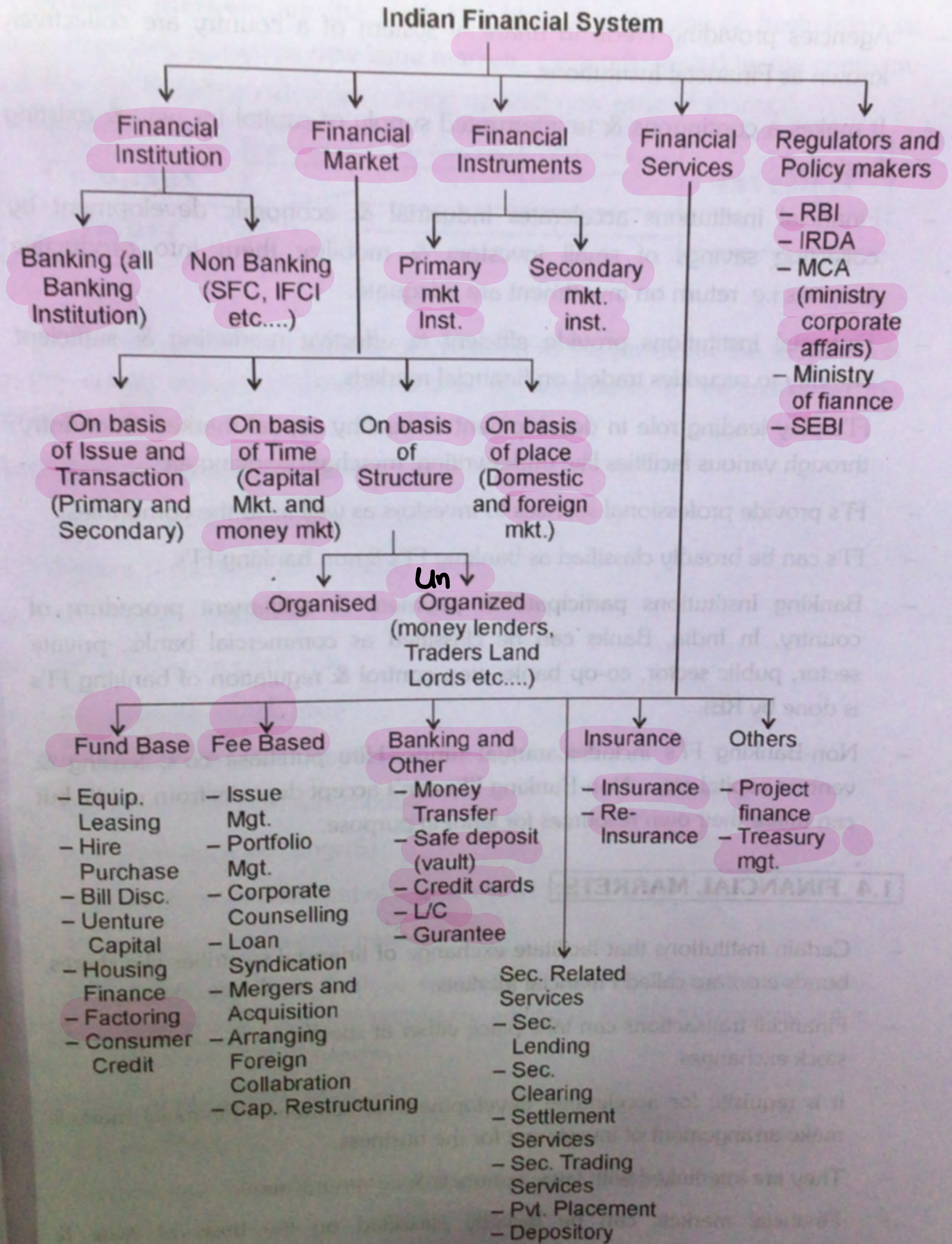
Prof. CA Lalit Pahuja

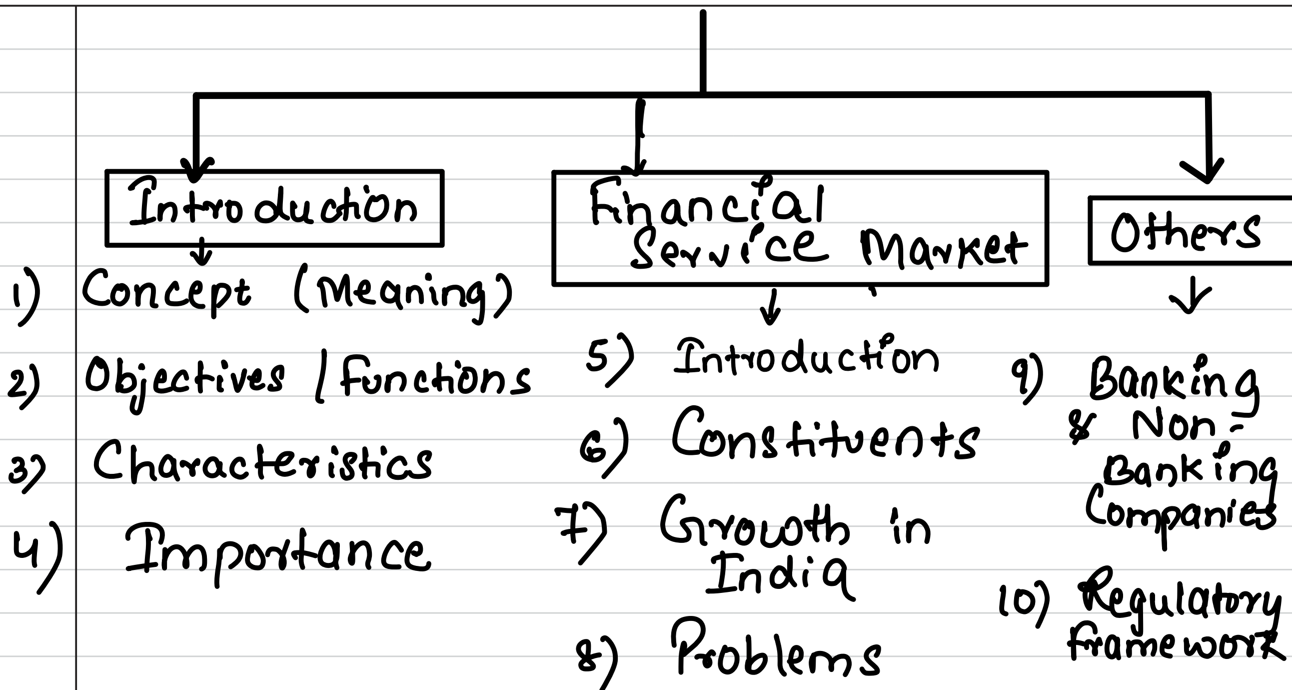


1.2.2 FINANCIAL SYSTEM: STRUCTURE

Indian Financial System

- Financial Institution
  - Banking (all Banking Institution)
  - Non Banking (SFC, IFCI etc....)
- Financial Market
  - On basis of Issue and Transaction (Primary and Secondary)
  - On basis of Time (Capital Mkt. and money mkt)
  - On basis of Structure
    - Organised
    - Un Organized (money lenders, Traders Land Lords etc....)
  - On basis of place (Domestic and foreign mkt.)
- Financial Instruments
  - Primary mkt Inst.
  - Secondary mkt. inst.
- Financial Services
  - Fund Base
    - Equip. Leasing
    - Hire Purchase
    - Bill Disc.
    - Uenture Capital
    - Housing Finance
    - Factoring
    - Consumer Credit
  - Fee Based
    - Issue Mgt.
    - Portfolio Mgt.
    - Corporate Counselling
    - Loan Syndication
    - Mergers and Acquisition
    - Arranging Foreign Collabration
    - Cap. Restructuring
  - Banking and Other
    - Money Transfer
    - Safe deposit (vault)
    - Credit cards
    - L/C
    - Gurantee
  - Sec. Related Services
    - Sec. Lending
    - Sec. Clearing
    - Settlement Services
    - Sec. Trading Services
    - Pvt. Placement
    - Depository
  - Insurance
    - Insurance
    - Re-Insurance
  - Others
    - Project finance
    - Treasury mgt.
- Regulators and Policy makers
  - RBI
  - IRDA
  - MCA (ministry corporate affairs)
  - Ministry of fiannce
  - SEBI

1. Financial Services : Introduction



1]. Concept (Meaning)

- Refers to Services provided by financial Industry.
- Covers broad range of organisations - like,
  - Banks
  - Insurance Companies
  - Credit Card Companies
  - Stock brokers
  - Merchant Bankers
  - Investment funds
  - Hedge funds
  - Mutual funds
  - Venture Capital
  - financial planners / advisors
- Concerned with design and delivery of financial products

2]. Objectives / Functions

(1) Mobilization and allocation of Savings

(2) Facilitate buying and Selling of financial Services

(3) Provide - efficient and effective payment, clearing and management system

(4) Provide fair and transparent system of financial transactions

(5) Provide cost efficient and prompt financial services

(6) Selection of Project and monitoring performance of industries

(7) Offer portfolio valuation

(8) Provide advisory Services

(9). Promote process of financial deepening and broadening.

3]. Characteristics (IIVHI)

(1) Intangibility :- Quality, Innovation, Customer Oriented Services

(2) Inseparability :- Origination and Supply of fin. Services takes place Simultaneously.

(3) Variability :- Competition, Customer oriented service.

(4). Human element :- Dominance, Requires Competent and Skilled personnel

(5). Information based :-
- Creation, distribution, and Use
- essential element in financial Service

4] Importance

(1) Provision of Liquidity

(2) Promotion of Savings

(3) Capital formation

(4) Creation of employment opportunities

(5) Contribution to GNP. Gross National Product

(6) Economic growth

(7). Benefit to Government

5]. Financial Service Market

→ (1). • Banks provide wide range of Services. Huge Competition amongst different category of banks such as PSU banks, private sector banks and Foreign banks.

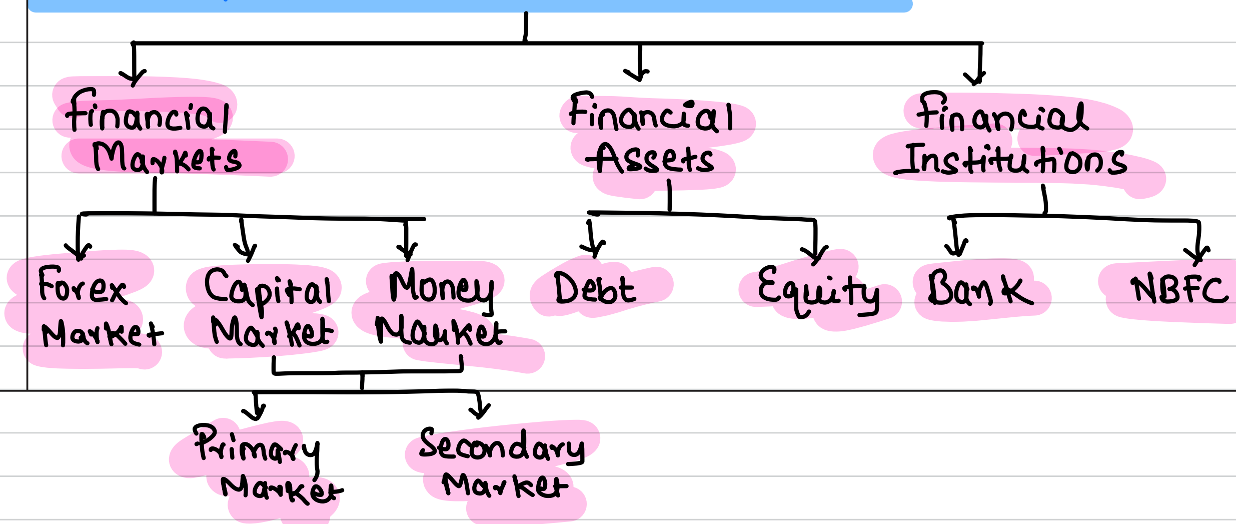
• Electronic revolution results in -
  - widened the reach to customers
  - reduced the cost of marketing
  - improved speed of Service

(2) NBFC - Serving unbanked customers
  - Focus - Retail asset backed lending
    - Microfinance
  - Aspiring to be One Stop Shop for all financial Services.

(3) In Insurance Sector - launch of Innovative Products
  - Online application for policy
  - Faster settlement of claim

(4) Mutual Funds - Asset Under Management (AUM) increased sharply
  - More transparency
  - Ease of transactions
  - Reduction in transaction cost.
  - Effective regulatory control by SEBI

6]. Financial Service Market Constituents :-



(1). **Primary Market** :
Deals with those securities which are issued to public for first-time.

(2) **Secondary Market** :
After IPO, securities are quoted in stock-exchange and continous & regular secondary market for buying/selling available.

(3) **Forex Market** :
Trading of foreign exchange.

(4) **Capital Market** :
Deals with Long-term or equity-backed Securities

(5) **Money Market** :
Deals with Short-term securities

(6) **Financial Assets** :
is a tangible Liquid asset that gets its value from a Contractual claim. (No inherent physical worth)
eg :- Stocks, bonds, bank deposits
Main classes of FA - Equity and debt.

(7) **Financial Institutions** :
is an establishment that conducts financial transactions such as Investments, loans & deposits.
Two main categories - Banks and NBFC's.

9]. Banking and Non-Banking Companies

(1). As per Section 5 of Banking Regulation Act, 1949 — a Banking Company means the accepting, [for the purpose of lending or investment,] of deposits of money from the public, repayable on demand or otherwise and withdrawn by Cheque, draft, order or otherwise.

(2) RBI has defined NBFC as :

- a financial institution which is a Company;
- a non-banking institution which is a company and which has as its principal business of ① receiving deposits, under any Scheme or arrangement or in any other manner, or ② lending in any manner;
- Such other non-banking institution or class of such institutions, as the RBI may, with the previous approval of Central Government and by notification in the official Gazette, Specify.

→ Difference between a Bank and NBFC :-

(1). Demand Deposits cannot be accepted by NBFC

(2) Unlike banks, NBFC is not a part of payment and settlements system regulated by RBI.

(3) NBFC Cannot issue cheques on its name

(4) For the depositors in NBFC the deposit insurance facility and Credit guarantee is not available.

10]. Regulatory Framework

objectives of financial regulators are usually :

(1) Market confidence : To maintain confidence in the financial system.

(2) Financial Stability : Contributing to the protection and enhancement of stability of the financial system.

(3) Consumer Protection : Securing the appropriate degree of protection for consumers.

(4) Reduction of financial crime : Reducing the extent to which it is possible for a regulated business to be used for a purpose connected with financial crime.

(5) Regulating Foreign Participation in the financial markets.

Read

The scheme of regulation of the working and operations of the NBFCs comprises:

(i) RBI Act

(ii) RBI Directions

(iii) ALM (Asset-Liability) Framework

(iv) Guidelines of Fair Practices Code

(iv) Credit Information Companies Act, 2005

The RBI regulates and supervises the NBFCs under the RBI Act. The regulatory and supervisory objective is to :

(a) ensure the healthy growth of NBFCs

(b) ensure that they function as part of the financial system within the policy framework in such a manner that their existence and functioning do not lead to any systematic aberration and

(c) ensure that the quality of surveillance and supervision is sustained by keeping pace with the developments that take place in this sector of the financial system.

It is mandatory that every NBFC should be registered with the RBI to commence/carry on any business.

The NBFCs which can be registered with the RBI are

(i) equipment leasing

(ii) hire-purchase

(iii) loan and

(iv) investment companies.

The other types of NBFCs are regulated by other regulators.

They can be further classified into those accepting deposits and those not accepting deposits.

The registered NBFCs are required to invest in unencumbered approved securities worth at least 5 per cent of their outstanding deposits.

Every NBFC is required to create a reserve fund by transferring at least 20 per cent of its net profit before declaring any dividend.

The RBI can regulate/prohibit solicitation of deposits from public.

It can give directions to NBFCs relating to

(i) prudential norms for income recognition, accounting standards, provisioning on capital adequacy and

(ii) deployment of funds.

It can also issue directions for providing information relating to deposits or for conduct of business.

For contravention/defaults by an NBFC, the RBI can impose penalty. It can also cancel registration of an NBFC.

The RBI Guidelines relating to ALM focus on interest rate and liquidity risk management systems in banks, which form a part of the ALM function. The main elements of the ALM system are ALM information system, ALM organization and ALM process.

The Reserve Bank of India vide its circular dated September 28, 2006, issued guidelines on Fair Practices Code (FPC) for all NBFCs to be adopted by them while doing lending business. The guidelines covered general principles on adequate disclosures on the terms and conditions of a loan and also adopting a non-coercive recovery

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method. The same was revised in view of the recent developments with sector including creation of New Category of NBFCs viz; NBFC-MFI and also the rapid growth in NBFCs lending against gold jewellery. Revised circular was issued on March 26, 2012.

Guidelines on Fair Practices Code for NBFCs pertaining to applications for loans and their processing are listed down

(a) All communications to the borrower shall be in the vernacular language or a language as understood by the borrower.

(b) Loan application forms should include necessary information which affects the interest of the borrower, so that a meaningful comparison with the terms and conditions offered by other NBFCs can be made and informed decision can be taken by the borrower. The loan application form may indicate the documents required to be submitted with the application form.

The NBFCs should devise a system of giving acknowledgement for receipt of all loan applications. Preferably, the time frame within which loan applications will be disposed of should also be indicated in the acknowledgement.

Note: There are several guidelines issued by RBI on fair practices Code for NBFCs which can be referred by the students on the website of RBI i.e. www.rbi.org.in

Credit Information Companies Act was enacted in 2005 to facilitate the efficient distribution of credit and to provide for regulation of CICs. Credit information includes (a) nature of loans, advances, amount under credit cards, other credit facilities; (b) nature of security; (c) guarantee/non-fund based facility; (4) credit worthiness of a borrower and so on.

The main elements of CIC's framework of regulation are: registration, management, auditors, functions, information privacy principles and offences /penalties.

7] Growth of Financial Service in India :-

GROWTH OF FINANCIAL SERVICES IN INDIA

The financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities.

The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance for Micro, Small and Medium Enterprises (MSMEs). These measures include launching Credit Guarantee Fund Scheme for Micro and Small Enterprises, issuing guideline to banks regarding collateral requirements and setting up a Micro Units Development and Refinance Agency (MUDRA).

In 2017, a new portal named 'Udyami Mitra' has been launched by the Small Industries Development Bank of India (SIDBI) with the aim of improving credit availability to Micro, Small and Medium Enterprises' (MSMEs) in the country.

With a combined push by both government and private sector, India is undoubtedly one of the world's most vibrant capital markets. Along with the secondary market, the market for Initial Public Offers (IPOs) has also witnessed rapid expansion.

The Mutual Fund (MF) industry in India has seen rapid growth in Assets Under Management (AUM). Total AUM of the industry stood at ₹ 2.52 trillion between April - August 2018. At the same time the number of Mutual fund (MF) equity portfolios reached a high of ₹ 74.6 million as of June 2018.

Another crucial component of India's financial industry is the insurance industry. The insurance industry has been expanding at

a fast pace. Further, India's leading bourse Bombay Stock Exchange (BSE) will set up a joint venture with Ebix Inc. to build a robust insurance distribution network in the country through a new distribution exchange platform. The relaxation of foreign investment rules has received a positive response from the insurance sector, with many companies announcing plans to increase their stakes in joint ventures with Indian companies.

Over the past few years India has witnessed a huge increase in Mergers and Acquisition (M&A) activity undertaken by investment banks.

In September 2018, SEBI asked for recommendations to strengthen rules which will enhance the overall governance standards for issuers, intermediaries or infrastructure providers in the financial market.

The Government of India launched India Post Payments Bank (IPPB), to provide every district with one branch which will help increase rural penetration.

India is today one of the most vibrant global economies, on the back of robust banking and insurance sectors.

8] Problems in Financial Service Sector

→ (1) Lack of qualified personnel

(2) Lack of Investor awareness

(3) Lack of transparency in disclosure requirements and accounting practices

(4) Lack of Specialisation in different financial Service

(5). Lack of adequate data to take financial Service related decisions

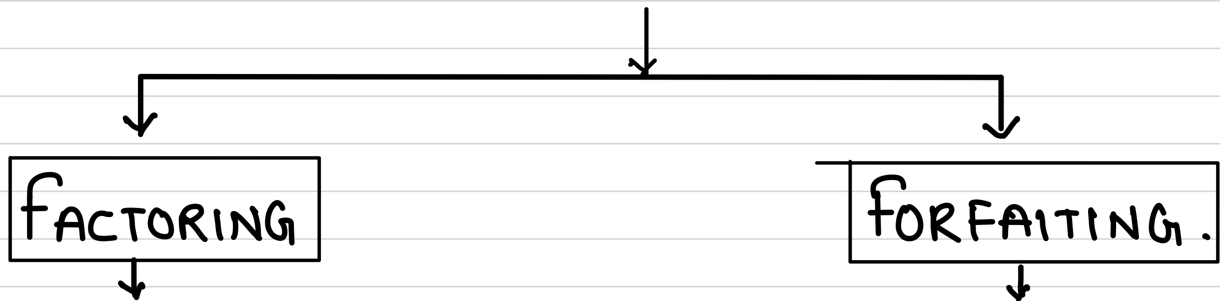
(6). Lack of efficient risk management system

(7). Inadequate Security of data

(8). Strong Competition

— X —

2. Factoring and Forfaiting



1). Introduction & Meaning

2). Types of factoring

3) Theoretical framework + Functions of a factor

4) Factoring Cost

5) Advantages & Disadvantages

6) Factoring in India

7) Working of forfaiting

8) Benefits & Drawbacks

9). Factoring Vs. forfaiting

10) Practical Problems

(P) for TYBMS.

1]. Introduction & Meaning :-

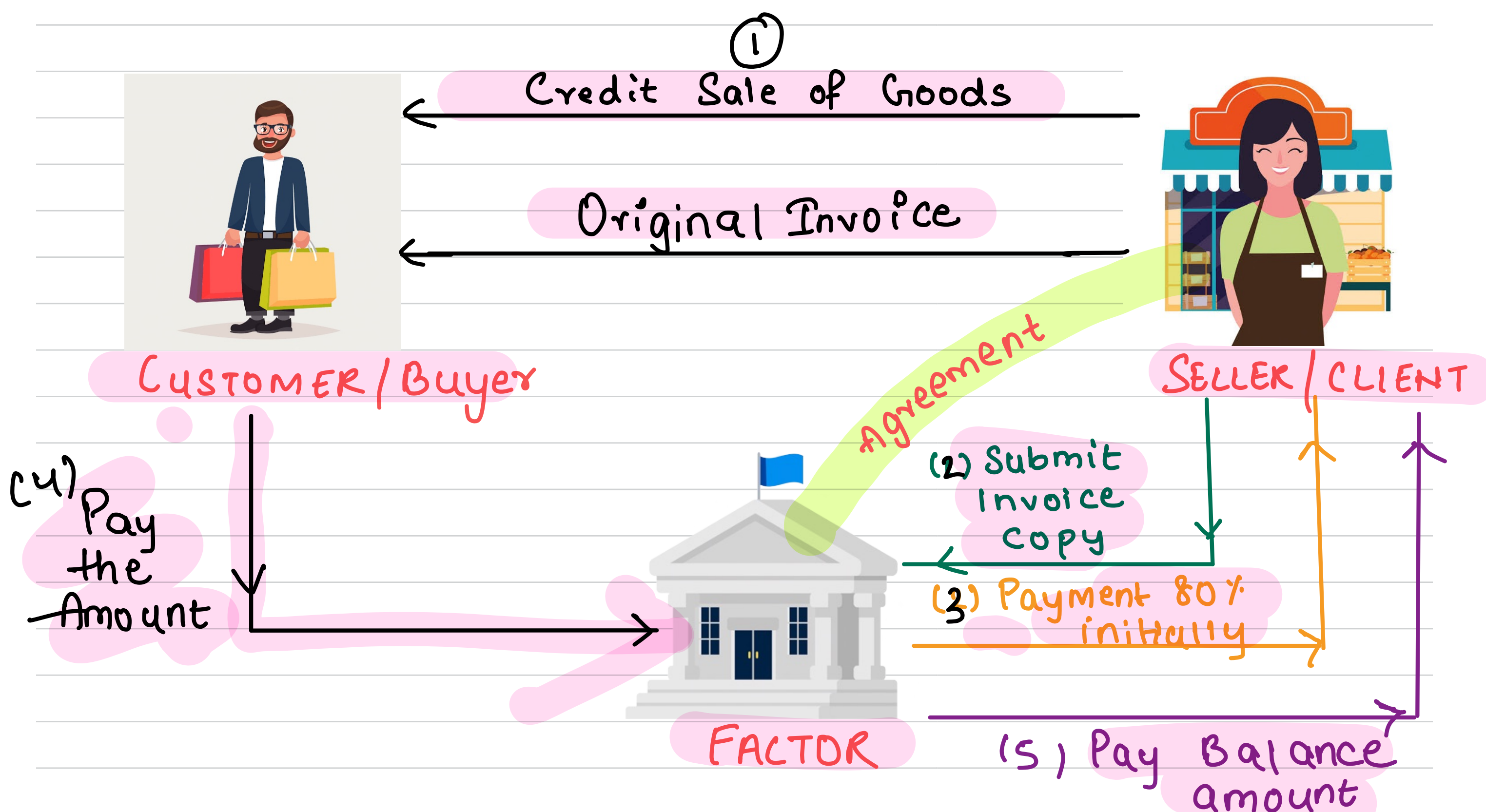
→ (1). Two different types of financing of receivables. Both are fund based FS.

(2). Def :- Factoring
- An agreement in which receivables arising out of sale of goods / services
- are sold by a firm / client
- to the 'Factor' (a financial intermediary)
- as a result of which the title to goods / services represented by the said receivables passed on to the factor.

Henceforth, the factors becomes responsible for -
- all credit control
- Sales accounting
- Debt collection

(3) Def :- Forfaiting / forfeiting
- A mechanism by which the right for export receivables of an exporter (client) is purchased by a 'forfaiter' (a financial intermediary) without recourse to him.

3]. Theoretical Framework :-



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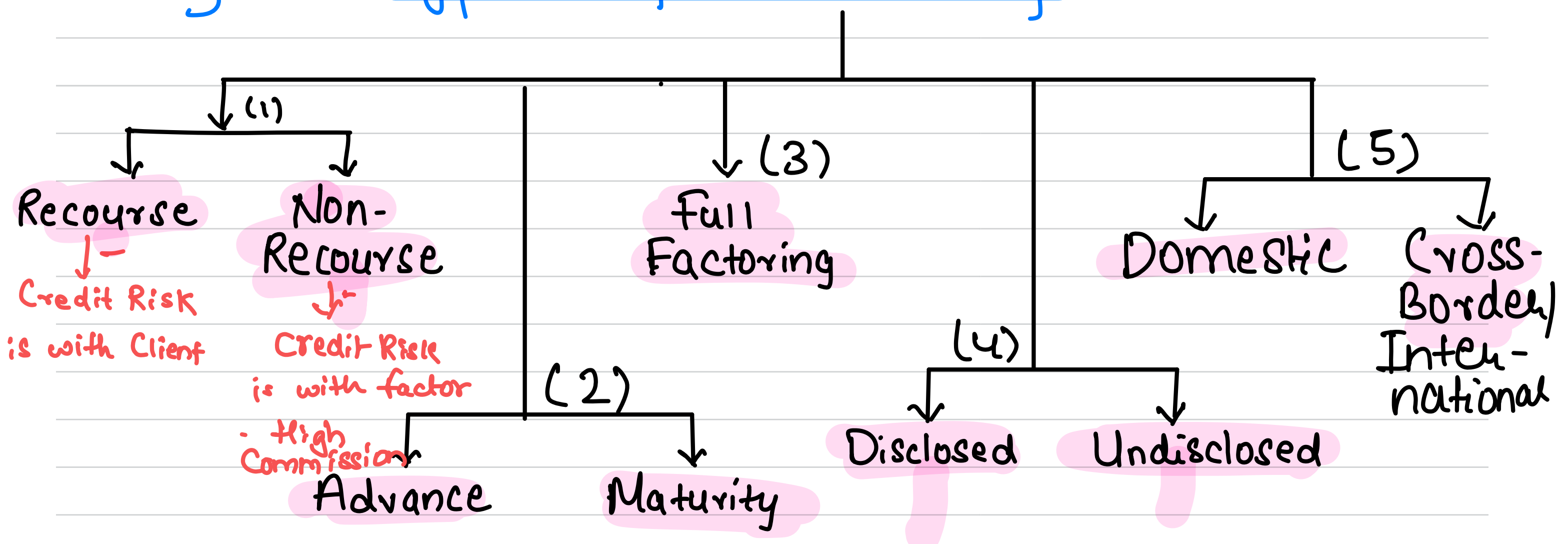
★ Function of a Factor :

(1). Administration of Sales Register
(2) Provision of Collection facility
(3) Financing Trade bills
(4) Credit Control
(5) Advisory Services

2]. Types of Factoring :-



4]. Factoring Cost :-

→ (1). Charge for collection and Sales ledger admin. is in the form of a Commission expressed as a % of value of debt purchased. It is collected up-front / in advance.

(2) Charge for Short-term financing (Advance part-payment) in the form of Interest charge/ Discount charge for the period between the date of advance payment and date of collection) guaranteed payment date.

5] (A) Advantages of Factoring :-

→ (1). Immediate Cash inflow
(2). Focus on business operations and growth
(3). Evasion of bad-debts
(4). Quicker arrangement of finance
(5). No requirement of Collateral
(6). Sale not loan
(7). Customer Analysis
(8). Competitive pricing
(9). Useful to small business
(10). Reduced Current liability

(B) Disadvantages :-

→ (1). Expensive
(2). Possible harm to Customer relationship
(3). Company's image distortion
(4). Constraints on business
(5). Enhanced administrative burden
(6). Purchase of accounts receivables of reputed companies only
(7). No funding for Capital expenditure

6] Factoring in India :

JR

FACTORING IN INDIA

Factoring service is of recent origin in India. It was recommended by the Kalyan Sundaram Study appointed by the RBI in 1989. Pursuant to the acceptance of these recommendations, the RBI issued guidelines for factoring services in 1990.

SBI Factors and Commercials Ltd. was the first factoring company to start its operation in India in April, 1991.

There was no legal framework to regulate factoring in India. By recognising the importance of the factoring services in the emerging financial services scenario in the country, the legal framework has been codified recently. The three elements of the framework are:

(i) Factoring Regulations Act, 2011,

(ii) Registration of Assignment of Receivables (Government)Rules, 2012, and

(iii) RBI's Non-Banking Financial Company-Factor Directions, 2012.

I Factoring Regulations Act

The object of the FRA is to provide for and regulate

(i) assignment of receivables through registration and

(ii) rights and obligations of partners to the contract for assignment of receivables. Assignment means transfer by agreement of individual interest of any assignor in any receivable due from any debtor in favour of a factor in India.

The main provisions of the FRA are:

(i) registration of factors

(ii) assignment of receivables

(iii) rights and obligations of parties to the contract for assignment of receivables

(iv) registration of assignment

(v) offences and penalties

(vi) miscellaneous.

2 Registration of Assignment of Receivables (Government) Rules, 2012

The main features of the rules framed by the Government under the FRA relate to :

(i) registration of transactions of assignment of receivables

(ii) time limit for registration/condonation of delay

(iii) inspection of records of central register and

(iv) fees

3 RBI's Non-Banking Financial Company-Factor Directions, 2012

The RBI had issued the NBFC - Factor Directions in 2012 under the Factoring Regulation Act. There are some specific directions applicable to the NBFC Factors.

They relate to the following :

(i) registration

(ii) net owned fund

(iii) principal business

(iv) conduct of business

(v) asset classification

(vi) Risk Management

(vii) Import / Export factoring

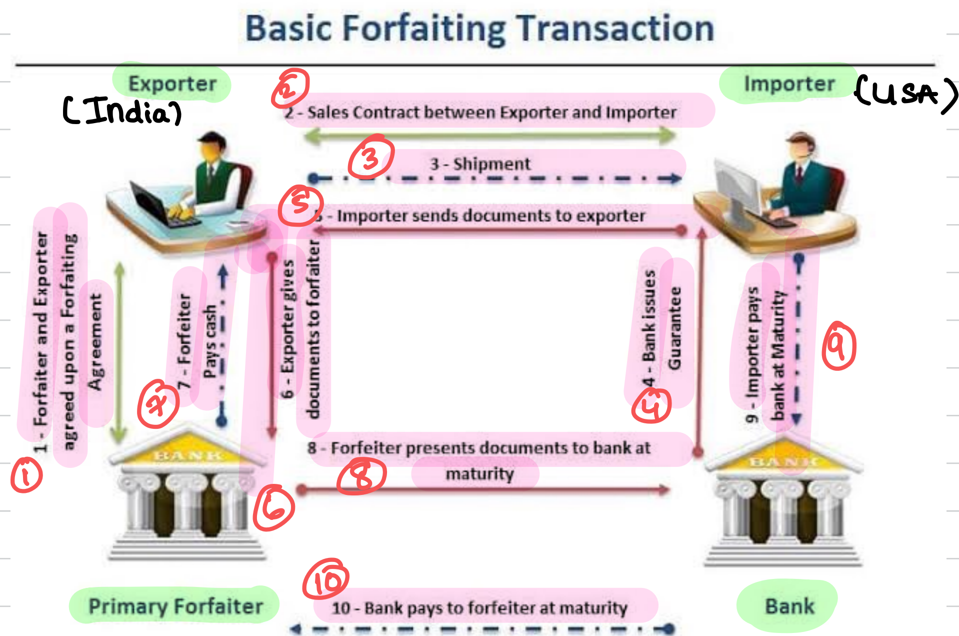
7]. (A) Forfaiting - Meaning :

→ Originated from french word 'Forfait', which means to surrender one's right on something to someone else.

→ Forfaiting is the discounting of international trade receivables such as promissory notes and Bills of exchange for cash.

→ All risks and collection problems are fully the responsibility of the forfaiter.

(B) Forfaiter - Working :-



8]. Benefits of forfaiting :-

→ (A) To Exporter :

(i) 100% financing
(ii) Improved Cashflows
(iii) Risk reduction – Economic, Political, Currency Risk
(iv) Reduction in Bad-debts
(v) Tools to expand sale
(vi) Protective tool
(vii) Reduced admin. Cost

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→ JR- (B) To Banks :

(i) Banks can offer new product range to Clients

(ii) Banks gain fee based income

(iii) Lower Credit admin. and credit follow up.

★ Drawbacks of forfaiting :

→ (i) Forfaiting is not available for deferred payments (while exporting capital goods)

(ii) No international Credit agency guarantee for forfaiting companies.

(iii) Only selected currencies are taken for forfaiting.

9]

FACTORING V/S FORFAITING

FACTORING	FORFAITING
1. *Meaning* It is an arrangement that converts the receivables into ready cash by selling these to factor.	Forfaiting is an arrangement in which the forfaiter purchases claims from the exporter in return for cash payment.
2. *Domestic/Foreign Trade Finance* Factoring is both domestic and foreign trade finance.	Forfaiting is only financing of foreign trade.
3. *Maturity of Receivables* Factoring involves account receivables of short maturities.	Forfaiting involves account receivables of medium to long term maturities.
4. *Extent of Finance* Factoring provides only 80% of invoice. (not fixed)	100% finance is provided in forfaiting.
5. *Letter of Credit* There is no letter of credit involved in factoring.	Forfaiting requires letter of credit.
6. *Recourse or No Recourse* Factoring may have recourse to seller in case of default by buyer.	There is no recourse to exporter in forfaiting.
7. *Scope for Discounting in Secondary Market* Factoring does not provide scope for discounting in the market as only 80% is financed.	Forfaiting provides scope for discounting the bill in the secondary market due to 100% finance.
8. *Series of Sales or Single Sale* Factoring may be for financing a series of sales involving bulk trading.	Only a single shipment is financed under forfaiting.

9. Cost Cost of factoring is borne by the seller (client).	Cost of forfaiting is borne by the overseas buyer.
10. Dealing with Negotiable Instruments NI × There is no dealing with negotiable instruments under factoring.	NI ✓ Forfaiting is evidenced by bills of exchange, promissory note or letter of credit.
11. Type of Goods Factoring involves trade receivable on ordinary goods.	Forfaiting usually takes place on trade receivable on capital goods.

★. Practical Problems :-

Illustration 1 :

Sales — 80% Credit, 20% cash

(Option I) The turnover of F Ltd. is ₹ 60 lakh of which 80 per cent is on credit. Debtors are allowed one month to clear off the dues. A factor is willing to advance 90 per cent of the bills raised on credit for a fee of (Cost) 2 per cent a month plus commission of 4 per cent on the total amount of debts. [F Ltd. as a result of this arrangement is likely to save (Savings) ₹ 21,600 annually in management costs and avoid bad debts at 1 percent on the credit sales.]

(Option II.) A bank has come forward to make an advance equal to 90 per cent of the debts at an annual interest rate of 18 per cent. However, its processing fee will be at 2 per cent on the debts. Would you accept factoring or the offer from the bank?

WN :- Credit Sales = 60 lacs × 80% = 48 lacs

Monthly Sales = 48 lacs/12 = 400,000

Solution :- (A) Option I :- Factoring

Cost of Factoring :- (₹).

Fees $\left[\left(\frac{48,00,000}{12}\right) \times 90\% \times 2\%\right]$ = 7200

Commission $\left[\left(\frac{48,00,000}{12}\right) \times 4\%\right]$ = 16,000

23,200

Less :- Savings in Cost :-

Management Cost (21600/12) 1800

Bad-debts $\left[\left(\frac{48,00,000}{12}\right) \times 1\%\right]$ 4000 (5800)

Net Cost of Factoring → 17,400

(B) Option II :- Bank Advance.

Cost :- Interest = 5400 ✓

$\left[\left(\frac{48,00,000}{12}\right) \times 90\% \times 18\% \times \frac{1}{12}\right]$

Processing fees (400,000 × 2%) = 8000 ✓

Bad-debts (400,000 × 1%) = 4000 ✓

17,400

Final Ans :- Since the Costs in both the options are equal, F Ltd. Can choose either of two- factoring or bank advance.

*Note :- It is assumed that F Ltd. will continue to incur management costs.

— x —

To be Continued...

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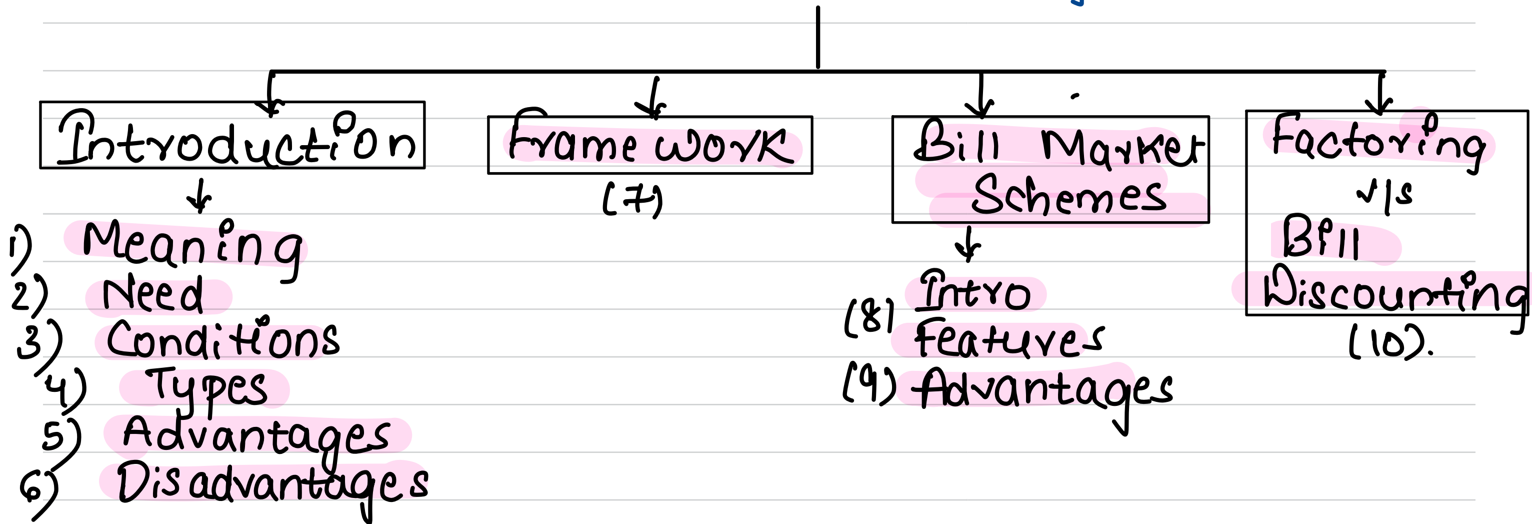
3. Bill Discounting



7]. Framework [Process] :-

Buyer / Drawee

SELLER / Drawer

Bank / finance Co.

① Credit Sale of Goods + Invoice

② Buyer accepts the Invoice & to pay on due date

③ Approach Bank and discount it

(4) Verify legitimacy of Bill + Buyer Creditworthiness

(5) Bank provides funds to Seller after discount / fees.

(6) Seller gets the funds and use it for business.

(7) Pay the Amount on Due-date

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1]. Introduction :-

→ **Meaning** [Bill discounting aka 'Bill of Exchange']

(1). It is an arrangement whereby the seller recovers an amount of Sales bill from the bank / FI before due-date (for a fee/discount).

(2) This bill is presented to seller's customer on due-date and full amount is collected.

(3) Bills / Invoices → technicaly 'Bills of Exchange'
BOE is a negotiable instrument (can be endorsed)

(4) Source of Capital for the Seller

(5) (Bill Amount − Amount paid) = Fee of the bank/FI.
10,000 − 9500 = 500
Fee ↓ Depends - Period / Risk

(6) Eg. Drawer has a bill for ₹ 10,000
Discount with bank 3 months before due date @ 10 % p.a.

$$\text{Discount} = 10{,}000 \times 10\% \times \frac{3}{12} = \text{Rs. } 250$$

→ Drawer will receive cash of ₹ 9750
Loss = ₹ 250

(7) On Due date, Bank present the bill to acceptor

- Honoured
  - ↓ Bank receive Cash
- Dishonoured
  - ↓ No payment from Acceptor
  - ↓ Drawer who discounted will pay to bank.
  - ↓ ∴ Contingent liability for the drawer

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2] Need for Bill Discounting :

→ (1) Immediate Cash to Seller - (Easy finance)
+
(2) Long - Credit period to Buyer.

Bank
Fee / Discount charge

3] Conditions :-

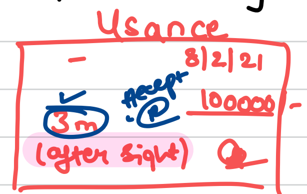
→ (1) A Bill must be Usance bill. (Time Maturity)

(2) Must be accepted and bears atleast two Signatures

(3) Bank normaly discount trade-bills only. (business related)

(4) Where a Usance bill drawn at a fixed period after sight, the bill must be accepted to establish the maturity.

(5) Discount period = From date of discount & Expires at date of maturity.



4]. Types of Bill Discounting :-

→ 1). Purchase bill discounting - Purchaser

2) Sales bill discounting - Seller

5]. Advantages of Bill Discounting :-

→ (1) For Seller - Immediate Cash for day-to day activities → (Instant Liquidity)

(2) -"- - No Collateral → No burden of mortgaging the asset with Bank.

(3) For Banks - Commission → Extra Income for a bank.
Less Risky

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6]. Disadvantages :-

→ (1). Bank Discount → Extra Cost for the holder of bill.

(2). Not honouring of bill → additional burden on the bank
→ additional admintrative expense

(3) Short-term source of finance → Not advisable for business.

10]. Factoring Vs. Bill Discounting :-

FACTORING	BILL DISCOUNTING
1. ***Definition :*** Factoring receivables is a source of short term finance in which the trader sells their unpaid invoices to factoring companies such as banks and financial institutions at a discounted rate. Then these factoring companies immediately pay the value of their invoices minus a fee to the trader.	Bill discounting is a source of short term finance in which the seller of goods draws up a bill of exchange on the buyer of the goods and then discounts the said bill of exchange with a bank or financial company.
2. ***Funding Arrangement :*** The factor gives maximum part of the amount as advance when the transaction takes place and the remaining amount at the time of settlement.	The entire bill is discounted and paid, when the transaction takes place.
3. ***Parties :*** There are three parties involved in factoring viz, Factor, Debtor and Client.	The parties involved in bill discounting arrangement are Drawer, Drawee and Payee.
4. ***Control of Sales Ledger :*** In factoring, the bank giving credit takes the onus of checking on the sales ledger, control of credit and chasing the seller's clients for paying back. The work of collection and follow up is outsourced to the bank.	Whereas bill discounting requires seller's own accounts team to take care of the sales invoice and follow-ups.

① Adv.
② Rem.

All pts :- (1). Defn
(2) Parties
(3) Type
(4) Charges / Compensation.
(5) Size of Business
(6) Funding Arrangement
(7) Control of Sales ledger
(8) Company Involvement
(9) Governing Statute.

5. ***Size of Business :*** Factoring is useful for larger businesses where an entire line-up of client credits have to be managed.	Bill discounting might be useful for small businesses. Also, bills might not be available on a continual basis for discounting.
6. ***Type :*** Factoring can be of two types recourse and non-recourse.	In bill discounting is under recourse only.
7. ***Company Involvement :*** Taking factor services allows the seller to focus on his business and the factor who is an expert in this field can provide a line of credit to him along with collection services.	Bill Discounting requires the seller's team to be involved in the entire process of recovery.
8. ***Governing Statute :*** Factoring is not governed by any specific Act.	[Bills of Exchange] Bill Discounting is governed by the Negotiable Instruments Act.
9. ***Compensation to Bank or Financier :*** In factoring bank or financier, charges commission along with interest.	The bank receives discounting charges for bill discounting.

★. Bill Market Schemes :

8]. Introduction -

→ . RBI introduced in November 1970.
- Object : Developing genuine bill market in India.
- As per the scheme, bills must be genuine trade bills ; bills which evidence sale / dispatch of goods.
- Rediscounting of these bills by RBI called "Bills Rediscounting Scheme".

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Features :-

Features

The main features of the New Bill Market Scheme are as follows.

(i) All licensed scheduled commercial banks including the public sector banks will be eligible to offer bills of exchange to the Reserve Bank for rediscounting.

(ii) The bills covered under the scheme must be genuine trade bills relating to the sale or dispatch of goods.

(iii) The Reserve Bank rediscounts these bills. That is why the scheme is also called 'Bills Rediscounting Scheme'. The rediscounting facility should be available at the Reserve Bank's offices at Mumbai, Kolkatta, Chennai and New Delhi. To avoid rediscounting of large number of small bills, such bills should be given in bunches.

(iv) The bill should be drawn on and accepted by the purchaser bank. If the purchaser's bank is not a licensed scheduled bank the bill should, in addition bear the signatures of a licensed scheduled bank.

(v) The bills should have maximum of 90 days.

(vi) The bills should bear at least two good signatures.

(vii) According to the modification of the scheme in 1971, the bills of exchange relating to the sale of goods to government departments and quasi government bodies as well as to statutory corporations have also been covered by the scheme.

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Advantages

The advantages of a genuine bill market to the banking system are stated below.

1. Normally, bills are self-liquidating and the date of repayment of a bank's advances by way of the discounting/rediscounting of bills is definite. In contrast, cash-credit is not self- liquidating.

2. Bills offer greater liquidity to their holders as they can be shifted to others in the market in case of need for cash.

3. A well-developed bill market helps greatly in evening out liquidity throughout the financial system, as those with short-term surplus funds of whatever duration can invest them in bills of desired maturities and can always hope to unload their holdings of bills to others in the market whenever they need cash. Thus, the short-term surpluses of some become available through the market to meet the short-run deficits of others.

4. The commercial bill rate is higher than the Treasury bill rate. Therefore, commercial banks and other financial institutions with short-run surpluses to invest find bills attractive not only for their liquidity but also for their return.

For Banks.

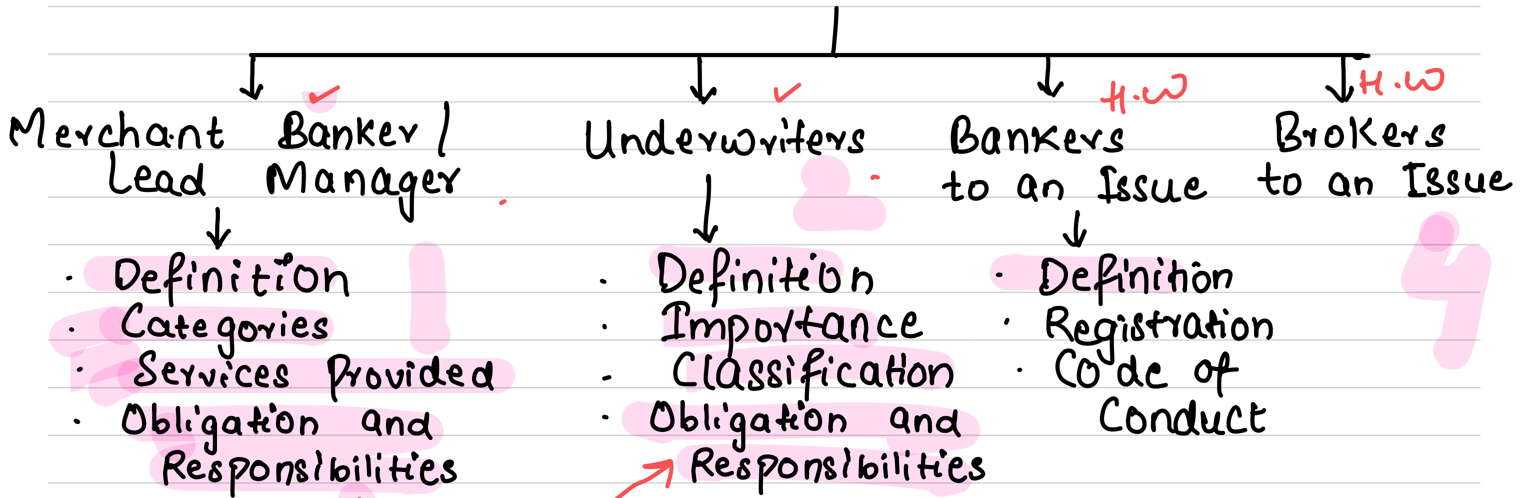
5. To the borrower, the cost of bill finance is lower than that of cash credit, because the bills carry the additional security in the form of acceptor's signature, are time-bound.

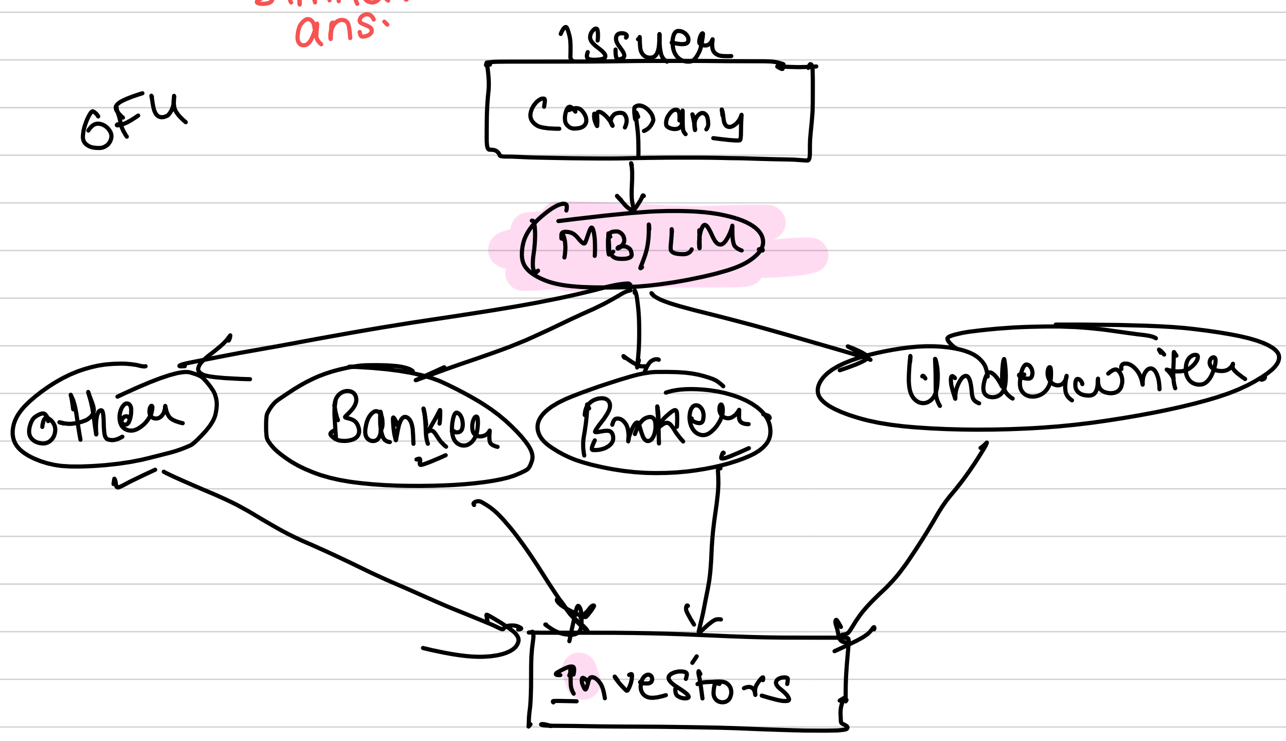
For borrower

6. Extensive use of bills as an instrument of short-term commercial credit and rediscounting of bills by the RBI makes the monetary system highly elastic. Whenever the economy is in need of more cash, banks can get a part of the bills in their portfolios rediscounted with the RBI and thereby increase the supply of money. The bill discounting process helps to meet the enhanced needs of busy-season finance.

—X—

3. Issue Management and Intermediaries





The securities markets in India have a long history. The Bombay Stock Exchange is the oldest stock exchange which commenced its operations in 1875. Prior to independence, the securities market was unregulated. Thus, the new issues in the market was regulated by the Controller of Capital Issues (CCI) as per the provisions of the Capital Issues (Control) Act, 1947. However, the Act was repealed and the office of the CCI was abolished in 1992.

There was a need felt for setting up a regulatory body to ensure investor protection and for the promotion of securities market. The Securities and Exchange Board of India (SEBI) was constituted on 12th April, 1988 and established as a statutory body on 21st February, 1992. Regulation of Indian securities market required SEBI to simultaneously perform both disciplinary and developmental roles. The disciplinary dimension involves providing for disincentives and penalties for unfair practices. The development dimension is a positive aspect that involves providing incentives to market participants to engage in a constructive role.

Intermediaries are indispensable in capital market. They play a pivotal role in today's capital market. While some trade dealings may involve only a single intermediary entity, more complex transactions requires several intermediaries at different levels.

Integration

Securities

Loan

SBI Bank.
Originator

Special Purpose Vehicle

Securitisation & Restructuring Co.

EMI ×

NPA.
[Non-Performing Asset]

B/S.

Liab.	Assets
D	
E	Loans & Adv. xxx

Invest

Int. (Return)

Investors

MF Cos, Ins. Cos, Banks, FI's.

Differentiation

Illiquid Asset → Liquid Asset

Hedgers, Speculators & Arbitragers

Mumbai

(30)

Crops
wheat → CMP ₹50.

Farmers

Contract to Sell

Contract
₹50

(60)

Parle

Wheat
Biscuit

Contract to Buy

- Existing Exposure
- To Reduce Risk

Hedger.

Contract ₹50.

contract to buy

Speculator

- No Existing Exposure
- To Earn profit on the basis of price expectation
- Loss possible

Contract to buy @ 50

Arbitragers.

- To Existing exposure
- To earn profit on the basis of price expectation
- Loss Not Possible

Contract to sell @ 58

Delhi

Farmers (Rs. 60)

₹60 Per kg

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