Basics of Financial Services

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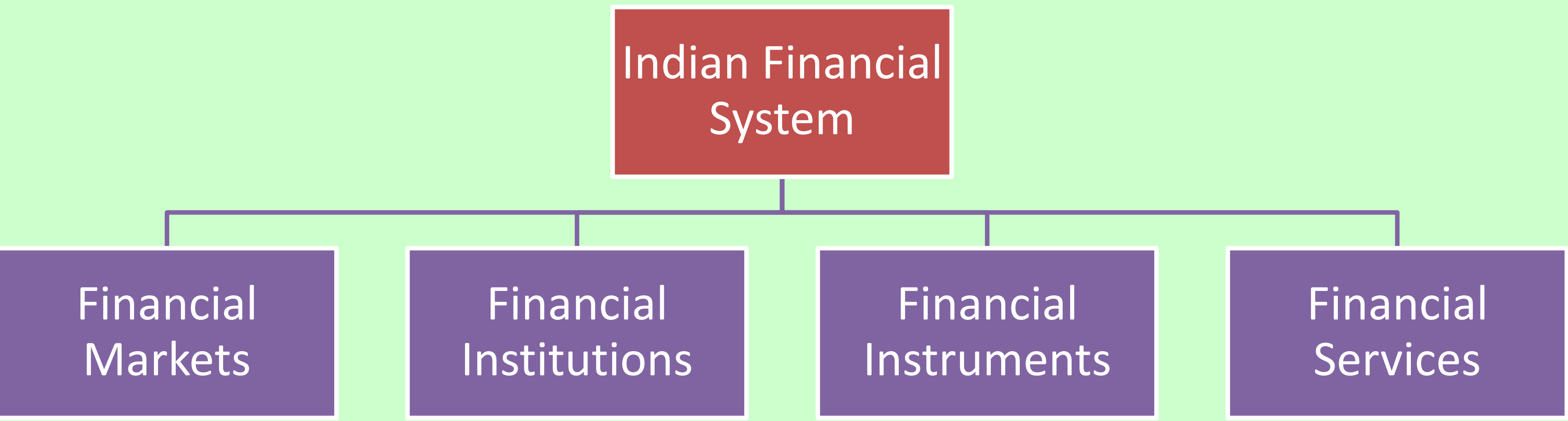
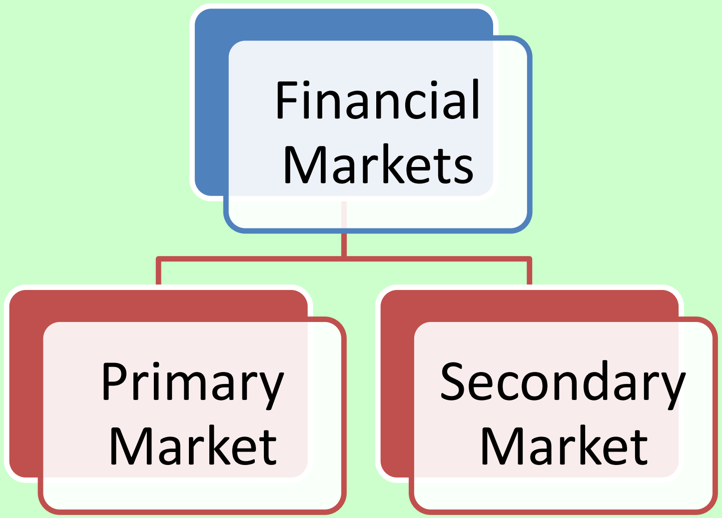
Constituents of Financial Markets



Financial Markets

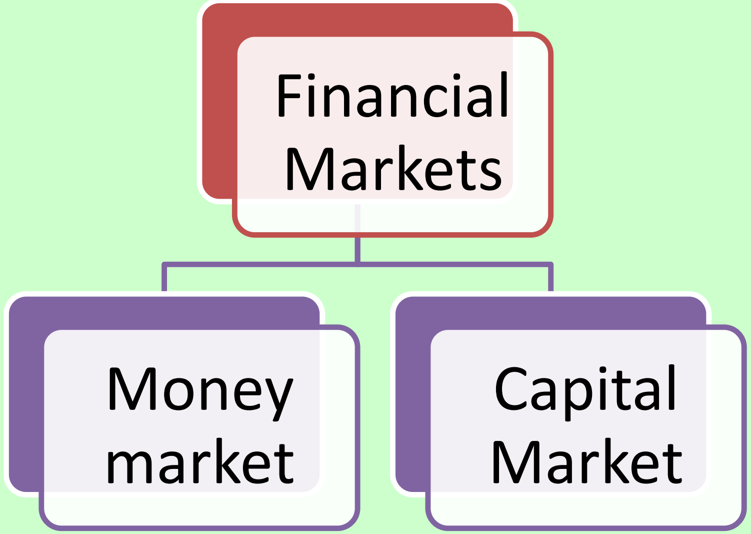
- The arrangement that provide facilities for buying and selling of financial claims and services are called as Financial Markets

- The participants in this financial market are Financial Institutions, Agents, brokers, dealers, Borrowers, lenders, savers and everyone who is related to the finance.



- Primary Market is called as New Issue Market because it deals in new financial claims.

- Secondary Market deals with securities which are issued and are exchanged regularly. e.g. Stock market, commodity market, currency exchange market.



- Money market is a market where securities of less than one year is traded. E.g. Trade bill market, Call money market, treasury bill market, commercial bill market.
- Capital Market is a market where securities of more than one year is traded. Capital market is very closely related to Stock market but the term Capital market is much wider term than compared to a stock market.

Financial Institutions

- Financial institutions are those organizations that perform as mobilisers and depositories of savings.
- Financial institutions includes:
  - Commercial banks, Co-operative banks
  - NBFC (Non-Banking Financial institutions)
  - Life Insurance Corporation of India
  - Unit Trust of India
  - Post offices
  - Industrial Development Bank of India
  - Non –banking financial intermediaries like Mutual funds, Investment Trust, Merchant Bankers, Hire purchase and Leasing Companies, Nidhis.

Financial Instruments

- The Financial services and claims which are dealt in the financial markets are called as Financial Instruments or Financial Assets or Securities.
- Examples of Financial Instruments are Bills of Exchange, Units of Mutual Funds, Bonds, Life insurance policies, stocks, shares, Postal instruments like Kisan Vikas Patra, National Saving Certificates, Commercial Bills, Treasury Bills.
- The characteristics of Financial instruments are Reliability, Liquidity, Marketability, transaction cost, tax benefits.

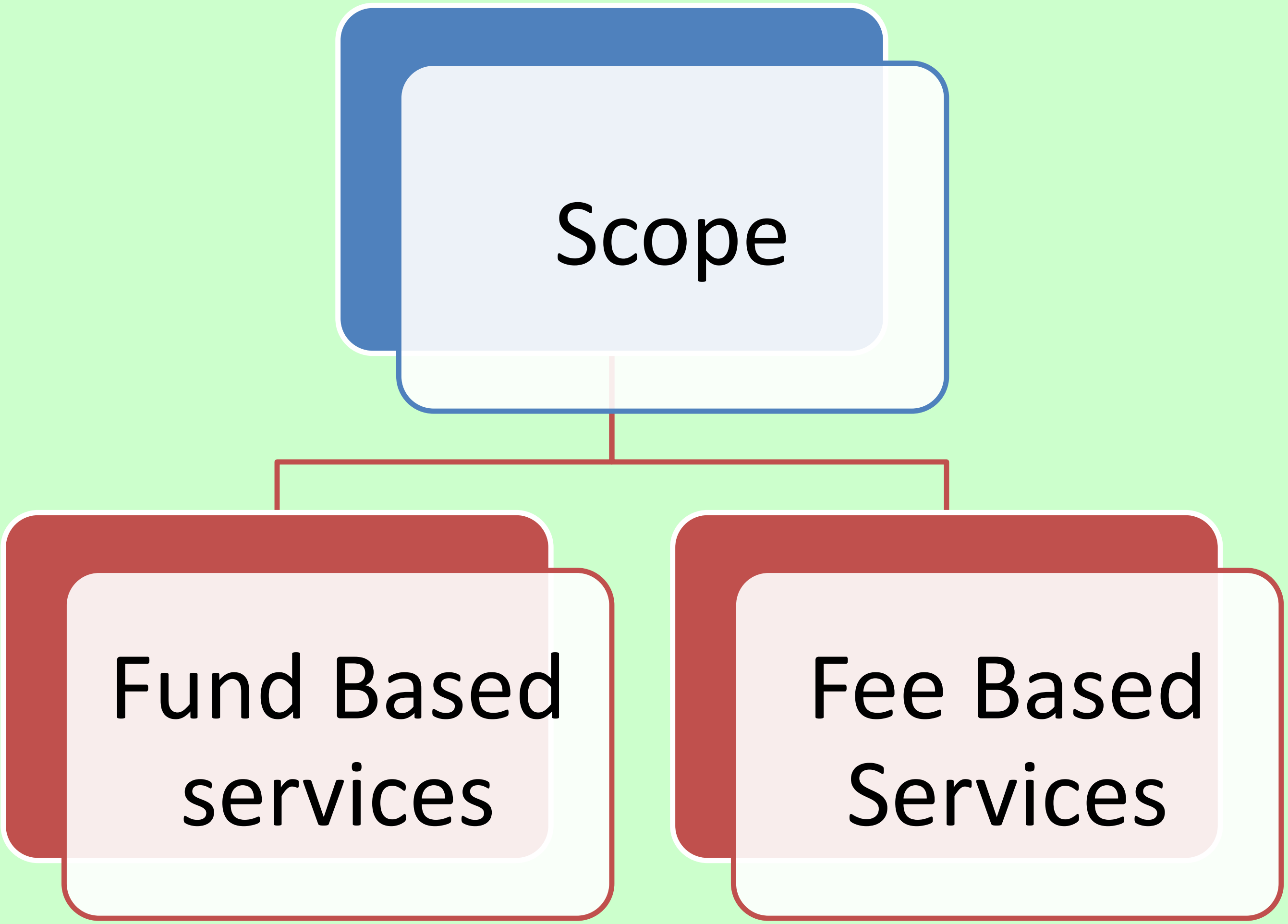
Financial Services

The services provided by various financial institutions in relation to creating awareness about various financial instruments are called as Financial Services.

Types of Financial Services:

- Banks
- Insurance
- Mutual Funds
- Merchant Banking
- Venture Capital (VC Financing)
- Factoring (Receivables)
- Forfeiting

Scope of Financial Services



Fund Based Services

- Leasing (Leasehold Property)
  - Getting the assets by making payment of rent of a few years in lumpsum.
  - The person giving the Asset is called as the “Lessor”
  - The person taking the asset is called as the “Lessee”
  - The Ownership of the asset remains with the Lessor, however it is used by Lessee for the term of the contract.
  - The benefit of depreciation is claimed by “Lessee” in their books of accounts.

- Hire Purchase System
  - It is a kind of Mortgage loan provided by a financial institution.
  - Mortgage – Giving a loan against a security.
  - EMI – Equated Monthly Installment
  - Under Installment selling, the ownership of the Asset was transferred to the buyer on the date of down payment. Under this system, there was lot of bad debts.
  - To overcome this situation, Hire purchase system was introduced.
  - Under H.P. System, the ownership is transferred to the buyer after payment of last installment.

- Bill Discounting
  - Selling of the bill to the bank at a certain discount is called as Discounting of a bill
  - In this case, the Bank becomes owner of the bill.
  - On the due date, the amount of bill will be recovered by the Bank.
  - The Bank charges discount for the "Unexpired period of bill"
  - The formula for calculating the amount of discount is as follows:

  Discount = Amount of bill x % /100 x months /12

  - If the bill is dishonoured on the due date, the bank recovers the amount of bill from the "Drawer"

Venture Capital

1. Place for bigger bets
2. Beyond the start up phase
3. Nexus venture partners, Accel partners, Bessemer Ventures

- Housing Finance
  - A finance company providing finance for building a house
  - It began as a fund based financial service in India with the establishment of National Housing Bank (NHB).
  - NHB is the apex institution for housing finance in India
  - Dewan Housing Finance, LIC housing finance, HDFC are some of the examples of housing finance companies.

- Insurance Services
  - Insurance is a contract for covering the risk between the insured and the insurer.
  - Insurance covers life as well as Non-life policies
  - The business of Insurance started with Non-life insurance policies
  - Since the business of Insurance grew with non-life policies, it extended covering human lives also.
  - Since life is precious for everybody, the business of Life Insurance grew instantly.
  - To curb, the cheating in the field of insurance, a regulatory body was established in all the countries.
  - In India, IRDA is established to regulate all insurance policies sold.

- **Factoring:**
  - Factoring is an arrangement under which the factor (agent) purchases the account receivables and makes immediate payment to the supplier or creditor.
  - In this agreement, the factor undertakes the risk (Bad debts and discount allowed)
  - For providing this service, the factor charges a fee which is calculated on the basis of Interest as well as expenses expected to be incurred for the purpose of collection.
  - The fees collected by the factor is called as factorage.

- Forfaiting:
  - Forfaiting is a method of financing of receivables related to International trader. (Exporter)
  - Under this agreement, the exporter surrenders his rights to the forfaiter to receive future payments from the buyer to whom the goods are sold.
  - The forfaiter undertakes the risk of foreign exchange fluctuation as well as the collection risk.
  - The Exporter can concentrate on his core activity after entering into forfaiting agreement.

- Mutual Fund:
  - Mutual Fund are financial intermediaries which mobilize the savings from the people and invest them in a mix of corporate and government securities.
  - The Mutual Fund managers manage the portfolio of securities and they earn through dividend, interest and capital gains.
  - The returns earned are eventually passed on to the mutual fund shareholders.

Fee Based Financial Services

- Merchant Banker
  - IPO – Initial Public Offer (Shares are issued to the public by a Corporate player)
  - Merchant Banking is investment management
  - Merchant banker acts as an intermediaries between the issuers of capital and investors who purchase these securities.
  - The services provided by merchant bankers include management of mutual funds, public issues, securities and international funds.
  - They also facilitate various transactions like mergers, acquisition of companies and public issues.

- <u>Credit Rating:</u>
  - Credit Information Bureau (India) Limited (CIBIL)
  - Credit rating means obtaining an expert opinion by a rating agency on the comparative willingness and ability of the issuer of a debt instrument to meet the financial obligation on the due date.
  - In simple words, Credit rating is evaluating the credit worthiness of a company by an independent organisation.

- Stock Broker:
  - A stock broker is a associate of a recognized stock exchange.
  - He buys/sells or deals in shares/securities on our behalf.
  - It is mandatory for each stock broker to get himself/herself registered with SEBI in order to act as a stock broker.
  - After he is registered as a Stock broker, he has to abide by the rules and regulations put forward by SEBI.

- <u>Custodian Services:</u>
  - Custodian is an institution or a person who is handed over securities by the security owner for safe keeping.
  - He is a care taker of a public property or security.
  - The fees charged by the custodian is called as Custodial charges.
  - The work of a custodian involves huge risk as his duty is to safeguard the securities or documents under safe custody.
  - Since, the work of custodian is risky, such services are costly in nature

- <u>Loan Syndication:</u>
  - Loan syndication is a procedure where a group of banks participate to provide funds for a single loan.
  - In a loan syndication, around 10 to 30 banks provide funds for a single project depending upon the viability of the project.
  - One of the banks which takes the initiative, is called as the ‘Lead Bank’.
  - This lead bank is decided by the corporate on the basis of trust on Lead Bank Manager
  - Loan Syndication is similar to Consortium Funding

Financial Innovation

- Innovation means to bring out newer things.
- Financial innovation means bringing out newer financial concepts and products in the market.
- Financial innovation can be done:
  – Financial System / Institutional innovation
  – Process Innovation
  – Product Innovation

- <u>Examples of Financial Innovations:</u>
  - Robotic Process Automatic (Process innovation)
  - Linking of Aadhar Card and Pan Card have brought a new revolution in the field of finance:
    - Opening of Bank Account
    - Application of Loans (CIBIL)
    - Investment procedure
    - Demat Account opening
    - Mutual Fund Statement is easily available
    - Online Insurance policy is issued
  - Bitcoins (Crypto Currency)
  - Medical Insurance – Family floater policy
  - Atal Pension Yojna
  - Pradhan Mantri Jeevan Bhima Yojna (Term Plan)
  - Gold Bonds
  - Venture Capital and Seed Funding firms

Challenges faced by Financial Sectors

- In the banking Sector
  - Consolidation (Merger of banks)
  - Cost management
  - Problem of NPA (Non-Performing Assets)
  - Cost of funds procurement
  - Risk management costs
- In the Insurance Sector
  - The financial innovations are not accepted directly
  - Return on Capital invested is less
  - High risk especially during pandemic times
- Development Challenges
- Inter-Linkage among Financial Market (Bank should be supported by all other financial intermediaries)