurance sector, the Authority deploys significant resources in monitoring market behaviors, compliance and solvency issues.

Insurance Regulatory and Development Authority (IRDA)

- ❖IRDA is the regulatory body in India that governs both Life insurance and General insurance companies. India is a vast country that offers great opportunities to varied segments one of which is the insurance sector.
- ❖Let us understand the concept of insurance regulator in a simple way. India witnesses the concept of a joint family where the head, most commonly the grandparents, acts as the guardian of each member. The head takes care of everyone's needs and maintains a balance for fair practices to keep the family united.
- ❖He treats everyone equal and helps the family in crisis guiding them on how to steer out of it. Now, Similar to how the head of the family plays, IRDA runs the Indian insurance industry as per its set rules and guidelines.

The Purpose of IRDA

- Insurance in India dates back to the year 1850 with the first General Insurance company established in Calcutta. Soon, with the passage of years the market became competitive as many insurers started emerging both in life and non-life sectors.
- Each company practiced business on its rates and rules. It made customers' insecure which brought the credibility of the insurance market at stake. As early as the government realized this fact, they thought of securing the customer's interest first and hence established an independent regulatory body called IRDA.
- Over time, new demands rolled and the market got flooded with several insurance products. Like a responsible head of the family would act to prevent the family from any damage, IRDA monitors the development of the insurance industry and other related activities.

Role of IRDA in the Insurance Sector In India

- At one point of time, some insurance companies used to deny coverage to their policyholders. The basis of the denial was either their choice of business to underwrite or was their understanding of good risk and bad risk. To regulate the market and minimize any sort of partial acts, the IRDA was established.
- Like the banking system in India is regulated as per the guidelines of RBI. It restricts the bankers to not behave unruly with the account holders.
- The banking institutes are allowed to offer loans and interest as per the rates pre-defined by RBI. It leaves no room for the monopoly to take over which in turn works best for the masses.
- Financial Institutes like banks and insurance companies will be successful in our democracy until market practices are for the majority and not just for fraction of people.

Financial Institutions and Markets

Unit - IV

Financial Services

- ❖Financial services is a broad range of more specific activities such as banking, investing, and insurance. Financial services are limited to the activity of financial services firms and their professionals, while financial products are the actual goods, accounts, or investments they provide.
- ❖The economy is made up of many different segments called sectors. These sectors are comprised of different businesses that provide goods and services to consumers. The variety of services offered by lending institutions, brokerage firms, and other businesses are collectively referred to as the financial services sector.
- ❖The financial services sector is comprised of banking, mortgages, credit cards, payment services, tax preparation and planning, accounting, and investing. Financial services are often limited to the activity of firms and professionals, while financial products are the financial instruments these professionals provide to their clients.

The Financial Services Sector

❖The financial services sector provides financial services to people and corporations. This segment of the economy is made up of a variety of financial firms including banks, investment houses, lenders, finance companies, real estate brokers, and insurance companies.

❖As noted above, the financial services industry is probably the most important sector of the economy, leading the world in terms of earnings and equity market capitalization. Large conglomerates dominate this sector, but it also includes a diverse range of smaller companies.

❖According to the finance and development department of the International Monetary Fund (IMF), financial services are the processes by which consumers or businesses acquire financial goods. For example, a payment system provider offers a financial service when it accepts and transfers funds between payers and recipients. This includes accounts settled through credit and debit cards, checks, and electronic funds transfers.

Investment Banking

❖A special segment of banking operation that helps individuals or organizations raise capital and provide financial consultancy services to them. They act as intermediaries between security issuers and investors and help new firms to go public.

❖ They either buy all the available shares at a price estimated by their experts and resell them to public or sell shares on behalf of the issuer and take commission on each share.

Description

❖Investment banking is among the most complex financial mechanisms in the world. They serve many different purposes and business entities.

❖They provide various types of financial services, such as proprietary trading or trading securities for their own accounts, mergers and acquisitions advisory which involves helping organizations in M&As,; leveraged finance that involves lending money to firms to purchase assets and settle acquisitions, restructuring that involves improving structures of companies to make a business more efficient and help it make maximum profit, and new issues or IPOs, where these banks help new firms go public.

Merchant Banking

❖A professional service provided by the merchant banks to their customers considering their financial needs, for adequate consideration in the form of fee. Merchant banks are banks that conduct fundraising, financial advising and loan services to large corporations.

❖These banks are experts in international trade, which makes them experts in dealing with large corporations and industries. Merchant banking provides funds to the multinational businesses and large business entities in the country which helps to boost the country's economic strength.

❖Merchant banks do not provide services to the general public; their services are limited to business entities and large business corporations.

❖Merchant banker is a person who provides assistance for the subscription of securities. The merchant banker plays an important role and carries a lot of responsibilities like, private placement of securities, managing public issue of securities, stock broking, international financial advisory services, etc.

Depository system

❖A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered depository participant. It also provides services related to transactions in securities.

❖In the early times, securities used to be in the form of physical certificates leading to settlement delays, forgery, theft, etc., which made the settlement system on the Indian Stock Exchange inefficient. To solve these issues, the Depository Act, 1996 was passed in India.

❖ The purpose of this Act was to ensure the free transferability of securities with security, accuracy, and speed. A depository is an organisation holding securities such as bonds, shares, debentures, etc., of the investors in electronic form. The depository holds these securities on the request of the investors through a registered Depository Participant.

Depository System In India

The depository acts the same way as banks. Banks hold deposits whereas depository holds various securities such as mutual funds, stocks, and bonds in electronic form. There are two leading stock exchanges in India: NSE (National Stock Exchange) and BSE (Bombay Stock Exchange).

Type Of Depository

There are three major types of depository institutions in the United States. They are commercial banks, thrifts (which include savings and loan associations and savings banks) and credit unions.

Objective

It removes the occurrences of forgery, duplicate share certificates, and bad deliveries. This can increase the liquidity of securities by making a way for easy transfer. Also, it can avoid the delay caused in the transfer of securities.

Introduction to Credit Rating

❖ A credit rating is an opinion of a particular credit agency regarding the ability and willingness an entity (government, business, or individual) to fulfill its financial obligations in completeness and within the established due dates. A credit rating also signifies the likelihood a debtor will default.

❖ A credit agency evaluates the credit rating of a debtor by analyzing the qualitative and quantitative attributes of the entity in question. The information may be sourced from internal information provided by the entity, such as audited financial statements, annual reports, as well as external information such as analyst reports, published news articles, overall industry analysis, and projections.

❖ A credit agency is not involved in the transaction of the deal and, therefore, is deemed to provide an independent and impartial opinion of the credit risk carried by a particular entity seeking to raise money through loans or bond issuance.

Types of Credit Ratings

Each credit agency uses its own terminology to determine credit ratings. That said, the notations are strikingly similar among the three credit agencies. Ratings are bracketed into two groups: investment grade and speculative grade.

Investment grade

Ratings mean the investment is considered solid by the rating agency, and the issuer is likely to honor the terms of repayment. Such investments are typically less competitively priced in comparison to speculative grade investments.

Speculative grade

Investments are high risk and, therefore, offer higher interest rates to reflect the quality of the investments.

CRISIL and ICRA

CRISIL – Credit rating and information services of India limited

❖CRISIL is a global company that provides the research, rating, risk related advisory services. The main objective of CRISIL is to rate the quality of bonds, deposits, debentures, etc. These are assessed when companies use these tools to raise debt capital.

❖Thus, this rating helps an investor to understand the risk of the debt related to the company. The main shareholder of CRISIL is Standard and Poor's. They are also one of the leading credit agency in India.

ICRA – Investment information and credit agency

❖ ICRA limited was set up in 1991 by the investment and financial institutions. It is a professional investment information company that provides credit rating information. Also, the largest investor in ICRA is Moody’s investors.

❖They are internationally accredited rating agency. The objective of ICRA is to provide guidance and information to individuals as well as institutions. Furthermore, it wants to enhance the ability of issuers and borrowers to access the capital and money market. Also, it assists in promoting transparency to the regulators in financial markets.

Housing and Micro Finance

Unit : V

Housing Finance

- ❖Most of us think of a housing finance company when we want a home loan – and it's only logical to do so, given the specialization that these companies have in the home loan segment.
- ❖However, housing finance companies have grown over time and have diversified their portfolio of loan offerings to also cater to the needs of the non housing segment.
- ❖You can approach a housing finance company for several other types of loans – be it for purchase of non-residential (commercial) property or for funding of business or personal expenses.
- ❖Let's take a look at the loan options in the non housing segment offered by housing finance companies.

Loans for Commercial Premises

- ❖ Housing finance companies also offer loans for purchase, extension, construction or improvement of commercial premises, including built-up properties and plots.
- ❖ These loans can be availed by businessmen or professionals, including doctors, lawyers and chartered accountants etc.
- ❖ The amount of the loan can be as high as 75-90 percent of the cost of the property, while the tenure may extend to 15 years subject to the repayment capacity of the customer, as assessed by the lender.
- ❖ Housing finance companies often provide customers with expert legal and technical counseling to facilitate the purchase of commercial premises.

Leasing and Hire Purchase

- Leasing and hire purchase are low-risk forms of debt finance that can be used to acquire assets for a business. Such finance options are available directly from specialist providers, or indirectly through equipment suppliers or finance brokers.
- Leasing and hire purchase could be the perfect solution if your business needs new equipment which would otherwise be unaffordable because of cash-flow constraints.
- Because leases and hire-purchase agreements are secured wholly or largely on the asset being financed, the need for additional collateral is much reduced.
- There is more security for the user because the finance cannot be recalled during the life of the agreement, provided the business keeps up with payments.
- This means leasing and hire purchase can be useful to businesses at any stage. from start-ups to large, established organisations.

Leasing

- ❖ A leasing company buys and owns the equipment, which the business then rents for a predetermined period.
- ❖ Typically, the lease will have a set interest rate, which fixes the outgoings on that asset. The business also has the option to replace or update the equipment at the end of the lease period.

Concept of Leasing

- ❖ • Lease finance denotes procurement of assets through lease. The subject of leasing falls in the category of finance.
- ❖ • Leasing has grown as a big industry in the USA and UK and spread to other countries during the present century.
- ❖ • In India, the concept was pioneered in 1973 when first leasing company was set up in Madras and the eighties have seen a rapid growth of business.
- ❖ • Lease as a concept involves a contract whereby ownership, financing and risk taking of any equipment or asset are separated and shared by two or more parties.
- ❖ • Thus, the lesser may finance and lessee may accept risk through the use of it while a third party may own it.
- ❖ • Alternatively, the lesser may finance and own it while the lessee enjoys the use of it and bears the risk.

Features of Leasing

- 2 Parties
- Selection of an asset
- Purchase of an asset
- Use of the asset
- Rentals and installments payment
- Recovering the cost of an asset.
- Option of acquiring ownership of the asset.

A lease is a contractual agreement in which:

- A party owing an asset i.e. lesser
- Provides an asset for use to another party i.e. lessee
- For an agreed period of time i.e. lease period
- For a consideration i.e. lease rentals.

Lease Financing

- ❖Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments.
- ❖The owner of the asset is known as lessor and the user is called lessee.
- ❖The periodical payment made by the lessee to the lessor is known as lease rental.
- ❖Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Marketing of leasing is done by financing many kinds of assets to consumers as well as business which includes:

- ❖ Plant and machinery.
- ❖ Business cars.
- ❖ Commercial vehicles.
- ❖ Agricultural equipments.
- ❖ Hotel equipments.
- ❖ Medical and dental equipments.
- ❖ Computers including software packages.
- ❖ Office equipments etc.

Hire purchase

If a business wants to own the equipment at the end of the agreement, but avoid the cash flow impact of buying outright, then hire purchase is an option.

A finance company buys the equipment and the business repays the cash price plus interest through regular repayments. These agreements are also normally at fixed interest rates.

Meaning of Hire-Purchase

- Hire purchase is governed by the Hire Purchase Act,1972.It is a special system of credit purchase and sale. In this buyer pays the price in installments i.e. monthly ,quarterly or yearly etc. and also some amount of interest.
- Goods are delivered to the buyer at the time of hire purchase agreement but buyer will become the owner of goods only on the payment of the last installment. Such installments are to be treated as hire of these goods until a certain fixed amount has been paid ,when these goods become the property of the hire.
- Either the buyer or the seller has a right to terminate the agreement at any time before the property so passes. Every agreement shall be in writing and signed by all the parties thereto. • In the case of default, in the payment by the buyer, the seller has got a right to repossess the goods, as ownership lies with the seller, till the payment of last installment.
- The buyer cannot pledge, sell or mortgage the assets as he is not the owner of the assets till the last payment is made.

Features of Hire Purchase

- ❖ Credit purchase
- ❖ Installment payment
- ❖ Possession at time of agreement
- ❖ Ownership till last installment
- ❖ Right to use goods as a bailer
- ❖ Termination of the agreement
- ❖ Ownership of goods after all installments payment.

Installment Credit System

- ❖ Installment credit, also called Installment Plan, or Hire Purchase Plan in business, credit that is granted on condition of its repayment at regular intervals, or instalments, over a specified period of time until paid in full.
- ❖ The goods are advanced to the purchaser after making initial fractional payment called a down payment.

Financial Inclusion and Microfinance

The financial services include:

- Microinsurance (inclusive insurance) with all possible variants related to insurance (climate risk, death, etc.)
- Different credit products
- Pensions
- Savings products
- Money transfers

Non-financial services are very broad and can include:

- Training (in business management, risk management, governance, etc.)
- Decision support software (SIMFI, Microfact, etc.)
- Advice and technical expertise
- Financial education and awareness-raising measures


Thank you