Course Name: Financial Markets and Banking Operations
Course Code: 205 fin

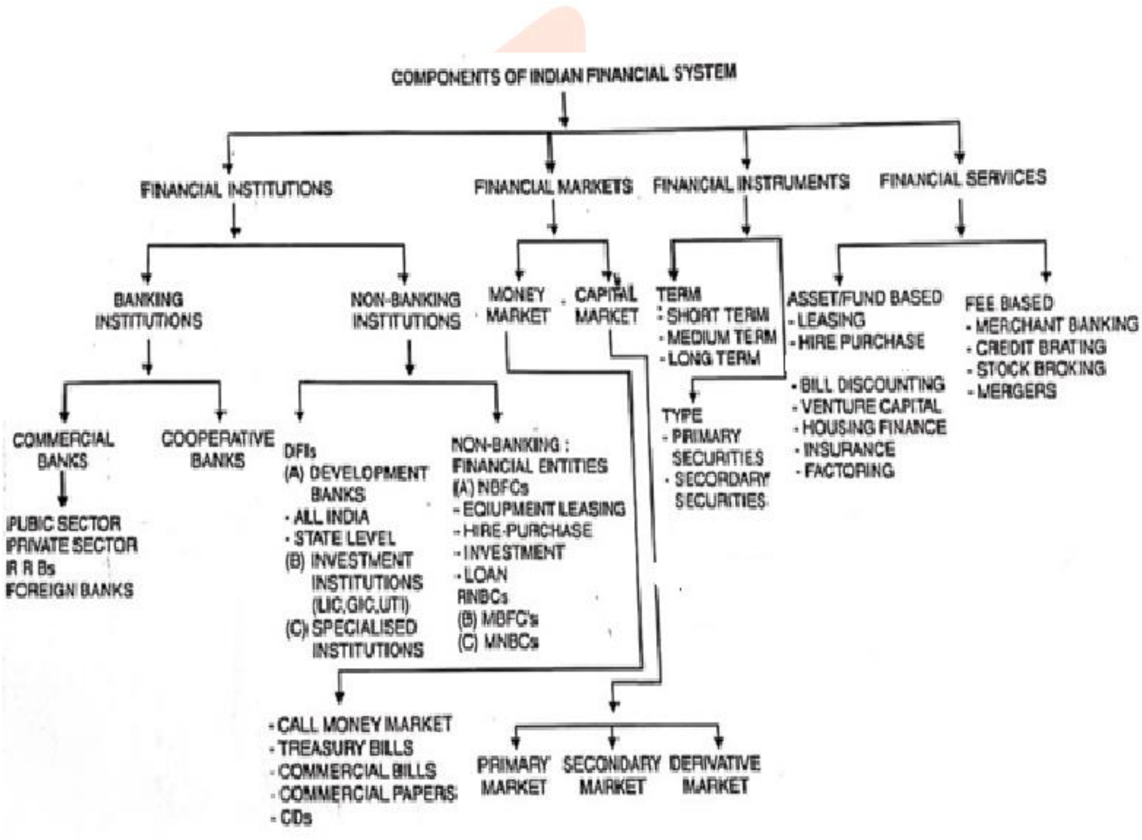
Unit-1

Indian Financial System

Introduction

Financial System is a set of institutional arrangements through which financial surpluses in the economy are mobilized from surplus units and transferred to deficit spenders.

Structure of Indian Financial system



The basic structure of Indian Financial System is divided into four components which are:

- Financial Services
- Financial Markets
- Financial Instruments

- Financial Institutions

Financial Services

As the name suggests **financial services** are the services provided by the Financial Institutions. These services generally include the *banking services, Foreign exchange services, investment services, insurance services* and few others. Following is a very brief description of the services

1. **Banking Services** – Includes all the operations provided by the banks including to the simple deposit and withdrawal of money to the issue of loans, credit cards etc.
2. **Foreign Exchange services** – this includes the currency exchange, foreign exchange banking or the wire transfer
3. **Investment Services** – It generally includes the asset management, hedge fund management and the custody services
4. **Insurance Services** – It deals with the selling of insurance policies, brokerages, insurance underwriting or the reinsurance
5. Some of the other services include the advisory services, venture capital, angel investment etc.

Financial Intermediaries

A financial intermediary is an institution which connects the deficit and the surplus. The best example of an intermediary can be a bank which transforms the bank deposits to bank loans. The role of financial intermediary is to channel funds from people who have extra inflow of money i.e., the savers to those who do not have enough money to full fill the needs or to carry out the basic activities i.e. the borrowers.

Functions of Financial Intermediaries

Functions of Financial Intermediary are basically classified in three parts which are as follows:

1. **Maturity transformation** – Deals with the conversion of short-term liabilities to long term assets.
2. **Risk transformation** – Conversion of risky investments into relatively risk-free ones.
3. **Convenience denomination** – Way of making the unmatched matching which is matching small deposits with large loans and large deposits with small loans.

Financial Intermediaries are classified into two types namely, Depository and Non-Depository Institutions.

Financial Instrument

Financial Instrument is a trade-able asset which can be in terms of cash, agreement, evidence of an ownership in an entity; or a contractual right which has the right to deliver cash or any kind of asset.
The types of financial instrument used worldwide are in the form deposits, stock, and debt.

1. **Deposits** – Deposit in a layman's term, means to save or to keep safely. Deposits can be made either with banking or non-banking firm.

2. **Stock** – Stocks represents the ownership of the issuing company. It is a form of corporate equity ownership where in the total stock of the company is divided into shares and the individuals has the provision to trade the shares in the exchange.
3. **Debts** – Unlike the stocks, financial assets which are in the form of debts create an obligation on the borrower of the fund to repay the amount borrowed. The debt instrument, thus in a sense, is a contract entered into by the borrower and the lender which specifies the amount of fund borrowed, period of borrow, the rate of interest that will be charged and the repayment methods.

Financial Market

Financial Market is a mechanism that allows people to indulge themselves in the buying and selling i.e. trade of financial securities (for example stocks and bonds), commodities (for example precious metals) at prices that reflect the market's effectiveness.
Following are the verticals of financial market:
1. Capital Market – Market where business enterprises or government entities raise fund for long term using the weapon of securities or debts. It includes the Stock market (equities) and Bond Market (debt) for fund raising.
2. Commodity Market – Commodity is a good for which there is a demand by the people thus commodity market is the market where such goods are traded.
3. Money Market – Deals with the assets involved in short-term borrowing and lending with original maturities ranging from a period of one year or even lesser time frames.
4. Derivative Market – The derivative market is the financial market meant for derivatives. The financial instruments like the futures contracts or options, which are derived from other forms of assets, are traded in these markets.
5. Insurance Market – Deals with the trading of insurance policies.
6. Futures Market – A vertical in financial market where people can trade standardized futures contracts which is a contract to buy specific number of quantities of a commodity or financial instrument at a specified price with the delivery of the commodity or financial instrument set at a specified time in the future**.**
7. Foreign Exchange Market – Also known as Forex is a global, worldwide decentralized financial market meant only for the trading of currencies.

Functions of Financial System

1. **Encourage Savings:**

Financial system promotes savings by providing a wide array of financial assets. With financial progress and innovations in financial technology, the scope of portfolio choice has also improved. Therefore, it is widely held that the savings-income ratio is directly related to both financial assets and financial institutions.

2. **Mobilisation of Savings**

Financial system is a highly efficient mechanism for mobilising savings.

3. Allocation of funds

Another important function of a financial system is to arrange smooth, efficient, and socially equitable allocation of credit. With modem financial development and new financial assets, institutions and markets have come to be organised, which are replaying an increasingly important role in the provision of credit. In the allocative functions of financial institutions lies their main source of power. By granting easy and cheap credit to particular firms, they can shift outward the resource constraint of these firms and make them grow faster.

Introduction to 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.

There are two types of FIs

1. Banking Institutions

Commercial banks accept deposits from the public and offer security to their customers. Due to commercial banks, it is no longer required to keep huge large currency on hand. Using commercial bank facilities, transactions can be done through checks or credit/debit cards.

2. Non-Banking Financial Institutions

Nonbank financial companies (NBFCs), also known as nonbank financial institutions (NBFIs) are financial institutions that offer various banking services but do not have a banking license. Generally, these institutions are not allowed to take traditional demand deposits—readily available funds, such as those in checking or savings accounts—from the public. This limitation keeps them outside the scope of conventional oversight from federal and state financial regulators.

Commodity market

A commodity exchange is an organized mar-ket that functions under established rules and regulations. This market is the place for the pur-chase and sale of commodities. The commodities which are generally traded in at the commodity exchanges include the follow-ing:

(i) Natural produce of the soil e.g. cotton, wheat, tea, jute etc.

(ii) Mineral products like copper, gold, mica, lead etc.

(iii) Some manufactured products like gunny bags, clothing, hides, artificial jams **etc.**

The products which possess the following characteristics are fit for dealing in commodity exchange:

1. Homogeneity
2. Durability
3. Gradeability
4. Price Fluctuation
5. Open Supply

Objectives of Commodity Exchanges

1. To provide an open platform for the interaction of free play of the forces of demand and supply.
2. Buying and selling, trading practices and ac-tual working of the organised market are governed by a code of rules and regulations and these can ensure fair dealings, fair prices and equity.
3. Only registers the prices reflecting the forces of de-mand and supply.

Functions of Commodity Exchanges:

Commodity exchanges are generally utilised for wholesale dealings in agricultural commodities or the products of some important primary indus-tries like lumbering.

These exchanges perform the following important functions:

1. Providing a Market Place:

A commodity exchange provides a convenient place where the members can meet at fixed hours and transact busi-ness in a commodity according to a certain well established rules and regulations. This type of facility is very important for trading in such com-modities as are produced in abundance and cover a very wide field as far as trading therein is con-cerned.

2. Regulating Trading:

As organised markets commodity exchanges establish and enforce rules and regulations with a view to facilitating trade on sound lines. The rules define the duties of mem-bers and lay down methods for business transac-tion.

3. Collecting and Disseminating Market In-formation:

The buyers and sellers on the commod-ity exchange enter into deals for settlement in fu-ture after making an assessment the trends of price and the prospects of a rise or fall in prices of a com-modity. The commodity exchange acts as an asso-ciation of these traders collecting the necessary in-formation and the relevant statistical data and pub-lishing it for the benefit of traders all over the country.

4. Grading of Commodities:

Commodities which are traded on the commodity exchanges have, to be graded according to quality. In this manner, the dealers can quickly enter into agree-ments for the purchase and sale of commodities by description.

5. Settling Disputes through Arbitration:

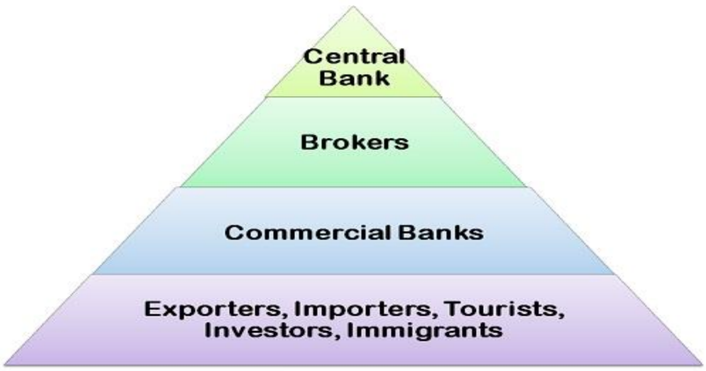
The commodity exchange provides machinery for the arbitration of trade disputes.

Foreign exchange markets

Introduction

The Foreign Exchange Market is a market where the buyers and sellers are involved in the sale and purchase of foreign currencies. In other words, a market where the currencies of different countries are bought and sold is called a foreign exchange market.

The structure of the foreign exchange market constitutes central banks, commercial banks, brokers, exporters and importers, immigrants, investors, tourists. These are the main players of the foreign market, their position and place are shown in the figure below.



Functions of Foreign Exchange Market

1. **Transfer Function:** The basic and the most visible function of foreign exchange market is the transfer of funds (foreign currency) from one country to another for the

settlement of payments. It basically includes the conversion of one currency to another, wherein the role of FOREX is to transfer the purchasing power from one country to another.

For example, If the exporter of India import goods from the USA and the payment is to be made in dollars, then the conversion of the rupee to the dollar will be facilitated by FOREX. The transfer function is performed through a use of credit instruments, such as bank drafts, bills of foreign exchange, and telephone transfers.

2. **Credit Function:** FOREX provides a short-term credit to the importers so as to facilitate the smooth flow of goods and services from country to country. An importer can use credit to finance the foreign purchases. Such as an Indian company wants to purchase the machinery from the USA, can pay for the purchase by issuing a bill of exchange in the foreign exchange market, essentially with a three-month maturity.

3. **Hedging Function:** The third function of a foreign exchange market is to hedge foreign exchange risks. The parties to the foreign exchange are often afraid of the fluctuations in the exchange rates, i.e., the price of one currency in terms of another. The change in the exchange rate may result in a gain or loss to the party concerned

   Types of Foreign Exchange Transactions

   The Foreign Exchange Transactions refers to the sale and purchase of foreign currencies. Simply, the foreign exchange transaction is an agreement of exchange of currencies of one country for another at an agreed exchange rate on a definite date**.**

   1. **Spot Transaction:** The spot transaction is when the buyer and seller of different currencies settle their payments within the two days of the deal. It is the fastest way to exchange the currencies. Here, the currencies are exchanged over a two-day period, which means no contract is signed between the countries. The exchange rate at which the currencies are exchanged is called the Spot Exchange Rate. This rate is often the prevailing exchange rate. The market in which the spot sale and purchase of currencies is facilitated is called as a Spot Market.

   2. **Forward Transaction:** A forward transaction is a future transaction where the buyer and seller enter into an agreement of sale and purchase of currency after 90 days of the dealat a fixed exchange rate on a definite date in the future. The rate at which the currency is exchanged is called a Forward Exchange Rate. The market in which the deals for the sale and purchase of currency at some future date is made is called a Forward Market.

   3. **Future Transaction:** The future transactions are also the forward transaction sand deals with the contracts in the same manner as that of normal forward transactions.

But however, the transactions made in a future contract differs from the transaction made in the forward contract on the following grounds:

- The forward contracts can be customized on the client's request, while the future contracts are standardized such as the features, date, and the size of the contracts is standardized.
- The future contracts can only be traded on the organized exchanges, while the forward contracts can be traded anywhere depending on the client's convenience.
- No margin is required in case of the forward contracts, while the margins are required of all the participants and an initial margin is kept as collateral so as to establish the future position**.**

4. **Swap Transactions:** The Swap Transactions involve a simultaneous borrowing and lending of two different currencies between two investors. Here one investor borrows the currency and lends another currency to the second investor. The obligation to repay the currencies is used as collateral, and the amount is repaid at a forward rate. The swap contracts allow the investors to utilize the funds in the currency held by him/her to pay off the obligations denominated in a different currency without suffering a foreign exchange risk.
5. **Option Transactions:** The foreign exchange option gives an investor the right, but not the obligation to exchange the currency in one denomination to another at an agreed exchange rate on a pre-defined date. An option to buy the currency is called as a Call Option, while the option to sell the currency is called as a Put Option.

Thus, the Foreign exchange transaction involves the conversion of a currency of one country into the currency of another country for the settlement of payments.

Participants in Foreign Exchange Market:

Participants in Foreign exchange market can be categorized into five major groups, viz.; commercial banks, Foreign exchange brokers, Central bank, MNCs and Individuals and Small businesses.

1.Commercial Banks:

The major participants in the foreign exchange market are the large Commercial banks who provide the core of market. As many as 100 to 200 banks across the globe actively "make the market" in the foreign exchange.

2. **Foreign Exchange Brokers**

Foreign exchange brokers also operate in the international currency market. They act as agents who facilitate trading between dealers. Unlike the banks, brokers serve merely as matchmakers and do not put their own money at risk.

3. Central banks:

Another important player in the foreign market is Central bank of the various countries. Central banks frequently intervene in the market to maintain the exchange rates of their currencies within a desired range and to smooth fluctuations within that range.

4. **MNCs:**

MNCs are the major non-bank participants in the forward market as they exchange cash flows associated with their multinational operations. MNCs often contract to either pay or receive fixed amounts in foreign currencies at future dates, so they are exposed to foreign currency risk.

5. Individuals and Small Businesses:

Individuals and small businesses also use foreign exchange market to facilitate execution of commercial or investment transactions. The foreign needs of these players are usually small and account for only a fraction of all foreign exchange transactions

Cryptocurrency

A cryptocurrency is a digital currency that operates in a decentralized manner and uses encryption. In other words, no central bank or government regulates this currency (it's decentralized). It is digital in that it is virtual, not like physical money. And it uses security features (encryption/cryptography) in order to avoid counterfeiters, secure transactions, and generate the units of currency.

History

The very first such cryptocurrency created is known as Bitcoin. It was created in 2009 by someone, or a group of people, who goes by the pseudonym of Satoshi Nakamoto. The short gist of it is, no one knows the exact details of who created this cryptocurrency.

This cryptocurrency was created in the wake of the 2008 financial crisis, which hit the world's economic systems pretty hard. People were upset at banks and governments for a wide variety of reasons. One of these reasons was the implicit nature that citizens had to trust banks and governments, things completely outside of their control, with their hard-earned money.

Characteristics

1) Trust less

Bitcoin is trust less because it was designed in a way that nobody has to trust anybody else in order for the network to function.

Every form of currency before bitcoin required a central authority that you had to trust in order to use it. In all cases, that central authority becomes the central weakness that leads to the demise of the currency.

2) Immutable

Immutable", in its simplest sense, means "cannot be undone."

Immutability in regards to blockchain and cryptocurrency should follow 3 principles:

- It should be highly improbable or difficult to rewrite history.
- It should be impossible for anyone but the owner of a private key to move funds.
- All transactions are recorded on the blockchain**.**

3) Decentralized

Since "decentralization" is such a relevant buzzword in the crypto community, it's important to define it well. It can take on different meanings**.**

Derivatives markets

A derivative is an instrument whose value depends on the values of other more basic underlying variables. The underlying vari-ables could be:

1. Stock prices,

2. Exchange rates, and

3. Interest rates.

Functions of Derivatives:

1. Derivatives shift the risk from the buyer of the derivative product to the seller and as such are very effective risk management tools.
2. Derivatives improve the liquidity of underlying assets.

Salient Features of Derivatives:

1. Financial Derivatives are products whose values are derived from the values of the underlying assets.

2. Derivatives have the characteristics of high leverage and of being complex in their pricing and trading mechanism.

3. Derivatives enable price discovery, improve the liquidity of the underlying asset, serve as effective hedge instruments and offer better ways of raising money.

4. The main players in a financial market include hedgers, speculators, arbitrageurs and traders.

5. Hedging can be done in two ways viz. fixing a price (the linear way) and taking an insurance (non-linear or asymmetric way).

Participants in the Derivatives Market

The participants in the derivatives market can be broadly categorized into the following four groups:

1. Hedgers

Hedging is when a person invests in financial markets to reduce the risk of price volatility in exchange markets, i.e., eliminate the risk of future price movements. Derivatives are the most popular instruments in the sphere of hedging. It is because derivatives are effective hedges in correspondence with their respective underlying assets.

2. Speculators

Speculation is the most common market activity that participants of a financial market take part in. It is a risky activity that investors engage in. It involves the purchase of any financial instrument or an asset that an investor speculates to become significantly valuable in the future. Speculation is driven by the motive of potentially earning lucrative profits in the future.

3. Arbitrageurs

Arbitrage is a very common profit-making activity in financial markets that comes into effect by taking advantage of or profiting from the price volatility of the market. Arbitrageurs make a profit from the price difference arising in an investment of a financial instrument such as bonds, stocks, derivatives, etc

4. Margin traders

In the finance industry, the margin is the collateral deposited by an investor investing in a financial instrument to the counterparty to cover the credit risk associated with the investment.

Types of Derivative Contracts

Derivative contracts can be classified into the following four types

1. Options

Options are financial derivative contracts that give the buyer the right, but not the obligation, to buy or sell an underlying asset at a specific price (referred to as the strike price) during a specific period of time. American options can be exercised at any time before the expiry of its option period. On the other hand, European options can only be exercised on its expiration date.

2. Futures

Futures contracts are standardized contracts that allow the holder of the contract to buy or sell the respective underlying asset at an agreed price on a specific date. The parties involved in a futures contract not only possess the right but also are under the obligation, to carry out the contract as agreed. The contracts are standardized, meaning they are traded on the exchange market.

3. Forwards

Forwards contracts are similar to futures contracts in the sense that the holder of the contract possess not only the right but is also under the obligation to carry out the contract as agreed. However, forwards contracts are over the counter products, which means they are not regulated and are not bound by specific trading rules and regulations.

Since such contracts are unstandardized, they are traded over the counter and not on the exchange market. As the contracts are not bound by a regulatory body's rules and regulations, they are customizable to suit the requirements of both parties involved.

4. Swaps

Swaps are derivative contracts that involve two holders, or parties to the contract, to exchange financial obligations. Interest rate swaps are the most common swaps contracts entered into by investors. Swaps are not traded on the exchange market. They are traded over the counter, because of the need for swaps contracts to be customizable to suit the needs and requirements of both parties involved.

Criticisms of the Derivatives Market

1. Risk

The derivatives market is often criticized and looked down on, owing to the high risk associated with trading in financial instruments.

2. Sensitivity and volatility of the market

Many investors and traders avoid the derivatives market because of its high volatility. Most financial instruments are very sensitive to small changes such as a change in the expiration period, interest rates, etc., which makes the market highly volatile in nature.

3. Complexity

Owing to the high-risk nature and sensitivity of the derivatives market, it is often a very complex subject matter. Because the derivatives trading is so complex to understand, it is most often avoided by the general public, and they often employ brokers and trading agents in order to invest in financial instruments.

4. Legalized gambling

Owing to the nature of trading in financial markets, derivatives are often criticized for being a form of legalized gambling, as it is very similar to the nature of gambling activities.

Trade in Derivative market

1. First, need to understand the functioning of derivative markets before trading. The strategies applicable in derivatives are completely different from that of the stock market.
2. Derivative market requires you to deposit margin amount before starting trading. The margin amount cannot be withdrawn until the trade is settled.
3. Should have an active trading account which permits derivative trading.
4. For selection of stocks, consider factors like cash in hand, the margin requirements, the price of the contract and that of the underlying shares. Make sure that everything is as per your budget.

Unit-2

Money Market

Introduction

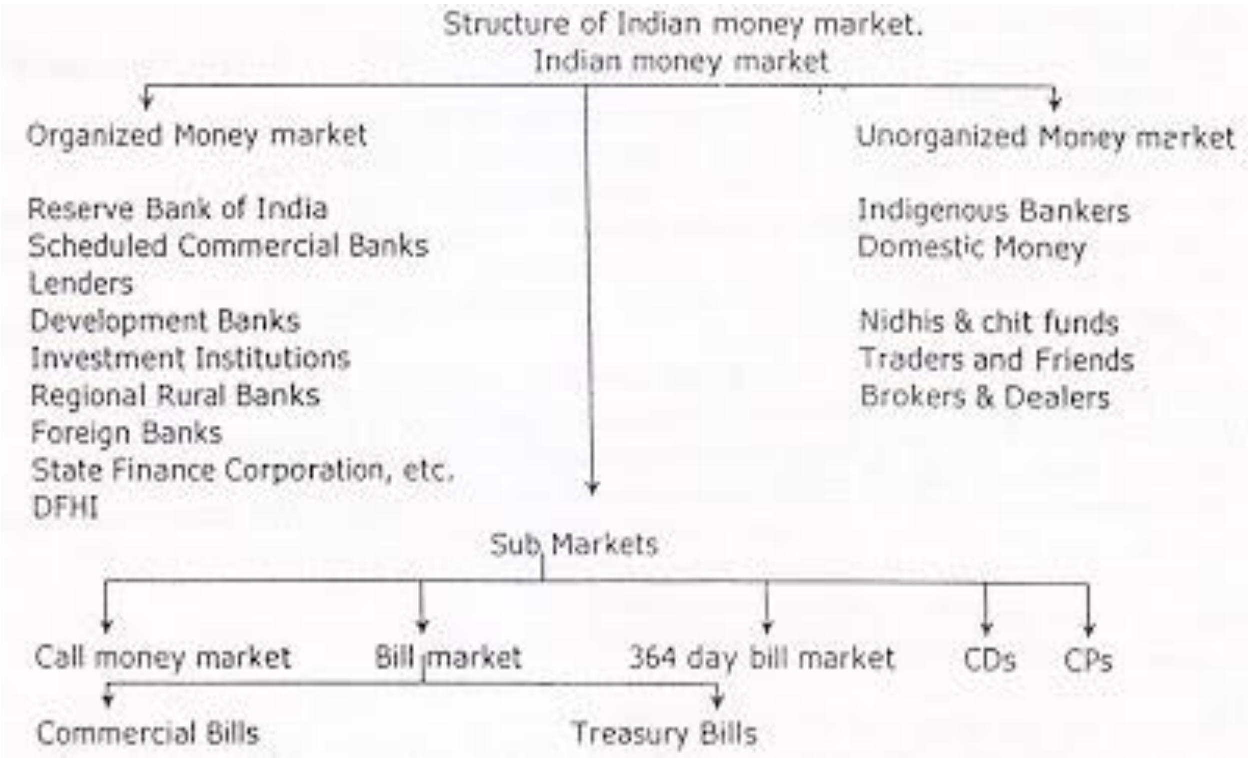
The Money Market is a market for lending and borrowing of short-term funds. It deals in funds and financial instruments having a maturity period of one day to one year. It covers money and financial assets that are close substitutes for money. The instruments in the money market are of short-term nature and highly liquid.

- As per RBI definitions “A market for short terms financial assets that are close substitute for money, facilitates the exchange of money in primary and secondary market”.
- The money market is a mechanism that deals with the lending and borrowing of short-term funds (less than one year).
- It doesn’t actually deal in cash or money but deals with substitute of cash like trade bills, promissory notes & govt papers which can convert into cash without any loss at low transaction cost.
- It includes all individual, institution and intermediaries.

Structure or components of Indian money market.

The Indian money market consists of two segments,

1. Organized sector
2. Unorganized sector.



The RBI is the most important constituents of Indian money market. The organized sector is within the direct purview of RBI regulation. The unorganized sector comprises of indigenous bankers, money lenders and unregulated non-banking financial institutions. The structure or components of Indian money market is depicted the following:

(A) Organised Sector

1. **Call and Notice Money Market:**

Under call money market, funds are transacted on overnight basis. Under notice money market funds are transacted for the period between 2 days and 14 days. The funds lent in the notice money market do not have a specified repayment date when the deal is made. The lender issues a notice to the borrower 2-3 days before the funds are to be paid. On receipt of this notice, the borrower will have to repay the funds within the given time. Generally, banks rely on the call money market where they raise funds for a single day. The main participants in the call money market are commercial banks (excluding RRBs), cooperative banks and primary dealers. Discount and Finance House of India (DFHI), Non-banking financial institutions such as LIC, GIC, UTI, NABARD etc. are allowed to participate in the call money market as lenders.

2. **Treasury Bills (T-Bills):**

Treasury bills are short-term securities issued by RBI on behalf of Government of India. They are the main instruments of short term borrowing by the Government. They are useful in managing short-term liquidity. At present, the Government of India issues three types of treasury bills through auctions, namely – 91 days, 182-day and 364-day treasury bills. There are no treasury bills issued by state governments. With the introduction of the auction system, interest rates on all types of TBs are being determined by the market forces.

3. **Commercial Bills:**

Commercial bill is a short-term, negotiable, and self-liquidating instrument with low risk. They are negotiable instruments drawn by a seller on the buyer for the value of goods delivered by him. Such bills are called trade bills. When trade bills are accepted by commercial banks, they are called commercial bills. If the seller gives some time for payment, the bill is payable at future date (i.e. usance bill). Generally, the maturity period is up to 90 days. During the usance period, if the seller is in need of funds, he may approach his bank for discounting the bill. Commercial banks can provide credit to customers by discounting commercial bills. The banks can rediscount the commercial bills any number of times during the usance period of bill and get money.

4. **Certificates of Deposits (CDs):**

CDs are unsecured, negotiable promissory notes issued at a discount to the face value. They are issued by commercial banks and development financial institutions. CDs are marketable receipts of funds deposited in a bank for a fixed period at a specified rate of interest. CDs were introduced in India in June 1989. The main purpose of the scheme was to enable commercial banks to raise funds from the market through CDs. According to the original scheme, CDs were issued in multiples of Rs.25 lakh subject to minimum size of an issue being Rs.1 crore. They had the maturity period of 3 months to one year. They are freely transferable but only after the lock in period of 45 days after the date of issue.

5. **Commercial Papers (CPs):**

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note with fixed maturity. They indicate the short-term obligation of an issuer. They are quite safe and highly liquid. They are generally issued by the leading, nationally reputed, highly rates and credit worthy large manufacturing and finance companies is the public as well as private sector. CPs were introduced in India January 1990. CPs were launched in India with a view to enable highly rated corporate borrowers to diversify their sources of short-term borrowings and also to provide an additional instrument to investors. RBI has modified its original scheme in order to widen the market for CPs. Corporates and primary dealers (PDs) and the all India financial institutions can issue CPs. A corporate can issue CPs provided they fulfill the following conditions: (a) The tangible net worth of the company is not less than Rs.4 crore. (b) The company has been sanctioned working capital limit by banks or all India financial institutions, and (c) The borrowed account of the company is classified as a standard asset by the financing institution or bank.

6. **Repos:**

A repo or reverse repo is a transaction in which two parties agree to sell and repurchase the same security. Under repo, the seller gets immediate funds by selling specified securities with an agreement to repurchase the same at a mutually decided future date and price. Similarly, the buyer purchases the securities with an agreement to resell the same to the seller at an agreed date and price. The repos in government securities were first introduced in India since December 1992. Since November 1996, RBI has introduced "Reverse Repos", i.e. to sell government securities through auction.

7. **Discount and Finance House of India (DFHI):**

It was set up by RBI in April 1988 with the objective of deepening and activating money market. It is jointly owned by RBI, public sector banks and all India financial institutions which have contributed to its paid-up capital. The DFHI deals in treasury bills, commercial bills, CDs, CPs, short-term deposits, call money market and government securities. The presence of DFHI as an intermediary in the money market has helped the corporate entities, banks, and financial institutions to invest their short-term surpluses in money market instruments.

8. **Money Market Mutual Funds (MMMFs):**

RBI introduced MMMFs in April 1992 to enable small investors to participate in the money market. MMMFs mobilizes savings from small investors and invest them in short-term debt instruments or money market instruments such as call money, repos, treasury bills, CDs and CPs. These instruments are forms of debt that mature in less than a year.

(B) Unorganised Sector

The unorganized Indian money market is largely made up of indigenous bankers, money lenders and unregulated non-bank financial intermediaries. They do operate in urban centres but their activities are largely confined to the rural sector. This market is unorganized because its activities are not systematically coordinated by the RBI. The main components of unorganized money market are:

1. **Indigenous Bankers:**

They are financial intermediaries which operate as banks, receive deposits and give loans and deals in hundies. The hundi is a short-term credit instrument. It is the indigenous bill of exchange. The rate of interest differs from one market to another and from one bank to another. They do not depend on deposits entirely; they may use their own funds.

2. **Money Lenders:**

   They are those whose primary business is money lending. Money lenders predominate in villages. However, they are also found in urban areas. Interest rates are generally high. Large amount of loans are given for unproductive purposes. The borrowers are generally agricultural labourers, marginal and small farmers, artisans, factory workers, small traders, etc.

3. **Unregulated non-bank Financial Intermediaries:**

   The consist of Chit Funds, Nithis, Loan companies and others. (a) Chit Funds: They are saving institutions. The members make regular contribution to the fund. The collected funds is given to some member based on previously agreed criterion (by bids or by draws). Chit Fund is more famous in Kerala and Tamilnadu. (b) Nidhis: They deal with members and act as mutual benefit funds. The deposits from the members are the major source of funds and they make loans to members at reasonable rate of interest for the purposes like house construction or repairs. They are highly localized and peculiar to South India. Both chit funds and Nidhis are unregulated.

4. **Finance Brokers:**

   They are found in all major urban markets specially in cloth markets, grain markets and commodity markets. They are middlemen between lenders and borrowers.

Functions of Money Market:

1. To maintain monetary balance between demand and supply of short term monetary transactions.

2. Money market plays a very important role of making funds available to many units or entities engaged in diversified field of activities be it agriculture, industry, trade, commerce or any other business.

3. By providing funds to developing sectors it helps in growth of economy also.

4. Another important feature that money market provides is discounting of bills of exchange which facilitates growth of trade.

5. No doubt it provides a base for the implementation of monetary policy also.

5. The money market provides opportunity for short term investments, which provide for short term savings, which in turn help formation of capital base also.

Characteristics of Money Market

1. It is a market purely for short-terms funds or financial assets called near money.
2. It deals with financial assets having a maturity period less than one year only.
3. In Money Market transaction can not take place formal like stock exchange, only through oral communication, relevant document and written communication transaction can be done.
4. Transaction have to be conducted without the help of brokers.
5. It is not a single homogeneous market, it comprises of several submarket like call money market, acceptance & bill market.
6. The component of Money Market are the commercial banks, acceptance houses & NBFC (Non-banking financial companies).

Features of Money Market

1. Existence of Unorganized Money Market:

This is one of the major defects of Indian money market. It does not distinguish between short term and long-term finance, and also between the purposes of finance. Since it is outside the control and supervision of RBI, it limits the RBI's control of over money market.

2. Lack of Integration:

The Indian money market is broadly divided into two sectors, the organized money market and the unorganized market. The organized market constitutes several institutions such as RBI, State Bank of India, commercial banks, cooperative banks and financial institutions. RBI as an apex body regulates their working. The unregulated sector is not homogenous in itself. It constitutes indigenous bankers, loan companies, money lenders, etc. There is no uniformity in their practices and there is multiplicity of functionaries.

3. Multiplicity in Interest Rates:

There exist too many rates of interest in the Indian money market such as the borrowing rate of government, deposits and lending rates of cooperative and commercial banks, lending rates of financial institutions, etc. This is due to lack of mobility of funds from one section of the money market to another. The rates differ for funds of same durations lent by different institutions.

4. **Inadequate Funds:**

   Generally, there is shortage of funds in Indian money market on account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy, etc. However, the banking development particularly branch expansion, has improved the mobilization of funds to some extent in the recent years.

5. **Seasonal Stringency of Money:**

   The seasonal stringency of money and high rate of interest during the busy season (November to June) is a striking feature of Indian money market. There are wide fluctuations in the interest rates from one season to another. RBI has been taking various measures to avoid such fluctuations in the money market by adding money into the money market during the busy season and withdrawing the funds during the slack season.

6. **Absence of Bill Market:**

   A well-organized bill market is necessary for linking up various credit agencies effectively to RBI. The bill market is not yet developed on account of many factors such as the practice of banks keeping a large amount of cash for liquidity purposes, preference for borrowing rather than discounting bills, dependence of indigenous bankers on one another, widespread practice of using cash credit, high stamp duty on usance bill, etc.

7. **Inadequate Credit Instruments:**

   The Indian money market did not have adequate short-term paper instruments till 1985-86. There were only call money and bill markets. Moreover, there were no specialist dealers and brokers dealing in the money market. After 1985-86, RBI has introduced new credit instruments such as 182-day treasury bills, 364-day treasury bills, CDs and CPs. These instruments are still in underdeveloped state in India. The above defects of Indian money market clearly indicate that it is relatively less developed and has yet to acquire sufficient depth and width. Thus, it cannot be compared with developed money markets such as London and New York money markets.

Reforms of Money Market

The Committee to Review the Working of Monetary System chaired by S. Chakravarty made several recommendations in 1985 to develop Indian money market. As a follow-up, the RBI set up a Working Group on money market under the chairmanship of N. Vaghul, in 1987. Based on the recommendations of Vaghul Committee, RBI initiated a number of measures to widen and deepen the money market. The main measures are as follows.

1. **Deregulation of Interest Rates**:

   From May 1989, the ceiling on interest rates on the call money, inter-bank short-term deposits, bills rediscounting and inter-bank participation was removed and the rates were permitted to be determined by the market forces. Thus, the system of administered interest rates is being gradually dismantled.

2. Introduction of New Money Market Instruments:

In order to widen and diversify the Indian money market RBI has introduced many new money market instruments such as 182-days treasury bills, 364-day treasury bills, CDs & CPs. Through these instruments the government, commercial banks, financial institutions and corporate can raise funds through the money market. They also provide investors additional instruments for investments. In order to expand the investor base for CDs and CPs the minimum amount of investment and the minimum maturity periods are reduced by RBI.

3. **Repurchase Agreements (Repos):**

   RBI introduced repos in government securities in December 1992 and reverse repos in November 1996. Repos and reverse repos help to even out short-term fluctuations in liquidity in the money market. They also provide a short-term avenue to banks to park their surplus funds. Through changes in repo and reverse repo rates RBI transmits policy objectives to entire money market.

4. **Liquidity Adjustment Facility (LAF):**

   RBI has introduced LAF from June 2000 as an important tool for adjusting liquidity through repos and reverse repos. Thus, in the recent years RBI is using repos and reverse repos as a policy to adjust liquidity in the money market and therefore, to stabilize the short-term interest rates or call rates. LAF has, therefore, emerged as a major instrument of monetary policy.

5. **Money Market Mutual Funds (MMMF):**

   RBI introduced MMMFs in April 1992 to enable the individual investors to participate in money market. To make the scheme flexible and attractive, RBI has brought about many modifications. The important features of this scheme as of now are: (i) It can be set up by commercial banks, financial institutions and private sector. (ii) Individual investors, corporates and others can invest in MMMFs. (iii) Resources mobilized through this scheme can be invested in money market instruments as well as rated corporate bonds and debentures with a maturity period up to one year. (iv) The minimum lock in period is now 15 days.

6. **Discount and Finance House of India (DFHI**):

   In order to impart liquidity to money market instruments and help the development of secondary market in such instruments, DFHI was set up in 1988 jointly by RBI, public sector banks and financial institutions.

7. **Development of Inter-bank Call and Notice Money Market:**

   The call and notice money market is an inter-bank market the world over and therefore the Narsimham Committee has recommended that we adopt the same in India. However, RBI in the past had given permission to non-bank institutions to participate in the call money market as lenders. As per the recommendations of Narsimham Committee RBI in 2001-02 has underlined the need for transforming the call money market into a pure inter-bank money market.

8. **Regulation of NBFCs:**

   The RBI Act was amended in 1997 to provide for a comprehensive regulation of NBFC sector. According to the amendment, no NFBC can carry on any business of a financial institution, including acceptance of public deposit, without obtaining a Certificate of Registration (CoR) from RBI.

9. **The Clearing Corporation of India Limited (CCIL):**

   The CCIL was registered on April 30, 2001 under the Companies Act, 1956, with the State Bank of India as the chief promoter. The CCIL clears all transactions in government securities and repos reported on the Negotiated Dealing System (NDS) of RBI.

Instrument of Money Market

A variety of instrument are available in a developed money market. In India till 1986, only a few instruments were available They were:

- Treasury bills
- Commercial papers.
- Certificate of deposit.
- Call Money Market
- Commercial bills market

Treasury Bills (T-Bills)

- Treasury bills (TBs), offer short-term investment opportunities, generally up to one year.
- They are thus useful in managing short-term liquidity.
- Types of treasury bills through auctions
- 91- Day, 182- day, 364- day, and 14- day TBs

Commercial paper (CP)

- CP is a short term unsecured loan issued by a corporation typically financing day to day operation.
- CP is very safe investment because the financial situation of a company can easily be predicted over a few months.
- Only company with high credit rating issues CP's.

CERTIFICATES OF DEPOSIT

- Certificate of Deposit (CD) is a negotiable money market instrument and issued in dematerialised form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institution for a specified time period
- Scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs)
- Select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella limit fixed by RBI.

CALL MONEY MARKET

- Call money market is that part of the national money market where the day to day surplus funds, mostly of banks are traded in.
- They are highly liquid, their liquidity being exceed only by cash.
- The loans made in this market are of the short-term nature.

COMMERCIAL BILLS MARKET

- Funds for working capital required by commerce and industry are mainly provided by banks through cash credits, overdrafts, and purchase/discontinuing of commercial bills.

BILL OF EXCHANGE

- The financial instrument which is traded in the bill market of exchange. It is used for financing a transaction in goods that takes some time to complete.

Participants in Money Market

- Central Government:
- State Government:
- Public Sector Undertakings:
- Scheduled Commercial Banks (SCBs)
- Private Sector Companies:
- Provident Funds:
- General Insurance Companies
- Life Insurance Companies:
- Mutual Funds
- Non-banking Finance Companies:

Unit-3

Capital Market

Capital market is the market for medium and long-term funds. It refers to all the facilities and the institutional arrangements for borrowing and lending term funds (medium-term and long-term funds). The demand for long-term funds comes mainly from industry, trade, agriculture and government. The central and state governments invest not only on economic overheads such as transport, irrigation, and power supply but also a basic and consumer goods industry and hence require large sums from capital market. The supply of funds comes largely from individual savers, corporate savings, banks, insurance companies, specialized financial institutions and government.

Functions of Capital Market:

- It acts in linking investors and savers
- 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
- Minimization of transaction and information cost
- Encourages a massive range of ownership of productive assets
- Quick valuations of financial instruments
- Through derivative trading, it offers insurance against market or price threats
- Facilitates transaction settlement
- Improvement in the effectiveness of capital allocation
- Continuous availability of funds

Significance of Capital Market in economic development.

Capital market has a crucial significance to capital formation. Adequate capital formation is indispensable for a speedy economic development. The main function of capital market is the collection of savings and their distribution for industrial development. This stimulates capital formation and hence, accelerates the process of economic development. A sound and efficient capital market facilitates the process of capital formation and thus contributes to economic development. The significance of capital market in economic development is explained below.

1. **Mobilization of Savings**: Capital market is an organized institutional network of financial organizations, which not only mobilizes savings through various instruments but also channelizes them into productive avenues. By making available various types of financial assets, the capital market encourages savings. By providing liquidity to these financial assets through the secondary

markets capital market is able to mobilize large amount of savings from various sections of the people such as individuals, families, and associations. Thus, capital market mobilizes these savings and make the same available for meeting the large capital needs of industry, trade and business.

2. **Channelization of Funds into Investments**: Capital market plays a crucial role in the economic development by channelizing funds in accordance with development priorities. The financial intermediaries in the capital market are better placed than individuals to channel the funds into investments which are more favourable for economic development.

3. **Industrial Development**: Capital market contributes to industrial development in the following ways: (a) It provides adequate, cheap and diversified finance to the industrial sector for various purposes. (b) It provides funds for diversified purposes such as for expansion, modernization, upgradation of technology, establishment of new units etc. (c) It provides a variety of services to entrepreneurs such as provision of underwriting facilities, participating in equity capital, credit rating, consultancy services, etc. This helps to stimulate industrial entrepreneurship.

4**. Modernization and Rehabilitation of Industries**: Capital market can contribute towards modernization, rationalization and rehabilitation of industries. For example, the setting up of development financial institutions in India such as IFCI, ICICI, IDBI and so on has helped the existing industries in the country to adopt modernization and replacement of obsolete machinery by providing adequate finance.

5. **Technical Assistance**: An important bottleneck faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to the preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in the capital market play an important role in stimulating industrial entrepreneurship. This helps to stimulate industrial investment and thus promotes economic development.

6**. Encourage Investors to invest in Industrial Securities**: Secondary market in securities encourage investors to invest in industrial securities by making them liquid. It provides facilities for

continuous, regular and ready buying and selling of securities. Thus, industries are able to raise substantial amount of funds from various segments of the economy.

7**. Reliable Guide to Performance**: The capital market serves as a reliable guide to the performance and financial position of corporate, and thereby promotes efficiency. It values companies accurately and toes up manager compensation to stock values. This gives incentives to managers to maximize the value of companies. This stimulates efficient resource allocation and growth.

Reforms in Capital Market

The reforms in the capital market are explained below with respect to primary and capital markets in India.

Primary Market Reforms

A number of measures has been taken in India especially since 1991 to develop primary market in India. These measures are discussed below:

1**. Abolition of Controller of Capital Issues**: The Capital Issues (Control) Act, 1947 governed capital issues in India. The capital issues control was administered by the Controller of Capital Issues (CCI). The Narasimham Committee (1991) had recommended the abolition of CCI and wanted SEBI to protect investors and take over the regulatory function of CCI. Thus, government replaced the Capital Issues (Control) Act and abolished the post of CCI. Companies are allowed to approach the capital market without prior government permission subject to getting their offer documents cleared by SEBI.

2. **Securities and Exchange Board of India (SEBI**): SEBI was set up as a non-statutory body in 1988 and was made a statutory body in January 1992. SEBI has introduced various guidelines for capital issues in the primary market. They are explained below.

3. **Disclosure Standards**: Companies are required to disclose all material facts and specific risk factors associated with their projects. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures.

4. **Freedom of Determine the Par Value of Shares**: The requirement to issue shares at a par value of Rs.10 and Rs.100 was withdrawn. SEBI has allowed the companies to determine the par value of shares issued by them. SEBI has allowed issues of IPOs through “book building” process.

5. **Underwriting Optional**: To reduce the cost of issue, underwriting by the issuer is made optional. It is subject to the condition that if an issue was not underwritten and was not able to collect 90% of the amount offered to the public, the entire amount collected would be refunded to the investors.

6. **FIIs Permitted to Operate in the Indian Market**: Foreign institutional investors such as mutual funds and pension funds are allowed to invest in equity shares as well as in debt market, including dated government securities and treasury bills.

7. Accessing Global Funds Market: Indian companies are allowed to aces global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Indian companies can list their securities on foreign stock exchanges through ADR./GDR issues.

8. Intermediaries under the Purview of SEBI: Merchant bankers, and other intermediaries such as mutual funds including UTI, portfolio managers, registrars to an issue, share transfer agents, underwriters, debenture trustees, bankers to an issue, custodian of securities, and venture capital funds have been brought under the purview of SEBI.

9**. Credit Rating Agencies**: Various credit rating agencies such as Credit Rating Information Services of India Ltd. (CRISIL – 1988), Investment Information and Credit Rating Agency of India Ltd. (ICRA – 1991). Cost Analysis and Research Ltd. (CARE – 1993) and so on were set up to meet the emerging needs of capital market.

Secondary Market Reforms

A number of measures have been taken by the government and SEBI for the growth of secondary capital market in India. The important reforms or measures are explained below.

1. **Setting up of National Stock Exchange (NSE):** NSE was set up in November 1992 and started its operations in 1994. It is sponsored by the IDBI and co-sponsored by other development finance institutions, LIC, GIC, Commercial banks and other financial institutions.

2**. Over the Counter Exchange of India (OTCEI):** It was set in 1992. It was promoted by a consortium of leading financial institutions of India including UTI, ICICI, IDBI, IFCI, LIC and others. It is an electronic national stock exchange listing an entirely new set of companies which will not be listed on other stock exchanges.

3**. Disclosure and Investor Protection (DIP) Guidelines for New Issues**: In order to remove inadequacies and systematic deficiencies, to protect the interests of investors and for the orderly growth and development of the securities market, the SEBI has put in place DIP guidelines to govern the new issue activities. Companies issuing capital in the primary market are now required to disclose all material facts and specify risk factors with their projects.

4**. Screen Based Trading:** The Indian stock exchanges were modernized in the 90s, with Computerised Screen Based Trading System (SBTS). It electronically matches orders on a strict price / time priority. It cuts down time, cost, risk of error and fraud, and therefore leads to improved operational efficiency.

5. Depository System: A major reform in the Indian Stock Market has been the introduction of depository system and scripless trading mechanism since 1996. Before this, the trading system was based on physical transfer of securities. A depository is an organization which holds the securities of shareholders in electronic form, transfers securities between account holders, facilitates transfer of ownership without handling securities and facilitates their safekeeping.

6. Rolling Settlement: Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day are settled after certain days.

7**. The National Securities Clearing Corporation Ltd. (NSCL):** The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of the NSE. Clearing and settlement of trades and risk management are its central functions.

8. Trading in Central Government Securities: In order to encourage wider participation of all classes of investors, including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

9. Mutual Funds: Emergency of diversified mutual funds is one of the most important development of Indian capital market. Their main function is to mobilize the savings of general public and invest them in stock market securities. Mutual funds are an important avenue through which households participate in the securities market.

Components of Capital Market

1. Primary Market
2. Secondary Market or Stock Exchange
3.

Primary Market

In a **primary market**, securities are created for the first time for investors to purchase. New securities are issued in this market through a stock exchange, enabling the government as well as companies to raise capital.
For a transaction taking place in this market, there are three entities involved. It would include a company, investors, and an underwriter. A company issues security in a primary market as an initial public offering (IPO), and the sale price of such new issue is determined by a concerned underwriter, which may or may not be a financial institution. An underwriter also facilitates and monitors the new issue offering. Investors purchase the newly issued securities in the primary market. Such a market is regulated by the Securities and Exchange Board of India (SEBI).

Functions of Primary Market

1. **New issue offer**

The primary market organises offer of a new issue which had not been traded on any other exchange earlier. Due to this reason, it is also called a New Issue Market. Organising new issue offers involves a detailed assessment of project viability, among other factors. The financial arrangements for the purpose include considerations of promoters’ equity, liquidity ratio, debt-equity ratio and requirement of foreign exchange**.**

2. **Underwriting services**

Underwriting is an essential aspect while offering a new issue. An underwriter's role in a primary marketplace includes purchasing unsold shares if it cannot manage to sell the required number of shares to the public. A financial institution may act as an underwriter, earning a commission on underwriting. Investors rely on underwriters for determining whether undertaking the risk would be worth its returns. It may so thus happen that an underwriter ends up buying all the IPO issue, and subsequently selling it to investors.

3. **Distribution of new issue**

A new issue is also distributed in a primary marketing sphere. Such distribution is initiated with a new prospectus issue. It invites the public at large to buy a new issue and provides detailed information on the company, issue, and involved underwriters.

Types of Primary Market Issuance

After the issuance of securities, investors can purchase such securities in various ways. There are 5 types of primary market issues.

1. **Public issue**

Public issue is the most common method of issuing securities of a company to the public at large. It is mainly done via Initial Public Offering (IPO) resulting in companies raising funds from the capital market. These securities are listed in the stock exchanges for trading.

A privately held company converts into a publicly-traded company when its shares are offered to the public initially through IPO. Such public offer allows a company to raise funds for expansion of business, improving infrastructure, and repay its debts, among others. Trading in an open market also increases a company's liquidity and provides a scope for issuance of more shares in raising further capital for business.

The Securities and Exchange Board of India is the regulatory body that monitors IPO. As per its guidelines, a requisite due enquiry is conducted for a company's authenticity, and the company is required to mention its necessary details in the prospectus for a public issue.

2. **Private placement**

When a company offers its securities to a small group of investors, it is called private placement. Such securities may be bonds, stocks or other securities, and the investors can be both individual and institutional.

Private placements are easier to issue than initial public offerings as the regulatory stipulations are significantly less. It also incurs reduced cost and time, and the company can remain private. Such issuance is suitable for start-ups or companies which are in their early stages. The company may place this issuance to an investment bank or a hedge fund or place before ultra-high net worth individuals (HNIs) to raise capital.

3. **Preferential issue**

A preferential issue is one of the quickest methods available to companies for raising capital. Both listed and unlisted companies can issue shares or convertible securities to a select group of investors. However, the preferential issue is neither a public issue nor a rights issue. The shareholders in possession of preference shares stand to receive the dividend before the ordinary shareholders are paid.

4. **Qualified institutional placement**

Qualified institutional placement is another kind of private placement where a listed company issues security in the form of equity shares or partly or wholly convertible debentures apart from such warrants convertible to equity shares and purchased by a Qualified Institutional Buyer (QIB).

QIBs are primarily such investors who have the requisite financial knowledge and expertise to invest in the capital market. Some QIBs are –

- Foreign Institutional Investors registered with the Securities and Exchange Board of India.
- Foreign Venture Capital Investors.
- Alternate Investment Funds.
- Mutual Funds.
- Public Financial Institutions.
- Insurers.
- Scheduled Commercial Banks.
- Pension Funds.

Issuance of qualified institutional placement is simpler than preferential allotment as the former does not attract standard procedural regulations like submitting pre-issue filings to SEBI. The process thus becomes much easier and less time-consuming.

5. Rights and bonus issues

Another issuance in the primary market is rights and bonus issue, in which the company issues securities to existing investors by offering them to purchase more securities at a predetermined price (in case of rights issue) or avail allotment of additional free shares (in case of bonus issue). For rights issues, investors retain the choice of buying stocks at discounted prices within a stipulated period. Rights issue enhances control of existing shareholders of the company, and also there are no costs involved in the issuance of these kinds of shares. For bonus issues, stocks are issued by a company as a gift to its existing shareholders. However, the issuance of bonus shares does not infuse fresh capital.

Secondary Market

A secondary market is a platform wherein the shares of companies are traded among investors. It means that investors can freely buy and sell shares without the intervention of the issuing company. In these transactions among investors, the issuing company does not participate in income generation, and share valuation is rather based on its performance in the market. Income in this market is thus generated via the sale of the shares from one investor to another.

History of Stock Exchange

The first organised stock exchange in India was started in 1875 at Bombay and it is stated to be the oldest in Asia. In 1894 the Ahmedabad Stock Exchange was started to facilitate dealings in the shares of textile mills there. The Calcutta stock exchange was started in 1908 to provide a market for shares of plantations and jute mills.

Then the madras stock exchange was started in 1920. At present there are 24 stock exchanges in the country, 21 of them being regional ones with allotted areas. Two others set up in the reform era, viz., the National Stock Exchange (NSE) and Over the Counter Exchange of India (OICEI), have mandate to have nation-wise trading.

The Stock Exchanges are being administered by their governing boards and executive chiefs. Policies relating to their regulation and control are laid down by the Ministry of Finance. Government also Constituted Securities and Exchange Board of India (SEBI) in April 1988 for orderly development and regulation of securities industry and stock exchanges.

Functions of Secondary Market

- A stock exchange provides a platform to investors to enter into a trading transaction of bonds, shares, debentures and such other financial instruments.
- Transactions can be entered into at any time, and the market allows for active trading so that there can be immediate purchase or selling with little variation in price among different transactions. Also, there is continuity in trading, which increases the liquidity of assets that are traded in this market.
- Investors find a proper platform, such as an organised exchange to liquidate the holdings. The securities that they hold can be sold in various stock exchanges.
- A secondary market acts as a medium of determining the pricing of assets in a transaction consistent with the demand and supply. The information about transactions price is within the public domain that enables investors to decide accordingly.
- It is indicative of a nation's economy as well, and also serves as a link between savings and investment. As in, savings are mobilised via investments by way of securities.

Online Trading in Stock Exchange

The Trading procedure involves the following steps:

1**. Selection of a broker:**

The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator.

2. Opening Demat Account with Depository:

Demat (Dematerialized) account refer to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (e.g. Shares, Debentures, Bonds, Mutual (Funds, etc.) At present in India there are two depositories: NSDL (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.) There is no direct contact between depository and investor. Depository interacts with investors through depository participants only.

Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

3. Placing the Order:

After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.

Investor must place the order very clearly specifying the range of price at which securities can be bought or sold. e.g. “Buy 100 equity shares of Reliance for not more than Rs 500 per share.”

4. Executing the Order:

As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

5. Settlement:

This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There can be two types of settlement.

(a) On the spot settlement:

It means settlement is done immediately and on spot settlement follows. T + 2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday**.**

(b) Forward settlement:

It means settlement will take place on some future date. It can be T+5 or T+7 etc.

Capital Market Instruments

1. **Equity shares**

Equity shares are also known as ordinary shares. They are the form of fractional or part ownership in which the shareholder, as a fractional owner, takes the maximum business risk. The holders of Equity shares are members of the company and have voting rights. Equity shares are the vital source for raising long-term capital.

Equity shares represent the ownership of a company and capital raised by the issue of such shares is known as ownership capital or owner's funds. They are the foundation for the creation of a company.

Equity shareholders are paid on the basis of earnings of the company and do not get a fixed dividend. They are referred to as 'residual owners'. They receive what is left after all other claims on the company's income and assets have been settled. Through their right to vote, these shareholders have a right to participate in the management of the **company.**

Merits of Equity Shares

- Equity capital is the foundation of the capital of a company. It stands last in the list of claims and it provides a cushion for creditors.
- Equity capital provides creditworthiness to the company and confidence to prospective loan providers.
- Investors who are willing to take a bigger risk for higher returns prefer equity shares.
- There is no burden on the company, as payment of dividend to the equity shareholders is not compulsory.
- Equity issue raises funds without creating any charge on the assets of the company.
- Voting rights of equity shareholders make them have democratic control over the management of the company

Preference Shares

Preference shares are the shares which promise the holder a fixed dividend, whose payment takes priority over that of ordinary share dividends. Capital raised by the issue of preference shares is called preference share capital.

The preference shareholders are in superior position over equity shareholders in two ways: first, receiving a fixed rate of dividend, out of the profits of the company, before any dividend is declared for equity shareholder and second, receiving their capital after the claims of the company's creditors have been settled, at the time of liquidation. In short, the preference shareholders have a preferential claim over dividend and repayment of capital as compared to equity shareholders.

Dividends are payable only at the discretion of the directors and only out of profit after tax, to that extent, these resemble equity shares. Preference resemble debentures as both bear fixed rate of return to the holder. Thus, preference shares have some characteristics of both equity shares and debentures. Preference shareholders generally do not enjoy any voting rights. In certain cases, holders of preference shares may claim voting rights if the dividends are not paid for two years or more on cumulative preference shares and three years or more on non-cumulative preference shares.

Types of Preference Shares

1. Cumulative and Non-Cumulative:

The preference shares that have the right to collect unpaid dividends in the future years, in case the same is not paid during a year are known as cumulative preference shares. Non-cumulative shares, the dividend is not accumulated if it is not paid in a particular year.

2**. Participating and Non-Participating:**

Preference shares which have a right to participate in the extra surplus of a company shares which after dividend at a certain rate has been paid on equity shares are called participating preference shares. These non-participating preference shares do not enjoy such rights of participation in the profits of the company.

3. **Convertible and Non-Convertible:**

Preference shares that can be converted into equity shares within a specified period of time are known as convertible preference shares. Non-convertible shares are such that cannot be converted into equity shares. intervals say six months or one year.

Merits of Preference Shares

- It does not affect the control of equity shareholders over the management as preference shareholders don't have voting rights.
- Payment of fixed rate of dividend to preference shares may make a company to announce higher rates of dividend for the equity shareholders in good times.
- Preference shares have reasonably steady income in the form of fixed rate of return and safety of the investment.
- Also, they are suitable for those investors who want a fixed rate of return with low risk.
- Preference shareholders have a preferential right of repayment over equity shareholders in the event of liquidation or bankruptcy of a company.

- Preference capital does not create any sort of charge against the assets of a company.

Debentures

Debentures are a debt instrument used by companies and government to issue the loan. The loan is issued to corporates based on their reputation at a fixed rate of interest. Companies use debentures when they need to borrow the money at a fixed rate of interest for its expansion. Secured and Unsecured, Registered and Bearer, Convertible and Non-Convertible, First and Second are four types of Debentures

Types of Debenture

1. Secured and Unsecured:

Secured debenture creates a charge on the assets of the company, thereby mortgaging the assets of the company. Unsecured debenture does not carry any charge or security on the assets of the company.

2**. Registered and Bearer:**

A registered debenture is recorded in the register of debenture holders of the company. A regular instrument of transfer is required for their transfer. In contrast, the debenture which is transferable by mere delivery is called bearer debenture.

3**. Convertible and Non-Convertible:**

Convertible debenture can be converted into equity shares after the expiry of a specified period. On the other hand, a non-convertible debenture is those which cannot be converted into equity shares.

4**. First and Second:**

A debenture which is repaid before the other debenture is known as the first debenture. The second debenture is that which is paid after the first debenture has been paid back.

Advantages of Debentures

- Investors who want fixed income at lesser risk prefer them.
- As a debenture does not carry voting rights, financing through them does not dilute control of equity shareholders on management.
- Financing through them is less costly as compared to the cost of preference or equity capital as the interest payment on debentures is tax deductible.
- The company does not involve its profits in a debenture.
- The issue of debentures is appropriate in the situation when the sales and earnings are relatively stable.

Depository Receipt

DP is a mechanism through which a domestic company can raise finance from the international equity market. In this system, the shares of the company domiciled in one country are held by the depository i.e. Overseas Depository Bank, and issues claim against these shares. Such claims are known as Depository Receipts that are denominated in the convertible currency, mostly US$, but these can also be denominated in Euros. Now, these receipts are listed on the stock exchanges.

GDR or Global Depository Receipt

GDR or Global Depository Receipt is a negotiable instrument used to tap the financial markets of various countries with a single instrument.

The receipts are issued by the depository bank, in more than one country representing a fixed number of shares in a foreign company.

The holders of GDR can convert them into shares by surrendering the receipts to the bank

Process of issuing GDR

Step -1

To find the Domestic Custodian Bank

Step -2

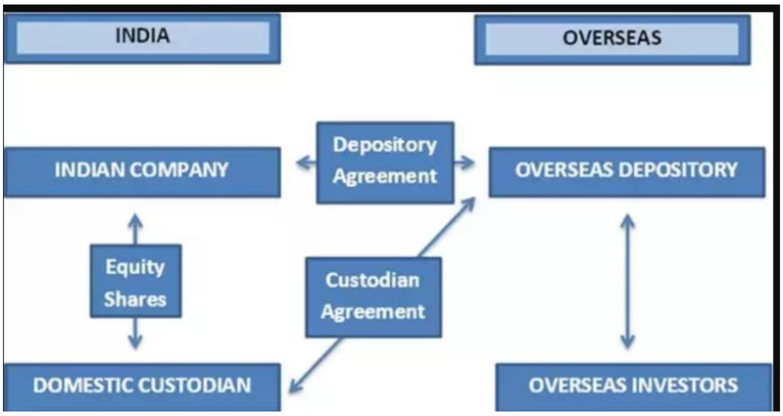
To find the Depository bank

Step -3

Issue the Shares to Domestic Custodian Bank
Shares cannot issue to foreign investors. But shares are issued to Domestic Custodian Bank and Domestic Custodian Bank transfer the shares to depository bank. Depository bank will accept the shares of Indian companies as the custodian of foreign investors

Step -4

Issue of GDRs and Record



ADR (American Depository Receipts)

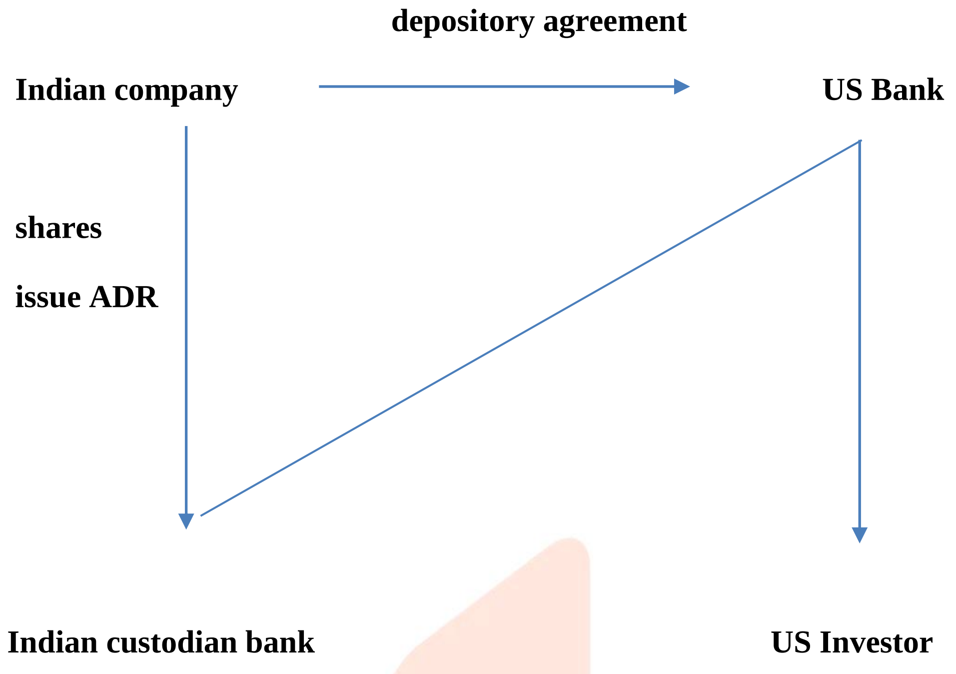
ADR is a negotiable certificate, issued by US bank in US currency. ADR represents the foreign currency traded in US stock market. ADR is the claim against the underlying shares.

The features of ADR

1. ADRs are denominated only in US dollars.
2. They are issued only to investors who are American residents.
3. The depository bank should be located in US.
4. The approval of Securities and Exchange Commission (SEC) of US needs to be obtained for issuing ADR.

Steps of Issuing ADR

- The domestic company, already listed in its local stock exchange, sells its shares in bulk to a U.S. bank to get itself listed on U.S. exchange.
- The U.S. bank accepts the shares of the issuing company. The bank keeps the shares in its security and issues certificates (ADRs) to the interested investors through the exchange.
- Investors set the price of the ADRs through bidding process in U.S. dollars. The buying and selling in ADR shares by the investors is possible only after the major U.S. stock exchange lists the bank certificates for trading.
- The U.S. stock exchange is regulated by Securities Exchange Commission, which keeps a check on necessary compliances that need to be complied by the foreign company.



SEBI (Security Exchange Board of India)

The formation of the Securities and Exchange Board of India (SEBI) was done on 12th April 1988. This was followed by the establishment of the SEBI Act on 30th January 1992, which gave SEBI their powers and functions.

The main aim of the SEBI was to control and regulate the capital markets. This was done with the view of protecting the interests of the investors. The government wanted to ensure that the money which the public was investing was safe.

Functions of SEBI:

SEBI primarily has three functions-

1. Protective Function
2. Regulatory Function
3. Development Function

Protective Functions

As the name suggests, these functions are performed by SEBI to protect the interest of investors and other financial participants.

It includes-

- Checking price rigging
- Prevent insider trading
- Promote fair practices
- Create awareness among investors
- Prohibit fraudulent and unfair trade practices

Regulatory Functions

These functions are basically performed to keep a check on the functioning of the business in the financial markets. These functions include-

- Designing guidelines and code of conduct for the proper functioning of financial intermediaries and corporate.
- Regulation of takeover of companies
- Conducting inquiries and audit of exchanges
- Registration of brokers, sub-brokers, merchant bankers etc.
- Levying of fees
- Performing and exercising powers
- Register and regulate credit rating agency

Development Functions

SEBI performs certain development functions also that include -

- Imparting training to intermediaries
- Promotion of fair trading and reduction of malpractices
- Carry out research work
- Encouraging self-regulating organizations
- Buy-sell mutual funds directly from AMC through a broker

SEBI has been empowered with the following powers:

- to approve by–laws of Securities exchanges.
- to require the Securities exchange to amend their by–laws.
- inspect the books of accounts and call for periodical returns from recognised Securities exchanges.
- inspect the books of accounts of financial intermediaries.
- compel certain companies to list their shares in one or more Securities exchanges.
- registration of Brokers and sub-brokers

Objectives of SEBI:

SEBI has following objectives-

1. **Protection to the investors**

The primary objective of SEBI is to protect the interest of people in the stock market and provide a healthy environment for them.

2. **Prevention of malpractices**

This was the reason why SEBI was formed. Among the main objectives, preventing malpractices is one of them.

3. **Fair and proper functioning**

SEBI is responsible for the orderly functioning of the capital markets and keeps a close check over the activities of the financial intermediaries such as brokers, sub-brokers, etc.

Structure of SEBI

The SEBI Board consist of nine members:

1. One Chairman appointed by the Government of India
2. Two members who are officers from Union Finance Ministry
3. One member from Reserve Bank of India
4. Five members appointed by the Union Government of India

Role of SEBI in Capital Market

SEBI Guidelines for primary Market

1.All applications should be submitted to SEBI in the prescribed form.

2.Applications should be accompanied by true copies of industrial license.

3.Cost of the project should be furnished with scheme of finance.

4.Company should have the shares issued to the public and listed in one or more recognized stock exchange.

5.Where the issue of equity share capital involves offer for subscription by the public for the first time, the value of equity capital subscribed capital privately held by promoters and their friends shall be not less than 15% of the total issued equity capital**.**

6. An equity-preference ratio of 3:1 is allowed.

7. New company cannot issue the share at premium.

8. All the details of Underwriting Agreement.

a) Types of underwriter

(i) Institutional underwriters – IDBI, IFCI, UTI, SBI Capital Market

(ii)Non-Institutional underwriters – Any NBFC.

b) Responsibilities of Underwriters

(i) An underwriter, not only has to underwrite the securities but has to subscribe within 45 days that part of shares which remain unsubscribed by the public.

(ii) His underwriting obligations should not exceed, at any time, 20 times of his net worth

(iii) The underwriter cannot derive any other benefit except the

underwriting commission which is 5% for shares and 2½% for debentures.

Merits of Underwriting

- Ensures success of the proposed issue of shares.
- Enables a company to get the required minimum subscription.
- Reputation of the underwriter acts as a confidence to investors

9. Minimum subscription is required for the IPO is 90% otherwise company has to refund the money.

10. For the debt securities minimum subscription is 75%.

SEBI guidelines for Secondary Market

1. Listing of Share

- Shares of a company shall be offered to the public through the prospectus.
- Date of opening of subscription, receipt of the application and other details should be mentioned in the prospectus.
- The capital structure of the company should be wide and the securities of the company should be in public interest.
- The requirement for the Minimum issued is Rs. 3 Crores out of which 1.8 Crore must be offered to the public.

2. Intra-day trading and exposure limits

with a view to enhancing market safety, the SEBI decided that the upper limit for gross exposure of the member brokers of the stock exchanges would be fixed at 20 times the base minimum capital and additional capital of the member brokers.

3. Chandratre Committee on delisting of securities

The SEBI had set up a committee under the Chairmanship of Dr. K R Chandratre, to principally look into the issue of delisting of securities by the exchanges. Delisting is an extreme measure of disciplinary action which an exchange might take against a company, which if indiscriminately used, would adversely affect the interests of the investors.

4. Bhave Committee on Disclosure Standards

The SEBI had appointed a Committee under the chairmanship of Shri C B Bhave, to recommend measures for improving the continuing disclosure standards by corporates and timely dissemination of price sensitive information to the public.

Unit-4

Banks and NBFC

Introduction

A bank is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. There are also nonbanking institutions that provide certain banking services without meeting the legal definition of a bank. Banks are a subset of the financial services industry.

Need of the Banks

- To provide the security to the savings of customers.
- To control the supply of money and credit
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers

History of Indian Banking System

The first bank in India, called The General Bank of India was established in the year 1786. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. In 1921, all presidency banks were amalgamated to form the Imperial Bank of India which was run by European Shareholders. After that the Reserve Bank of India was established in April 1935.

The following are the major steps taken by the Government of India to Regulate Banking institutions in the country: -

1949: Enactment of Banking Regulation Act.

1955: Nationalization of State Bank of India.

1959: Nationalization of SBI subsidiaries.

1961: Insurance cover extended to deposits.

1969: Nationalization of 14 major Banks.

1971: Creation of credit guarantee corporation.

1975: Creation of regional rural banks.

1980: Nationalization of seven banks with deposits over 200 Crore

Reserve bank of India

The reserve bank of India is a central bank and was established in April 1, 1935 in accordance with the provisions of reserve bank of India act 1934. The central office of RBI is located at Mumbai since inception. Though originally the reserve bank of India was privately owned, since nationalization in 1949, RBI is fully owned by the Government of India. It was inaugurated with share capital of Rs. 5 Crores divided into shares of Rs. 100 each fully paid up.

The RBI Act 1934 was commenced on April 1, 1935. The Act, 1934 provides the statutory basis of the functioning of the bank. The bank was constituted for the need of following: -

- To regulate the issues of banknotes.
- To maintain reserves with a view to securing monetary stability –
- To operate the credit and currency system of the country to its advantage.

Functions of RBI as a central bank of India are explained briefly as follows:

1. **Bank of Issue:**

   The RBI formulates, implements, and monitors the monitory policy. Its main objective is maintaining price stability and ensuring adequate flow of credit to productive sector.

2. **Regulator-Supervisor of the financial system:**

   RBI prescribes broad parameters of banking operations within which the country's banking and financial system functions. Their main objective is to maintain public confidence in the system, protect depositor's interest and provide cost effective banking services to the public.

3. **Manager of exchange control:**

   The manager of exchange control department manages the foreign exchange, according to the foreign exchange management act, 1999. The manager's main objective is to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

4. **Issuer of currency:**

A person who works as an issuer, issues and exchanges or destroys the currency and coins that are not fit for circulation. His main objective is to give the public adequate quantity of supplies of currency notes and coins and in good quality.

5. **Developmental role:**

   The RBI performs the wide range of promotional functions to support national objectives such as contests, coupons maintaining good public relations and many more.

6. **Related functions:**

   There are also some of the related functions to the above mentioned main functions. They are such as, banker to the government, banker to banks etc…. • Banker to government performs merchant banking function for the central and the state governments; also acts as their banker. • Banker to banks maintains banking accounts to all scheduled banks.

7. **Controller of Credit:**

   RBI performs the following tasks:

   - It holds the cash reserves of all the scheduled banks
   - It controls the credit operations of banks through quantitative and qualitative controls.
   - It controls the banking system through the system of licensing, inspection and calling for information.
   - It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

8. **Supervisory function:**

   The Reserve Bank Act 1934 and the banking regulation act 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation.

9. **Promotional Functions:**

   With economic growth assuming a new urgency since independence, the range of the Reserve Bank's functions has steadily widened. The bank now performs a variety of developmental and promotional functions

NBFC (Non-Banking Financial companies)

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares / stocks / bonds / debentures / securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. In lay man language Non-Banking Financial Companies (NBFCs) are the financial institutions that offer the banking services but does not comply with the legal definition of a bank, i.e. it does not hold a bank license.

Features of NBFCs

1. The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
2. NBFCs cannot offer interest rates higher than the ceiling rate prescribed by RBI from time to time. The present ceiling is 12.5 per cent per annum. The interest may be paid or compounded at rests not shorter than monthly rests.
3. NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.
4. NBFCs (except certain AFCs) should have minimum investment grade credit rating.
5. The deposits with NBFCs are not insured.
6. The repayment of deposits by NBFCs is not guaranteed by RBI.
7. There are certain mandatory disclosures about the company in the Application Form issued by the company soliciting deposits.

Types of NBFCs

I. **Asset Finance Company (AFC)** : An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipment's, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

II. Investment Company (IC): IC means any company which is a financial institution carrying on as its principal business the acquisition of securities,

III. Loan Company (LC): LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

IV. Infrastructure Finance Company (IFC): IFC is a non-banking finance company

a) Which deploys at least 75 per cent of its total assets in infrastructure loans,

b) Has a minimum Net Owned Funds of ? 300 crore,

c) Has a minimum credit rating of 'A 'or equivalent d) and a CRAR of 15%.

V. Systemically Important Core Investment Company (CIC-ND-SI): CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions: -

(a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
(b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
(c) It does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
(d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies.
(e) Its asset size is ? 100 crore or above and
(f) It accepts public funds
VI. Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC): IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5 year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF-NBFCs.
VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI): NBFC-MFI is a non-deposit taking NBFC having not less than 85% of its assets in the nature of qualifying assets which satisfy the following criteria:
A. loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding? 1,00,000 or urban and semi-urban household income not exceeding ? 1,60,000;
B. loan amount does not exceed ? 50,000 in the first cycle and ? 1, 00,000 in subsequent cycles;
C. total indebtedness of the borrower does not exceed ? 1, 00,000;
D. tenure of the loan not to be less than 24 months for loan amount in excess of ? 15,000 with prepayment without penalty;
E. loan to be extended without collateral;
F. aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs;
G. loan is repayable on weekly, fortnightly or monthly instalments at the choice of the borrower
VIII. Non-Banking Financial Company – Factors (NBFC-Factors): NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

IX. Mortgage Guarantee Companies (MGC) - MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is 100 crore.

X. NBFC- Non-Operative Financial Holding Company (NOFHC) is financial institution through which promoter / promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

Schedule banks

Scheduled Banks in India constitute those banks which have been included in the second schedule of RBI act 1934. RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42(6a) of the Act. "Scheduled banks in India" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the s State Bank of India (subsidiary banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve bank of India Act, 1934 (2 of 1934), but does not include a co-operative bank". For the purpose of assessment of performance of banks, the Reserve Bank of India categories those banks as public sector banks, old private sector banks, new private sector banks and foreign banks, i.e. private sector, public sector, and foreign banks come under the umbrella of scheduled commercial banks

Co-operative Banks

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

Features

1. Cooperative banks issue shares of unlimited liability.
2. In a cooperative bank, one shareholder has one vote whatever the number of shares he may hold.
3. Cooperative banks are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities.
4. operative banking in India is federal in structure. Primary credit societies are at the lowest rung. Then, there are central cooperative banks at the district level and state cooperative banks at the state level.
5. Cooperative credit societies are located in the villages spread over entire country.

6. They function on "no profit, no loss" basis. By nature, co-operative banks do not pursue the goal of profit maximization.

Advantages of co-operative banking system are:

1. Co-operative banks promote thrift and savings among their members and mobilize their small savings for productive or useful purposes.

2. Co-operative banks are suitable to help people of small means.

3. Co-operative banks make their members financially more secure.

4. Co-operative banks may provide loans to their members at lower rates of interest.

5. Co-operative banks instill among their members a strong feeling of responsibility for prompt payment of interest and repayment of loans.

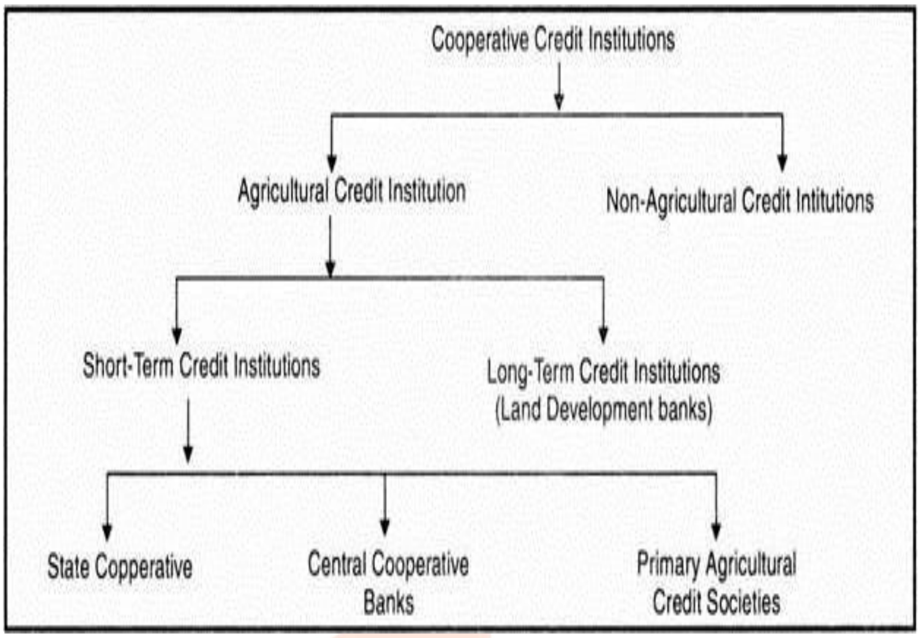
6. Co-operatives may have lower administrative costs on account of voluntary services rendered by their members.

7. Co-operatives, like money-lenders, can possess intimate knowledge of the character and financial position of their members, and local production possibilities and chances of growth.

8. The procedure of deposit and withdrawal of a co-operative credit society is far less complicated, since personal identification and such other problems do not exist.

Structure of Cooperative Banking:

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure.



Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions.

The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies.

Long-term agricultural credit is provided by the land development banks. The whole structure of cooperative credit institutions is shown in the chart given.

Short-Term Rural Cooperative Credit Structure:

In rural India, there exists a 3-tier short-term rural cooperative structure. Tier-I includes state cooperative banks (SCBs) at the state level; Tier-II includes central cooperative banks (CCBs) at the district level; and Tier- III includes primary agricultural credit societies (PACSs).

1. State Cooperative Banks (SCBs):

Functions and Organisation:

State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank.

State cooperative banks occupy a unique position in the cooperative credit structure because of their three important functions:

(a) They provide a link through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,

(b) They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks. The central cooperative banks are not permitted to borrow or lend among themselves,

(c) They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.

2. Central Cooperative Banks (CCBs):

Functions and Organisation:

Central cooperative banks are in the middle of the three-tier cooperative credit structure.

Central cooperative banks are of two types:

(a) There can be cooperative banking unions whose membership is open only to cooperative societies. Such cooperative banking unions exist in Haryana, Punjab, Rajasthan, Orissa and Kerala.

(b) There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type.

The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others.

3. Primary Agricultural Credit Societies (PACSs):

Functions and Organisation:

Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments.

It serves as the last link between the ultimate borrowers, i.e., the rural people, on the one hand, and the higher agencies, i.e., Central cooperative bank, state cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member.

The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of the society in case of its failure. The management of the society is under the control of an elected body.

Land Development Banks (LDBs) or Cooperative Agricultural and Rural Development Banks (CARDBs):

Besides short-term credit, the agriculturists also need long-term credit for making permanent improvements in land, for repaying old debts, for purchasing agricultural machinery and other implements. Traditionally, the long-term requirements of agriculturists were mainly met by money lenders and some other agencies. But this source of credit was found defective and has been responsible for the exploitation of farmers.

Cooperative banks and commercial banks by their very nature are not in a position to provide long-term loans because their deposits are mainly demand (short-term) deposits. Thus, there was a great need for a specialised institution for supplying long-term credit to agriculturists. The establishment of land development banks now known as cooperative and rural development banks (CARDBs) is an effort in this direction.

Structure:

The land development banks are registered as cooperative societies, but with limited liability.

These banks have two-tier structure:

(a) At the state level, there are state or central land development banks, now known as state cooperative agricultural and rural development banks (SCARDBs) generally one for each state. They were previously known as central land mortgage banks,

(b) At the local level, there are branches of the state land development banks or SCARDBs and primary land development banks now known as primary cooperative agricultural and rural development banks (PCARDBs).

In some states, there are no primary land development banks, but the branches of the state land development bank. In Madhya Pradesh, the state cooperative bank itself functions as the state land development bank. In other states like Andhra Pradesh, Kerala and Maharashtra, there are more than one state land development banks.

Similarly, the primary land development banks also vary organizationally in different states. At the national level, the land development banks have also formed a union, called All-India Land Development Banks' Union.

Major weaknesses are given below:

I. General Weaknesses of Primary Credit Societies:

Organizational and financial limitations of the primary credit societies considerably reduce their ability to provide adequate credit to the rural population.

The All India Rural Credit Review Committee pointed out the following weaknesses of the primary credit societies:

(a) Cooperative credit still constitutes a small proportion of the total borrowings of the farmers,

(b) Needs of tenants and small farmers are not fully met.

(c) More primary credit societies are financially weak and are unable to meet the production-oriented credit needs,

(d) Overdues are increasing alarmingly at all levels,

(e) Primary credit societies have not been able to provide adequate and timely credit to the borrowing farmers.

II. Inadequate Coverage:

Despite the fact that the cooperatives have now covered almost all the rural areas of the country, its rural household membership is only about 45 per cent. Thus, 55 per cent of rural households are still not covered under the cooperative credit system.

In fact, the borrowing membership of the primary credit societies is significantly low and is restricted to a few states like Maharashtra, Gujrat, Punjab, Haryana, Tamil Nadu and to relatively rich land owners.

Criteria of determining borrowing membership include:

(a) Borrowing members as a proportion of rural households,

(b) The average amount of loan issued per borrowing member, and

(c) The proportion of loans going to weaker sections.

The banking Commission 1972 has brought out the following reasons for the low borrowing membership cooperative societies:

(a) Inability of the people to provide the prescribed security;

(b) Lack of up-to-date land records;

(c) Ineligibility of certain purposes for loans;

(d) Inadequacy of prescribed credit limits;

(e) Onerous conditions prescribed for loans such as share capital contribution at 10 or 20 per cent of loans outstanding and compulsory saving deposits; and

(f) Default of members to repay loans.

III. Inefficient Societies:

In spite of the fact that the primary agricultural credit societies in most of the states have been reorganized into viable units, their loaning business has not improved. As the Seventh Plan has observed that out of 94089 primary agricultural credit societies in the country in 1982-83, only 66000 societies had full time paid secretaries. About 34000 societies were running at loss.

IV. Problem of Overdues:

A serious problem of the cooperative credit is the overdue loans of the cooperative institutions which have been continuously increasing over the years. In 1991-92, percentage of overdues to demand at the level of land development banks was 57, at the level of central cooperative banks was 41 and at the level of primary agricultural credit societies was 39.

The overdues in the short-term credit structure are most alarming in North-Eastern States. In the long-term loaning sector, the problem of overdues has almost crippled the land development banks in 9 states, viz., Maharashtra, Gujarat, Madhya Pradesh, Bihar, Karnataka, Assam, West Bengal, Orissa and Tamil Nadu.

Large amounts of overdues restrict the recycling of the funds and adversely affect the lending and borrowing capacity of the cooperative societies.

The Banking Commission 1972 pointed out the following reasons for the overdue loans:

(a) Indifferent management or mismanagement of primary societies;
(b) Unsound lending policies resulting in over-lending or lending unrelated to actual needs, diversions of loans for other purposes;
(c) Vested interests and group politics in societies and willful defaulters;
(d) Inadequate supervision over the use of loans and poor recovery efforts;
(e) Lack of adequate control of central cooperative banks over primary societies;
(f) Lack of proper links between credit and marketing institutions;
(g) Failure to take quick action against willful defaulters; and
(h) Uncertain agricultural prices.

V. Regional Disparities:

There have been large regional disparities in the distribution of cooperative credit. According to the Seventh Plan, the eight states of Andhra Pradesh, Gujarat, Haryana, Kerala, Madhya Pradesh, Maharashtra, Punjab and Rajasthan account for about 80 per cent of the total credit disbursed. The per hectare short-term credit disbursed varied from Rs. 4 in Assam to Rs. 718 in Kerala.

VI. Benefits to Big Land Owners:

Most of the benefits from the cooperatives have been covered by the big land owners because of their strong socio-economic position. For instance, in 1984-85 the farmers having holdings less than two hectares got only 38.8 per cent of the total loans granted by the primary agricultural credit societies, whereas the land owners with holdings of more than 2 hectare received 55 per cent. The share of the poorest rural population (i.e. tenants, share croppers and landless labours) was only 6.2 per cent.

VII. Lack of Other Facilities:

Besides the provision of adequate and timely credit, the small and marginal farmers also need other facilities in the form of supply of inputs (i.e., better seeds, fertilizers, pesticides, etc.), extension and marketing services.

These facilities will enable them to utilize the borrowed credit in a proper way. Therefore, the credit societies should be reorganized into multi-purposes cooperatives.

Reserve Bank and Cooperative Banking:

Strengthening the cooperative credit movement has been the Reserve Bank of India’s special responsibility ever since its establishment in 1935.

The following are the various measures undertaken by the Reserve Bank to develop cooperative banking system and to promote cooperative finance in the country**:**

1. Agricultural Credit Department:

The Reserve Bank has a separate Agricultural Credit Department whose functions are:

(i) To maintain an expert staff to study all questions of agricultural credit and be available for consolation by the central and state governments, state cooperative banks and other banking organisations; and

(ii) To coordinate the operations of the Reserve Bank in connection with agricultural credit and relations with the state cooperative banks and other institutions engaged in the business of agricultural credit.

2. All-India Rural Credit Survey:

The Reserve Bank's real role in the cooperative credit movement started with the appointment of All-India Rural Credit Survey Committee in 1951. The objective of this Committee was to study the problems of rural credit and explore possibilities of expanding agricultural credit through cooperative credit system.

The committee submitted its report in December 1954 which highlighted the vital importance of cooperative rural credit.

The Committee found that while private credit agencies, i.e., money lenders and traders supply 70 per cent of the rural credit, the cooperative societies provided only 3 per cent of the total borrowed amount.

The Committee observed that the rural credit in India fell short of the right quantity, was not of right type, did not serve the right purpose, and often fail to go to the right people. Regarding the future of cooperative credit movement the committee said, "cooperation had failed, but cooperation must succeed."

3. Integrated Scheme of Rural Credit:

For the success of cooperative credit movement, the Survey Committee suggested an integrated scheme of rural credit based on the following fundamental principles- (a) state partnership in cooperative credit institutions; (b) full coordination between credit and other agricultural activities, particularly, marketing and processing; and (c) administration through adequately trained and efficient personnel, responsive to the needs of the rural population.

4. Provision of Finance:

In pursuance of the recommendations of the Survey Committee and the later committees like the Committee on Cooperative Credit (1960), the Reserve Bank has activity helped the cooperative system to expand rural credit. The Reserve Bank does not provide finance directly to the agriculturists, but only through cooperative sector.

The Reserve Bank provides financial assistance for meeting short-term, medium-term and long-term rural needs.

The needs are explained as under:

(i) Short-Term Finance:

The Reserve Bank provides short-term finance to the state cooperative banks in two ways- (a) through loans and advances; (b) through rediscounting facility. The financial assistance is given for seasonal agricultural operations and for marketing of crops.

In 1950-51, the Reserve Bank sanctioned short- term credit of Rs. 7.6 crore. This amount increased to Rs. 147 crore in 1960-61 and to Rs. 1090 crore in 1981-82.

(ii) Medium-Term Finance:

The Reserve Bank provides medium-term loans to state cooperative banks generally for 3 to 5 years. These loans are provided for- (a) land improvements like bunding, digging of wells and water channels; (b) repair of wells and other irrigational schemes; (c) purchase of livestock, implements and machinery; (d) construction of farm houses and cattle sheds.

The Reserve Bank also provides medium-term loans in scarcity affected areas. Over the years, the amount of medium- term loans sanctioned by the Reserve Bank has considerably increased from Rs. 27 lakh in 1954-55 to Rs. 24 crore in 1970-71 and to Rs. 110 crore in 1981-82.

(iii) Long-Term Finance:

The Reserve Bank provides long-term financial assistance for a maximum period of 20 years for agriculture in there ways- (a) It subscribes a portion of debentures issued by the land development banks. (b) It grants long term loans to such banks, (c) It grants loans to state governments for subscribing to the share capital of cooperative credit institutions. The total long- term loans sanctioned by the Reserve Bank were Rs. 212 crore in 1981-82.

5. Setting Up of Funds:

To meet its financial obligations, the Reserve Bank set up two national funds in 1956, i.e., the National Agricultural Credit (Long-Term Operations) Funds, and the National Agricultural Credit (Stabilisation) Fund.

The Purpose of the Long-Term Operations Funds was- (a) to make long- term loans available to state governments to enable them to subscribe the share capital of cooperative credit institutions; (b) to make medium-term loans to state cooperative banks for agricultural purposes; (c) to make long-term loans to the central land mortgage banks against the guarantee of the state government; and (d) to purchase debentures of central land mortgage banks against the guarantee of state government. The Stabilisation Fund helps the state cooperative banks to convert their short-term loans into medium-term loans in cases of draught, famine or other calamities.

6. Strengthening of Cooperative Banking Structure:

With a view to strengthen cooperative banking structure and promote cooperative credit, the Reserve Bank undertakes the following measures:

(i) It pays special attention towards rehabilitating and revitalising the weaker cooperative units.

(ii) It makes arrangements for maintaining the flow of cooperative credit by involving commercial banks to finance the primary agricultural societies.

(iii) It makes efforts in improving the lending policies and operational efficiency of cooperative credit institutions.
(iv) It provides financial accommodation to cooperative credit institutions.
(v) It conducts special training courses at the Cooperative Bankers' Training Colleges for the personnel of state, central and urban banks.

Regional Rural bank

The Narasimham Committee on rural credit recommended the establishment of Regional Rural Banks (RRB) on the ground that they would be much better suited than the commercial banks or co-operative banks in meeting the needs of rural areas. They would combine the local feel and familiarity with rural problems which cooperative possess and the degree of business organization, ability to mobilize deposit, access to central money markets and modernized outlook which the commercial banks have. On Narasimham Committees recommendation, the Government passed the Regional Rural Banks Act, 1976.

Objectives of RRB

1. To provide credit and other facilities particularly to small and marginal farmers, agricultural laborers, artesian and small entrepreneurs
2. Develop agriculture, trade, commerce, industry, and other productive activities in the rural areas.
   The first five RRB were set up on October 2 1975, at Moradabad and Gorakhpur in Uttar Pradesh, Bhiwani in Haryana, Jaipur and Rajasthan and Malda in West Bengal. These banks were sponsored by the Syndicate Bank, State Bank of India, Punjab National Bank, United Commercial Bank and United Bank of India.

Role of regional rural banks (RRB)

- To accept deposit
- To grant advances
- To provide ancillary banking services.
- To supply inputs and equipments to farmers.
- To provide assistance in the marketing of their products

The problems faced by RRB:

- Speedy and lack of coordination in branch expansion.
- Difficulties in deposit mobilization.
- Slow progress in lending activity.
- Urban orientation of staff.

Important points about RRB

1. The unique role of RRB in providing credit facilities to weaker sections in the villages must be preserved. The RRB should exist as rural banks of the rural poor.
2. The RRB may be permitted to lend up to 25% of their total advances to the richer section of the village society.
3. The State Government should also take keen interest in the growth of RRB.
4. Participation of local people in the equity share capital of the RRB should be allowed encouraged. 5. Local staff may be appointed as far as possible.
6. Cooperative societies may be allowed to sponsor or co-sponsor with commercial banks in the
establishment of the RRB.
7. A uniform pattern of interest rate structure should be devised for the rural financial agencies.
8. The RRB must strengthen effective credit administration by way of credit appraisal, monitoring the progress of loans and their efficient recovery.
9. The credit policy of the RRB should be based on the group approach of financing rural activities. 10. The RRB may initiate certain new insurable policies like deposit-linked cattle and other animals insurance policy, crop insurance policy or the life insurance policy for the rural depositors.
11. The RRB may relax their procedure for lending and make them more easy for village borrowers.
12.Co-ordination between district level development planning and district level credit planning is also required in order to chart out the specific role of the RRB as a development agency of the rural areas.
13. NABARD has laid out certain guidelines for the commercial banks, Regional Rural Banks and Cooperative Banks to provide the data to RBI including that regarding loans given by banks to the microfinance institutions.
14. NABARD has been instrumental in grounding rural, social innovations and social enterprises in the rural hinterlands. This endeavor is perhaps unparalleled in the country, it has in the process partnered with about 4000 partner organizations in grounding many of the interventions be it, SHG-Bank Linkage program , tree-based tribal communities" livelihoods initiative, watershed approach in soil and water conservation, increasing crop productivity initiatives through lead crop initiative or dissemination of information flow to agrarian communities through Farmer clubs. Despite all this, it pays huge taxes too, to the exchequer – figuring in the top 50 tax payers consistently. NABARD virtually ploughs back all the profits for development spending, in their unending search for solutions and answers. Thus the organization had developed a huge amount of trust capital in its 3 decades of work with rural communities

Wholesale banking

Wholesale banking is meant to describe the financial practice of lending and borrowing between two large institutions. Banking services that are considered "wholesale" are reserved only for government agencies, pension funds, corporations with strong financials and other institutional customers of similar size and stature. These services are made up of cash management, equipment financing, large loans, merchant banking and trust services, among others

Wholesale banking also refers to the borrowing and lending between institutional banks. This type of lending occurs on the interbank market and often involves extremely large sums of money.

Most standard banks operate as merchant banks and offer wholesale banking services in addition to traditional retail banking services. This means that an individual looking for wholesale banking wouldn't have to go to a special institution and could instead engage the same bank in which he conducts his personal retail banking.

The main functions of wholesale banks are:

1. Accepting deposits
2. Advancing loans

Other functions

1.Discounting of Bills of Exchange
2.Investment of Fund
3.transfer of money
4. work as trusty
5.work as representative

Retail banking

Retail banking, also known as consumer banking, is the provision of services by a bank to the general public, rather than to companies, corporations or other banks, which are often described as wholesale banking. Banking services which are regarded as retail include provision of savings and transactional accounts, mortgages, personal loans, debit cards, and credit cards. Retail banking is also distinguished from investment banking or commercial banking. It may also refer to a division or department of a bank which deals with individual customers.

Typical retail banking services offered by banks include:

- Transactional accounts
- Current accounts
- Savings accounts
- Debit cards
- ATM cards
- Credit cards
- Traveler's cheques
- Mortgages
- Home equity loans
- Personal loans
- Certificates of deposit/Term deposits.

Retail banking in India

Retail banking in India is not a new phenomenon. It has always been prevalent in India in various forms. For the last few years, it has become synonymous with mainstream banking for many banks.

The typical products offered in the Indian retail banking segment are housing loans, consumption loans for purchase of durables, auto loans, credit cards and educational loans. The loans are marketed under attractive brand names to differentiate the products offered by different banks. As the Report on Trend and Progress of India, 2003-04 has shown that the loan values of these retail lending typically range between Rs.20,000 to Rs.100 lakh. The loans are generally for duration of five to seven years with housing loans granted for a longer duration of 15 years. Credit card is another rapidly growing sub-segment of this product group.

In recent past retail lending has turned out to be a key profit driver for banks with retail portfolio constituting 21.5 per cent of total outstanding advances as on March 2004. The overall impairment of the retail loan portfolio worked out much less then the Gross NPA ratio for the entire loan portfolio. Within the retail segment, the housing loans had the least gross asset impairment. In fact, retailing make ample business sense in the banking sector.

While new generation private sector banks have been able to create a niche in this regard, the public sector banks have not lagged behind. Leveraging their vast branch network and outreach, public sector banks have aggressively forayed to garner a larger slice of the retail pie. By international standards, however, there is still much scope for retail banking in India. After all, retail loans constitute less than seven per cent of GDP in India vis-à-vis about 35 per cent for other Asian economies — South Korea (55 per cent), Taiwan (52 per cent), Malaysia (33 per cent) and Thailand (18 per cent). As retail banking in India is still growing from modest base, there is a likelihood that the growth numbers seem to get somewhat exaggerated. One, thus, has to exercise caution is interpreting the growth of retail banking in India.

Drivers of retail business in India

What has contributed to this retail growth? briefly highlight some of the basic reasons.

1. **Economic prosperity and the consequent increase in purchasing power has given a fillip to a consumer boom**. Note that during the 10 years after 1992, India's economy grew at an average rate of 6.8 percent and continues to grow at the almost the same rate – not many countries in the world match this performance.
2. **Changing consumer demographics indicate vast potential for growth in consumption both qualitatively and quantitatively**. India is one of the countries having highest proportion (70%) of the population below 35 years of age (young population). The BRIC report of the Goldman-Sachs, which predicted a bright future for Brazil, Russia, India and China, mentioned Indian demographic advantage as an important positive factor for India.
3. **Technological factors played a major role**. Convenience banking in the form of debit cards, internet and phone-banking, anywhere and anytime banking has attracted many new customers into the banking field. Technological innovations relating to increasing use of

credit / debit cards, ATMs, direct debits and phone banking has contributed to the growth of retail banking in India.

4. **The Treasury income of the banks**, which had strengthened the bottom lines of banks for the past few years, has been on the decline during the last two years. In such a scenario, retail business provides a good vehicle of profit maximization. Considering the fact that retail's share in impaired assets is far lower than the overall bank loans and advances, retail loans have put comparatively less provisioning burden on banks apart from diversifying their income streams
5. **Decline in interest rates have also contributed to the growth of retail credit by generating the demand for such credit.**

In this background, there are two specific domains of retail lending in India:

(a) credit cards

(b) housing.

Credit Cards in India

While usage of cards by customers of banks in India has been in vogue since the mid-1980s, it is only since the early 1990s that the market had witnessed a quantum jump. The total number of cards issued by 42 banks and outstanding, increased from 2.69 crore as on end December 2003 to 4.33 crore as on end December 2004. The actual usage too has registered increases both in terms of volume and value. Almost all the categories of banks issue credit cards. Credit cards have found greater acceptance in terms of usage in the major cities of the country, with the four major metropolitan cities accounting for the bulk of the transactions.

In view of this ever-increasing role of credit cards a Working Group was set up for regulatory mechanism for cards. The terms of reference of the Working Group were fairly broad and the Group was to look into the type of regulatory measures that are to be introduced for plastic cards (credit, debit and smart cards) for encouraging their growth in a safe, secure and efficient manner, as also to take care of the best customer practices and grievances redressal mechanism for the card users. The Reserve Bank has been receiving a number of complaints regarding various undesirable practices by credit card issuing institutions and their agents. Some of them are:

- Unsolicited calls to members of the public by card issuing banks/ direct selling agents pressurizing them to apply for credit card.
- Communicating misleading / wrong information regarding credit cards regarding conditions for issue, amount of service charges/ waiver of fees, gifts/prizes.
- Sending credit cards to persons who have not applied for them / activating unsolicited cards without the approval of the recipient.
- Charging very high interest rates /service charges.
- Lack of transparency in disclosing fees/charges/penalties. Non-disclosure of detailed billing procedure.

These recommendations are being processed within the RBI and a set of guidelines would be issued which are going to pave the path of a healthy growth in the development of plastic money in

India. The RBI is also considering bringing credit card disputes within the ambit of the Banking Ombudsman scheme. While building a regulatory oversight in this regard we need to ensure that neither does it reduce the efficiency of the system nor does it hamper the credit card usage.

Housing Credit in India

In view of its backward and forward linkages with other sectors of the economy, housing finance in developing countries is seen as a social good. In India, growth of housing finance segment has accelerated in recent years. Several supporting policy measures (like tax benefits) and the supervisory incentives instituted had played a major role in this market.

Thus, from miniscule amounts, the exposure of the banking sector to housing loans has gone up. Unlike many other countries, asset impairment on account of housing finance constitutes a very small portion. However, with growing competition in the housing finance market, there has been a growing concern over its likely impact on the asset quality. While no immediate financial stability concerns exist, there is a need to put in place appropriate risk management systems, strengthen internal control procedures and also improve regulatory oversight in this area. Banks also need to monitor their exposure and the credit quality. In a fiercely competitive market, there may be some temptation to slacken the loan scrutiny procedures and this needs to be severely checked.

Having delineated the broad contours of retail banking in India let me now come to its opportunities and challenges.

Opportunities and Challenges of Retail Banking in India

Retail banking has immense opportunities in a growing economy like India. As the growth story gets unfolded in India, retail banking is going to emerge a major driver. How does the world view us? I have already referred to the BRIC Report talking India as an economic superpower. A. T. Kearney, a global management consulting firm, recently identified India as the "second most attractive retail destination" of 30 emergent markets.

The rise of the Indian middle class is an important contributory factor in this regard. The percentage of middle to high income Indian households is expected to continue rising. The younger population not only wields increasing purchasing power, but as far as acquiring personal debt is concerned, they are perhaps more comfortable than previous generations. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt, is contributing to India's retail banking segment.

The challenges for the industry and its stakeholders

First, **retention of customers is going to be a major challenge**. According to a research by Reichheld and Sasser in the Harvard Business Review, 5 per cent increase in customer retention can increase profitability by 35 per cent in banking business, 50 per cent in insurance and brokerage, and 125 per cent in the consumer credit card market. Thus, banks need to emphasise retaining customers and increasing market share.

Second, rising indebtedness could turn out to be a cause for concern in the future. India's position, of course, is not comparable to that of the developed world where household debt as a proportion of disposable income is much higher. Such a scenario creates high uncertainty. Expressing concerns about the high growth witnessed in the consumer credit segments the Reserve Bank has, as a temporary measure, put in place risk containment measures and increased the risk weight from 100 per cent to 125 per cent in the case of consumer credit including personal loans and credit cards

Third, information technology poses both opportunities and challenges. Even with ATM machines and Internet Banking, many consumers still prefer the personal touch of their neighborhood branch bank. Technology has made it possible to deliver services throughout the branch bank network, providing instant updates to checking accounts and rapid movement of money for stock transfers. However, this dependency on the network has brought IT departments additional responsibilities and challenges in managing, maintaining and optimizing the performance of retail banking networks. Illustratively, ensuring that all bank products and services are available, at all times, and across the entire organization is essential for today's retails banks to generate revenues and remain competitive. Besides, there are network management challenges, whereby keeping these complex, distributed networks and applications operating properly in support of business objectives becomes essential. Specific challenges include ensuring that account transaction applications run efficiently between the branch offices and data centres.

Fourth, KYC Issues and money laundering risks in retail banking is yet another important issue. Retail lending is often regarded as a low risk area for money laundering because of the perception of the sums involved. However, competition for clients may also lead to KYC procedures being waived in the bid for new business. Banks must also consider seriously the type of identification documents they will accept and other processes to be completed. The Reserve Bank has issued details guidelines on application of KYC norms in November 2004.

Major attributes of the shape of things to come in this sector

1. **Customer service should be the be-all and end-all of retail banking**. The other day a document released by the British Bankers Association, entitled UK Retail Banking Manifesto: addressing the challenges that lie ahead for the industry and its stakeholders on September 29, 2004 came to my notice. This document analysed the key policy issues relevant to the retail banking sector and highlighted the role of financial inclusion, responsible lending, access to finance, and consumer protection. It is in this context that that one is reminded of the needs to develop the standards and codes for banking. The contribution of the Committee on Procedure & Performance Audit on Public Services (CPPAPS) (Chairman: Shri S.S. Tarapore) has been invaluable and has provided great insight. Based on the recommendation of the CPPAPS, the Annual Policy Statement for 2005-06 announced the decision to set up an independent Banking Codes & Standards Board of India on the model of the mechanism in the UK in order to ensure that comprehensive code of conduct for fair treatment of customers is evolved and adhered to.
2. **Sharing of information about the credit history of households is extremely important as far retail banking is concerned**. Perhaps due the confidential nature of banker-customer, banks have a traditional resistance to share credit information on the client, not only with one another, but also across sectors. Globally, Credit Information Bureaus have,

therefore, been set up to function as a repository of credit information - both current and historical data on existing and potential borrowers. The database maintained by these institutions can be accessed by the lending institutions. Credit Bureaus have been established not only in countries with developed financial systems but also in countries with relatively less developed financial markets, such as, Sri Lanka, Mexico, Bangladesh and the Philippines. In Indian case, the Credit Information Bureau (India) Limited (CIBIL), incorporated in 2000, aims at fulfilling the need of credit granting institutions for comprehensive credit information by collecting, collating and disseminating credit information pertaining to both commercial and consumer borrowers. At the same time banks must exercise due diligence before declaring a borrower as defaulter.

3. **Outsourcing has become an important issue in the recent past**. With the increasing market orientation of the financial system and to cope with the competition as also to benefit from the technological innovations such as, e-banking, the banks are making increasing use of **"**outsourcing**"** as a means of both reducing costs and achieving better efficiency. While outsourcing does have various cost advantages, it has the potential to transfer risk, management and compliance to third parties who may not be regulated. A recent BIS Report on "Outsourcing in Financial Services" developed some high-level principles. A basic requirement in this context is that a regulated entity seeking to outsource activities should have in place a comprehensive policy on outsourcing including a comprehensive outsourcing risk management programme to address the outsourced activities and the relationship with the service provider. Application of these principles in the Indian context is under consideration.
4. **retail banking does not refer to lending only. In the whole story of retailing one should not forget the role played by retail depositors.** The homemaker, the retail shop keeper, the pensioners, self-employed and those employed in unorganised sector - all need to get a place in the banks. It is in this backdrop that the Annual Policy for 2005-06 pointed out issues relating to financial exclusion and had announced that the RBI would implement policies to encourage banks which provide extensive services while disincentivizing those which are not responsive to the banking needs of the community, including the underprivileged. Furthermore, the nature, scope and cost of services need to be monitored to assess whether there is any denial, implicit or explicit, of basic banking services to the common person and banks have been urged to review their existing practices to align them with the objective of financial inclusion.

MUDRA Bank

Micro Units Development and Refinance Agency Bank (or MUDRA Bank) is a public sector financial institution in India. It provides loans at low rates to micro-finance institutions and non-banking financial institutions which then provide credit to MSMEs. It was launched by Prime Minister Narendra Modi on 8 April 2015. The MUDRA banks were set up under the Pradhan Mantri MUDRA Yojana scheme. It will provide its services to small entrepreneurs outside the service area of regular banks, by using last mile agents. About 5.77 crore (57.6 million) small business have been identified as target clients. The bank will also ensure that its clients do not fall into indebtedness and will lend responsibly. Those **eligible to borrow** from MUDRA bank are

- Small manufacturing unit
- Shopkeepers
- Fruit and vegetable vendors
- Artisans

MUDRA Bank are:

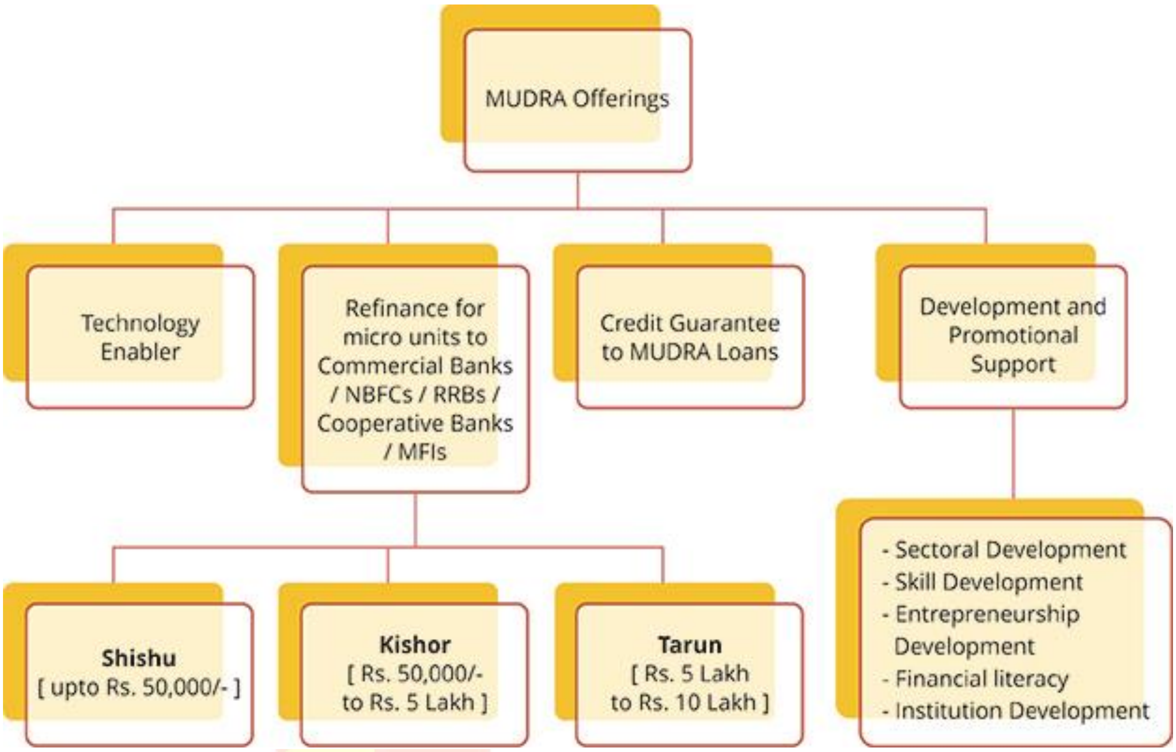
1. Regulate the lender and the borrower of microfinance and bring stability to the microfinance system through regulation and inclusive participation.
2. Extend finance and credit support to Microfinance Institutions (MFI) and agencies that lend money to small businesses, retailers, self-help groups and individuals.
3. Register all MFIs and introduce a system of performance rating and accreditation for the first time. This will help last-mile borrowers of finance to evaluate and approach the MFI that meets their requirement best and whose past record is most satisfactory. This will also introduce an element of competitiveness among the MFIs. The ultimate beneficiary will be the borrower.
4. Provide structured guidelines for the borrowers to follow to avoid failure of business or take corrective steps in time. MUDRA will help in laying down guidelines or acceptable procedures to be followed by the lenders to recover money in cases of default.
5. Develop the standardised covenants that will form the backbone of the last-mile business in future.
6. Offer a Credit Guarantee scheme for providing guarantees to loans being offered to micro businesses.
7. Introduce appropriate technologies to assist in the process of efficient lending, borrowing and monitoring of distributed capital.
8. Build a suitable framework under the Pradhan Mantri MUDRA Yojana for developing an efficient last-mile credit delivery system to small and micro businesses.

Major Product Offerings

MUDRA Bank has rightly classified the borrowers into three segments: the starters, the mid-stage finance seekers and the next level growth seekers.

To address the three segments, MUDRA Bank has launched **three Mudra loan instruments:**

1. **Shishu**: covers loans up to Rs 50,000/-
2. **Kishor**: covers loans above Rs 50,000/- and up to Rs 5 lakh
3. **Tarun**: covers loans above Rs 5 lakh and up to Rs 10 lakh



Under the aegis of Pradhan Mantri Mudra Yojana (PMMY), MUDRA has created products / schemes. The interventions have been named 'Shishu', 'Kishor' and 'Tarun' to signify the stage of growth / development and funding needs of the beneficiary micro unit / entrepreneur and also provide a reference point for the next phase of graduation / growth to look forward to :

- Shishu : covering loans upto 50,000/-
- Kishor : covering loans above 50,000/- and upto 5 lakh
- Tarun : covering loans above 5 lakh and upto 10 lakh

It would be ensured that more focus is given to Shishu Category Units and then Kishor and Tarun Categories.

Within the framework and overall objective of development and growth of micro enterprises sector under Shishu, Kishor and Tarun, the products being offered by MUDRA are so designed, to meet requirements of different sectors / business activities as well as business / entrepreneur segments.

The funding support from MUDRA are of four types :

- Micro Credit Scheme (MCS) for loans up to 1 lakh finance through MFIs.
- Refinance Scheme for Commercial Banks / Regional Rural Banks (RRBs) / Scheduled Co-operative Banks
- Women Enterprise program
- Securitization of loan portfolio

Micro Credit Scheme is offered mainly through Micro Finance Institutions (MFIs), which deliver the credit upto Rs.1 lakh, for various micro enterprise activities. Although, the mode of delivery may be through groups like SHGs/JLGs, the loans are given to the individuals for specific income generating micro enterprise activity. The MFIs for availing financial support need to enroll with MUDRA by complying to some of the requirements as notified by MUDRA, from time to time

Different banks like Commercial Banks, Regional Rural Banks and Scheduled Cooperative Banks are eligible to avail of refinance support from MUDRA for financing micro enterprise activities. The refinance is available for term loan and working capital loans, upto an amount of 10 lakh per unit. The eligible banks, who have enrolled with MUDRA by complying to the requirements as notified, can avail of refinance from MUDRA for the loan issued under Shishu, Kishor and Tarun categories.

in order to encourage women entrepreneurs, the financing banks / MFIs may consider extending additional facilities, including interest reduction on their loan. At present, MUDRA extends a reduction of 25bps in its interest rates to MFIs / NBFCs, who are providing loans to women entrepreneurs.

MUDRA also supports Banks / NBFCs / MFIs for raising funds for financing micro enterprises by participating in securitization of their loan assets against micro enterprise portfolio, by providing second loss default guarantee, for credit enhancement and also participating in investment of Pass Through Certificate (PTCs) either as Senior or Junior investor.

Mudra loan is extended for a variety of purposes which provide income generation and employment creation. The loans are extended mainly for :

- Business loan for Vendors, Traders, Shopkeepers and other Service Sector activities
- Working capital loan through MUDRA Cards
- Equipment Finance for Micro Units
- Transport Vehicle loans

Purpose of Mudra loan

Following is an illustrative list of the activities that can be covered under MUDRA loans:

- Transport Vehicle
- Purchase of transport vehicles for goods and personal transport such as auto rickshaw, small goods transport vehicle, 3 wheelers, e-rickshaw, passenger cars, taxis, etc.
- Community, Social & Personal Service Activities
- Saloons, beauty parlours, gymnasium, boutiques, tailoring shops, dry cleaning, cycle and motorcycle repair shop, DTP and Photocopying Facilities, Medicine Shops, Courier Agents, etc.
- Food Products Sector
- Activities such as papad making, achaar making, jam / jelly making, agricultural produce preservation at rural level, sweet shops, small service food stalls and day to day catering / canteen services, cold chain vehicles, cold storages, ice making units, ice cream making units, biscuit, bread and bun making, etc.
- Textile Products Sector / Activity
- Handloom, powerloom, khadi activity, chikan work, zari and zardozi work, traditional embroidery and hand work, traditional dyeing and printing, apparel design, knitting, cotton ginning, computerized embroidery, stitching and other textile non garment products such as bags, vehicle accessories, furnishing accessories, etc.
- Business loans for Traders and Shopkeepers

Financial support for on lending to individuals for running their shops / trading & business activities / service enterprises and non-farm income generating activities with beneficiary loan size of upto 10 lakh per enterprise / borrower.

- Equipment Finance Scheme for Micro Units

Setting up micro enterprises by purchasing necessary machinery / equipments with per beneficiary loan size of upto 10 lakh.

- Activities allied to agriculture

'Activities allied to agriculture', e.g. pisciculture, bee keeping, poultry, livestock, rearing, grading, sorting, aggregation agro industries, diary, fishery, Agri clinics and agribusiness centers, food & agro-processing, etc.(excluding crop loans, land improvement such as canal, irrigation and wells) and services supporting these, which promote livelihood or are income generating shall be eligible for coverage under PMMY in 2016-17.

Mudra card

MUDRA Card is an innovative product which provides working capital facility as a cash credit arrangement. MUDRA Card is a debit card issued against the MUDRA loan account, for working capital portion of the loan. The borrower can make use of MUDRA Card in multiple withdrawal and credit, so as to manage the working capital limit in a most efficient manner and keep the interest burden minimum. MUDRA Card will also help in digitalization of MUDRA transactions and creating credit history for the borrower. National Payment Corporation of India (NPCI) has given RuPay branding to MUDRA Card and also separate BIN / IIN for the same, by which credit history can be tracked.

MUDRA Card can be operated across the country for withdrawal of cash from any ATM / micro ATM and also make payment through any 'Point of Sale' machines.

The design of the MUDRA card as approved by DFS, GoI and NPCI is given below. Banks can customize the same by incorporating their logo and name.

Private Banks

Initially all the banks in India were private banks, which were founded in the pre independence era to cater to the banking needs of the people. In 1921, three major banks i.e. Banks of Bengal, Bank of Bombay, and Bank of Madras, were merged to form Imperial Bank

of India. In 1935, the Reserve Bank of India (RBI) was established and it took over the central banking responsibilities from the Imperial Bank of India, transferring commercial banking functions completely to IBI. In 1955, after the declaration of the first-five-year plan,

Imperial Bank of India was subsequently transformed into State Bank of India (SBI). Following this, occurred the nationalization of major banks in India on 19 July 1969.

The Government of India (GOI) issued an ordinance and nationalized the 14 largest commercial banks of India, including Punjab National Bank (PNB), Allahabad Bank, Canara Bank, Central Bank of India, etc. Thus, public sector banks revived to take up leading role in the banking structure. In 1980, the GOI nationalized 6 more commercial banks, with control over 91% of banking business of India. In 1994, the Reserve Bank of India issued a policy of liberalization to license limited number of private banks, which came to be known as New Generation tech-savvy banks. Global Trust Bank was, thus, the first private bank after liberalization; it was later amalgamated with Oriental Bank of Commerce (OBC).

Then Housing Development Finance Corporation Limited (HDFC) became the first (still existing) to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector. At present, Private Banks in India includes leading banks like ICICI Banks, ING Vysya Bank, Jammu & Kashmir Bank, Karnataka Bank, Kotak Mahindra Bank, SBI Commercial and International Bank, etc. Undoubtedly, being tech-savvy and full of expertise, private banks have played a major role in the development of Indian banking industry. They have made banking more efficient and customer friendly. In the process they have jolted public sector banks out of complacency and forced them to become more competitive.

Major Private banks in India are

1. **Bank of Rajasthan**

A leading private sector bank, the Bank of Rajasthan was founded on the auspicious day of Akshya Tritiya on May 8, 1943, at Udaipur. Shri Rai Bahadur P.C. Chatterji, then the finance minister of the erstwhile Mewar Government, extensively contributed towards the establishment of the Bank.

2. **Catholic Syrian Bank**

With the Swadeshi Movement of early 20th century as its base, Catholic Syrian Bank was incorporated on 26th November 1920, in the Thrissur district of Kerala. The bank commenced its operations on 1st January 1921, with an authorized capital of ` 5 lakhs and a paid up capital of ` 45270.

3. **Dhanal akshmi Bank**

The foundation of Dhana lakshmi Bank Limited was laid down on 14th November 1927, in the Thrissur district of Kerala. A group of innovative entrepreneurs had started the bank with a capital of `11, 000 and only 7 employees.

4. **Federal Bank**

Federal Bank Limited was founded as Travancore Federal Bank Limited in the year 1931, with an authorized capital of ` 5000. It was established at Nedumpuram, a place near Tiruvalla, in Central Travancore (a princely state later merged into Kerala), under Travancore Company's Act.

5. **HDFC Bank**

Housing Development Finance Corporation Limited, more popularly known as HDFC Bank Ltd, was established in the year 1994, as a part of the liberalization of the Indian

Banking Industry by Reserve Bank of India (RBI). It was one of the first banks to receive an 'in principle' approval from RBI, for setting up a bank in the private sector.

6. ICICI Bank

ICICI Bank started as a wholly owned subsidiary of ICICI Limited, an Indian

financial institution, in 1994. Four years later, when the company offered ICICI Bank's shares to the public, ICICI's shareholding was reduced to 46%. In the year 2000, ICICI Bank offered made an equity offering in the form of ADRs on the New York Stock Exchange (NYSE).

7. ING Vysya Bank

ING Vysya Bank Ltd came into being in October 2002, when erstwhile Vysya Bank Ltd was merged with ING, a global financial powerhouse boasting of Dutch origin. Vysya Bank Ltd, one of initial banks to be set up in the private sector of India.

8. Jammu & Kashmir Bank

The origin of Jammu and Kashmir Bank Limited, more commonly referred to as J&K Bank, can be traced back to the year 1938, when it was established as the first state-owned bank in India. The bank was incorporated on 1st October 1938 and it was in the following year (more precisely on 4th July 1939) that it commenced its business, in Kashmir (India).

9. Karnataka Bank

Karnataka Bank Limited is a leading private sector bank in India. It was incorporated on 18th February 1924 at Mangalore, a town located in the Kannada district of Karnataka. The bank emerged as a major player during the freedom movement of 20th Century India.

10. Karur Vysya Bank

The Karur Vysya Bank Limited commonly known as KVB was set up by Late Shri M.A. Venkatarama Chettiar and the Late Shri Athi Krishna Chettiar, the two great visionaries in 1916 in Karur, a textile town in the Tamil Nadu state of India.

11. Kotak Mahindra Bank

Kotak Mahindra Bank is one of India's leading financial private banking institutions. It offers banking solutions that covers almost every sphere of life. Some of its financial services include commercial banking, stock broking, mutual funds, life insurance and investment banking.

12. SBI Commercial and International Bank

SBI Commercial and International Bank, (SBICI) is a completely owned private auxiliary of India's biggest banking and financial services set up, the State Bank of India. Established in 1995 to back SBI's corporate and international banking services, the SBI Commercial and International Bank is the only bank in India to be been awarded ISO-9002 quality systems certification for the Bank as a whole.

13. UTI Bank

Axis Bank was formed as UTI when it was incorporated in 1994 when Government of India allowed private players in the banking sector. The bank was sponsored together by the administrator of the specified undertaking of the Unit Trust of India, Life Insurance Corporation of India (LIC) and General Insurance Corporation ltd.

14. YES Bank

Yes Bank is one of the top most private Indian banks. Awarded by the only

Greenfield license award by RBI in last 14 years, this bank is established and run by Rana Kapoor and Ashok Kapoor with the financial support of Rabo bank Netherland, the world's single AAA rated private Bank. For the purpose of assessment of performance of banks, the

IMPORTANCE OF PRIVATE SECTOR IN INDIAN ECONOMY

The importance of private sector in Indian economy over the last 15 years has been tremendous. The opening up of Indian economy has led to free inflow of foreign direct investment (FDI) along with modern cutting edge technology, which increased the importance of private sector in Indian economy considerably. Previously, the Indian markets were ruled by the government enterprises but the scene in Indian market has changed as soon as the markets were opened for investments. This saw the rise of the Indian private sector companies, which prioritized customer's need and speedy service. This further fueled competition amongst same industry players and even in government organizations. The post 1990 era witnessed total investment in favor of Indian private sector. The investment quantum grew from 56% in the first half of 1990 to 71 % in the second half of 1990. This trend of investment continued for over a considerable period of time. These investments were especially made in sector like financial services, transport and social services. The late 1990‟s and the period thereafter witnessed investments in sector like manufacturing, infrastructure, agriculture products and most importantly in Information technology and telecommunication. The present trend shows a marked increase in investment in areas covering pharmaceutical, biotechnology, semiconductor, contract research and product research and development. The importance of private sector in Indian economy has been very commendable in generating employment and thus eliminating poverty. Further, it also effected the following:

- Increased quality of life

- Increased access to essential items
- Increased production opportunities
- Lowered prices of essential items
- Increased value of human capital
- Improved social life of the middle-class Indian
- Decreased the percentage of people living below the poverty line in India
- Changed the age-old perception of poor agriculture-based country to a rising manufacturing-based country
- Effected increased research and development activity and spending
- Effected better higher education facilities especially in technical fields
- Ensured fair competition amongst market players
- Dissolved the concept of monopoly and thus neutralized market manipulation practices.

Economic Development through Banking System

The contribution of the banking sector in the process of economic development can be summarized as under:

1. **Banks help in Capital Formation:**

Banks mobilize the idle and dormant capital of a community and make it available

for productive purposes. In fact, banks have designed a number of schemes to attract the prospective customers to encourage the habit of savings among the people.

2. **Banks are the Creator of Money:**

Banks are described as factories of credit. They have the power to create money and it helps in the economic development of the country.

3. **Banks act as a link between the organized and unorganized sectors:**

In India, money market consists of organized and unorganized sectors. Both of them are required to be linked for economic development of the country and this function is performed by banks.

4. **Banks help in the effective implementation of monetary policy:**

The effective implementation of monetary policy can be done only through properly organized banking system of the country.

5. **Banks help in the development of agriculture and industries:**

The development of a country not only depends on the industrial development but also on the development of agriculture. The banks cater to the financial needs of these sectors which result in the economic development of the country.

6. **Banks act as catalyst in social change**:

In India banks are regarded as catalysts in bringing the desired social change in

community. Banks are able to achieve the desired change through it sectoral priorities and other social development program.

7. **Banks help in the development of entrepreneurship:**

Banks have special drives and specific schemes for the development of

entrepreneurship. Banks help in boosting their strength and health.

8. **Banks regulate the flow of national savings:**

Banks regulate the flow of national savings. They ensure the diversion of national

savings into productive purposes.

9. **Banks help in mitigating the effects of trade cycles:**

The effective banking system can help the government in controlling the circulation of money. It helps in mitigating the effects of trade cycles in a country.

10. **Banks help in maintaining the positive balance of trade**:

Banks also help in promoting import and maintaining the balance of trade at a

favorable position. From the above, it became clear that the banking system occupies an important position in an economy. Bankers are regarded as, "Public Conservators of Commercial Virtues." A country with an effective banking system has a secure foundation of economic development. The nationalization of the banks bestowed upon them variety of new obligations in the area of social banking. The major achievements of the nationalized banks are in the sphere of branch, expansion deposit mobilization and expansion of credit to heather to neglect sectors which are important for the national economy in terms of their contribution to the growth, employment generation and broadening the base of income distribution.

Foreign Banks

India is a vast country with a lot of trade opportunities. Banks had a major contribution in India's growth. Foreign banks, speaking about them as a definition, they are banks from a foreign country working in India through branches. RBI has provided rules and guidelines for a foreign bank to establish and operate in India.

Eligibility Criteria – Foreign Banks in India

There is an eligibility criterion on the basis of capital for the foreign bank to work in India. They must have at least 5 billion rupees towards capital on establishment. Moreover they must also be ready to credit 18 % of net ANBC ('adjusted net bank credit' – which is total investment made by bank on non-governmental securities.) towards agricultural loans.

Modes of Operation

The banks can have two modes of operation in India. As mentioned above branch mode or Subsidiary mode which is known as WOS (Wholly owned Subsidiary). They can either start the bank branches in the initial setup or later convert them to WOS. But to work as a WOS there are several factors to be met:

- Economic stability should be proved by the bank
- Bank must have a very good financial soundness
- The bank must provide necessary documents to show the proper ownership.
- The bank must be rated by any International rating agency
- Bank must have a risk management team.

Development Banks

"Development banks are those financial institutions whose prime goal (motive) is to finance the primary (basic) needs of the society. Such funding results in the growth and development of the social and economic sectors of the nation. However, needs of the society vary from region to region due to differences were seen in its communal structure, economy and other aspects."Working capital requirements are provided by commercial banks, indigenous bankers, co-operative banks, money lenders, etc. The money market provides short-term funds which mean working capital requirements.

The long-term requirements of business concerns are provided by industrial banks and the various long-term lending institutions which are created by the government. In India, these long-term lending institutions are collectively referred to as **development banks**:

1. Industrial Finance Corporation of India (IFCI), 1948
2. Industrial Credit and Investment Corporation of India (ICICI), 1955
3. Industrial Development of Bank of India (IDBI), 1964
4. State Finance Corporation (SFC), 1951
5. Small Industries Development Bank of India (SIDBI), 1990
6. Export-Import Bank (EXIM)
7. Small Industries Development Corporation (SIDCO)
8. National Bank for Agriculture and Rural Development (NABARD).

Objectives of Development Banks

The main objectives of the development banks are

1. to promote industrial growth,

2. to develop backward areas,

3. to create more employment opportunities,

4. to generate more exports and encourage import substitution,

5. to encourage modernization and improvement in technology,

6. to promote more self-employment projects,

7. to revive sick units,

8. to improve the management of large industries by providing training,

9. to remove regional disparities or regional imbalance,

10. to promote science and technology in new areas by providing risk capital,

11. to improve capital market in the country.

Development banks in India are classified into the following four groups:

1. **Industrial Development Banks**: It includes, for example, Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), and Small Industries Development Bank of India (SIDBI).
2. **Agricultural Development Banks**: It includes, for example, National Bank for Agriculture & Rural Development (NABARD).
3. **Export-Import Development Banks**: It includes, for example, Export-Import Bank of India (EXIM Bank).
4. **Housing Development Banks**: It includes, for example, the National Housing Bank (NHB).

Differences between Commercial banks and Development banks

The following are some of the differences between commercial banks and development banks.

Commercial Bank	Development Bank
1.Provide short term loans.	1. Provide long term loans.
2. Accept deposits from the public.	2. Accept deposits from commercial banks, Central and State governments.
3. Direct finance to customers.	3. Provide refinancing facilities to commercial bank
4. Plays an important role in the money market.	4. Play an important role in hire purchase, lease finance, housing loan.
5. Public sector banks have their share capital contributed by the government while private sector banks have share capital contributed by the public.	5. Central and Statement governments contribute capital.
6. Promote savings among the public and help commercial activities	6. They promote economic growth of the country.

Investment Banking

The team investment banking has come into common use only within recent years. It is now employed to designate a distinct work or branch of banking, which is characterized primarily by the fact that it is concerned with long-term credits.

The old generic term of “banking”, on the one hand, has been broadened considerably to permit this inclusion, and, on the other hand, the concept has been more sharply limited and defined through division into the two branches of commercial and investment banking, the one devoted to short-term financing, and the other to the financing of long-term or capital requirements.

Features and Growth:

1. Safety of Principal:

The safety sought in investment is not absolute or complete; it rather implies protection against loss under reasonably likely conditions or variations. It calls for careful review of economic and industry trends before deciding types and/or timing of investments. Thus, it recognizes that errors are unavoidable for which extensive diversification is suggested an antidote.

Adequate diversification means assortment of investment commitments in different ways. Those who are not familiar with the aggressive-defensive approach nevertheless often carry out the theory of hedging against inflation-deflation. Diversification may be geographical, wherever possible, because regional or local storms, floods, droughts, etc. can cause extensive real estate damage.

Vertical and horizontal diversification can also be opted for the same. Vertical diversification occurs when securities of various companies engaged in different phases of production from raw material to finished goods are held in the portfolio. On the other hand, horizontal diversification is the holding by an investor in various companies all of which carry on activity in the same stage of production.

Another way to diversify securities is to classify them according to bonds and shares and reclassify according to types of bonds and types of shares. Again, they can also be classified according to the issuers, according to the dividend or interest income date, according to the product which are made by the firms represented by the securities.

But over-diversification is undesirable. By limiting investment to a few issues, the investor has an excellent opportunity to maintain knowledge of circumstances surrounding each issue. Probably the simplest and most effective diversification is accomplished by holding different media at the same time having reasonable concentration in each.

2. Adequate Liquidity and Collateral Value:

An investment is a liquid asset if it can be converted into cash without delay at full market value in any quantity. For an investment to be liquid it must be (1) reversible or (2) marketable. The different between reversibility and marketability is that reversibility is the process whereby the transaction is reverse or terminated while marketability involves the sale of the investment in the market for cash.

To meet emergencies, every investor must have a sound portfolio to be sure of the additional funds which may be needed for the business opportunities. Whether money raising is to be done by sale or by borrowing it will be easier if the portfolio contains a planned proportion of high-grade and readily salable investment.

3. Stability of Income:

Stability of income must be looked at in different ways just as was security of principal. An investor must consider stability of monetary income and stability of purchasing power of income. However, emphasis upon income stability may not always be consistent with other investment principles. If monetary income stability is stressed, capital growth and diversification will be limited.

4. Capital Growth:

Capital appreciation has today become an important principle. Recognizing the connection between corporation and industry growth and very large capital appreciation, investors and their advisers constantly are seeking “growth stocks”. It is exceedingly difficult to make a successful choice. The ideal “growth stock” is the right issue in the right industry, bought at the right time.

5. Tax Benefits:

To plan an investment program without regard to one’s status may be costly to the investor. There are really two problems involved here, one concerned with the amount of income paid by the investment and the other with the burden of income taxes upon that income.

When investors’ incomes are small, they are anxious to have maximum cash returns on their investments, and are prone to take excessive risks. On the other hand, investors who are not pressed for cash income often find that income taxes deplete certain types of investment incomes less than others, thus affecting their choices.

6**. Purchasing Power Stability:**

Since an investment early always involves the commitment of current funds with the objective of receiving greater amounts of future funds, the purchasing power of the future fund should be considered by the investor. For maintaining purchasing power stability, investors should carefully study;

(i) The degree of price level inflation they expect,

(ii) The possibilities of gain and loss in the investment available to them, and

(iii) The limitations imposed by personal and family considerations.

7. Concealability:

To be safe from social disorders, government confiscation or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes because they combine high value with small bulk and are readily transferable.

Indian Investment Banking System and Growth:

India inherited an under-developed economy and the under-developed capital market from the British rulers. In the immediate post-independence period things did not improve fast because of the unchanged economic environment. Concentration of money power, managerial skills and entrepreneurship, all rested with the handful of managing agency houses which wanted to move with gains and individual achievements creating acute dearth of long-term capital for industrial ventures.

The various reasons for this dearth were noted viz.:

(a) Lack of new investment- tax evaded income held in cash and mostly used for speculation in the bullion and commodity market.

(b) Impact of socio-economic and political reforms curtailed the investible funds because of drastic cut in privy purses of erstwhile rulers and princes, zamindari abolition curtailed income of zamindars who used to invest their surplus money in investment channels,

(c) Lower savings and meager saving capacity dominated the economic scene. The unequal distribution of sources of income and wealth caused continuing existence of vicious circle of poverty in the country, and

(d) Post-independence flight of foreign capital and evil effects of the country's partition created wide gaps in resources particularly availability of monetary resources.

A network of planned economic development was taken up by the Government duly supported by legislative and other measures. Growth of capital market was considered as one of the key areas for accelerating the pace of economic development by mobilising savings of the household and business sector into investible channels in industry and trade. Efforts to boost the capital market were supplemented through legislative measures, policy frame-work and institutional support.

Drastic amendments were made in the legislative framework regulating the growth of business enterprise viz. Companies Act, Capital Issues (Control) Act, Banking Companies Act, etc. The managing agency system was sought to be abolished from the horizon of corporate management vide Companies Act, 1956, to do away with the stumbling blocks it had created in the development of a free capital market in India.

To improve investment climate in the country and boost capital market activity Industrial Finance Corporation of India (IFCI) was established at national level under the IFC Act, 1948 to provide long and medium-term finance to the industrial enterprises and give underwriting coverage to new issues. At State levels, State Financial Corporations (SFCs) were also established onwards 1951 under State Financial Corporation Act, 1950 with a view to provide financial assistance to industry.

Unit-5

Concepts in Banking and Accounting of Transactions

Banking Transaction

Banking transactions refer to all receipts and payment made through bank. It is inconvenient and risky affair to get and make payment of large sum directly in cash. A modern business operates bank account to settle all receipts and payment. It issues cheque for making payments accepts cheques for getting amount. It may also instruct its bank to pay and collect amount on its behalf. In fact, the bank is treated by the business as its agent for collecting all receipts and making all payments. Except the balance in petty cash account, no cash balance is maintained in the office of a modern business. Proper recording and accounting of cash and banking transactions are important to achieve the following objectives.

- To have systematic and permanent record of all cash and banking transactions in a separate book.
- To obtain reliable and detailed information of all cash receipts and payments easily and immediately.
- To keep effective control over misappropriation of cash and banking transaction.
- To know the main sources and heads of payment of cash.
- To know cash and bank balances.
- To help to prepare cash budget and to avoid the possibility of having excess or shortage of cash.
- To make the cashier and other concerned officers accountable for all cash and banking transactions.

Bank Credit and Bank Debit

Using the business owner perspective, Bank Credit is the transaction that increases the bank balance. For example, you say your bank was credited if money is deposited to it.

Using the business owner perspective, Bank Debit is the transaction that decreases the bank balance. For example, you say your bank was debited if money is taken out from it.

Online transfer methods

Online transfer methods are subject to availability based on the customer's eligibility and level of access granted by the bank. Additionally, the limits on fund value, timings, settlement speed, and other factors are a part of the online fund transfer method to provide a positive experience to the customer when they choose one transfer method over the other. Currently, NEFT, RTGS, and IMPS are the most popular methods of fund transfer in India, few of the notable differences between these methods are listed below:

NEFT - The funds transferred under this method are settled in batches (based on Deferred Net Settlement (DNS) and at a specific time of the day. If the transfer is initiative beyond the cut-off time specified by RBI, the funds are typically settled on the next working day.

National Electronic Fund Transfer is one of the most prominent electronic fund transfer systems of India. NEFT was introduced in November 2005, and it is a facility provided to bank customers to enable them to transfer funds quickly and securely to one account to another account. It is a nationwide payment system facilitating safe and secure transaction all over the country. In this article, we view the various aspects of NEFT in detail.

Advantages of NEFT

The benefits of NEFT given to the consumers are as follows:

- Safe and Effective – For a flawless transfer of funds on the Internet, NEFT helps you to transfer any amount of money quickly.
- Low Processing Charges– NEFT is flexible payment options which are very economical. To utilise this facility, you don't have to pay a huge sum of money to your bank. The processing charges are economical, and you can transfer any amount of money without any difficulty.
- Highly Dependable–NEFT, an integral aspect of Internet banking, is a highly dependable method of making payments and receiving funds online. In India, most of the banks are regulated under the norms set by RBI and, hence, the Internet banking facility too is quite safe.
- Rapid Settlement–Unlike the regular banking methods of fund transfer, NEFT transfer is really quick, and you can enjoy rapid settlement of accounts, thereby improving the overall functionality of your business.

NEFT Process

The NEFT process consists of following steps are listed out below:

- Request for NEFT by bank customer Data Entry at the Sending Bank Branch.
- Processing or Data Upload at Sending NEFT Service Centre.
- Transmission or submission of NEFT message to the NEFT centre.
- Processing and transmission of NEFT message to the beneficiary banks. Data validation at receiving NEFT Service Centre.
- Payment to the beneficiary.

Information Required for Remittance

The required information that the remitting customer would have to furnish at the time of remittance through NEFT are as follows:

- Original cancelled cheque leaf (with pre-printed account holder name, account number and IFSC code) / if cheque leaf is not personalised, please provide the copy of latest bank statement (original) or bank attested statement/passbook).
- IFSC code (11 digit character code appearing on your cheque leaf. If you do not find this on your cheque leaf, then please consult your bank).

NEFT System Transaction Procedure

The transaction process involved in NEFT is explained below in step by step procedure.

Step 1: Firstly, the remitter has to provide the requisite information like

- Beneficiary’s Name.
- Beneficiary’s Account number
- Beneficiary’s Account type (cash credit, loan account, etc.)
- Bank name, location & base branch in which the beneficiary account is held.
- IFSC code of beneficiary bank etc. to start the process of NEFT.

Step 2: The bank branch at which the fund transfer request originated, prepares a message and sends it to its pooling centre (also called the NEFT Service Centre).

Step 3: The pooling centre forwards the message to the NEFT Clearing Centre (operated by the National Clearing Cell, RBI, Mumbai) to be included in the next available batch.

Step 4: The RBI at the clearing centre sorts the transaction bank-wise and prepares to account entries to receive funds from(debit) the originating banks and give the funds to (credit) the destination banks. Therefore, bank-wise remittance messages are forwarded to the destination banks through their polling centre (the NEFT Service Centre).

Step 5: The destination banks receive the remittance messages from the Clearing Centre and pass on the credit to the beneficiary accounts.

RTGS - This type of transfer methods is applicable and available for fund transfers of a minimum of Rs.2 lakh and there is no upper limit, however, the biggest advantage for RTGS is the fastest/real-time settlement factor. As soon as the transfer instructions are sent, the fund gets settled almost immediately. However, in order to take advantage of the RTGS facility, both the originator's and the beneficiary’s account has to be RTGS-enabled. Even though most banks are a part of the vast and popular RTGS transfer network facilitated by RBI, individuals are recommended to either get in touch with their bank directly or refer to their online banking section to discover their eligibility concerning access to RTGS payment system. The transaction fee under RTGS is higher than the other methods due to the faster settlement speed performed on an instruction by instruction basis.

Advantage of RTGS

The benefits of RTGS given to the customer are as follows:

- Real-time Payment Settlement: Payments settled in real time on a transaction-by-transaction basis, as soon as the system accepts them.
- No Credit Risk: There is no credit and settlement risk involved in RTGS system for receiving participant as each payment transaction is settled instantly.
- Predictability of Cash Flows: RTGS facilitates predictability of cash flows as customers know when their accounts will be debited or credited.
- Benefits to Economy: The instant finality of payments ensures fast, secure and irrevocable settlement of major business and financial market transactions.

Transactions Supported through RTGS

The following are the transactions supported through RTFS system.

- Inter-bank Payments
- Customer Payments
- Own Account Transfers
- Net Clearing
- NDS / CCIL

Information Required for Remittance

The required information that the remitting customer would have to furnish to a bank for the remittance are as follows:

- Amount to be remitted
- Account number which is to be debited
- Name of the beneficiary bank
- Name of the beneficiary customer
- Account number of the beneficiary customer
- Sender to receiver information, if any
- The IFSC Number of the receiving branch.

Transaction Process involved in RTGS

The transaction process involved in RTGS is explained below in step by step procedure.

Step 1: The customer has to submit the outward Instruction slip.

Step 2: The verification of Instruction slip (Clear funds, name and a/c no. of the customer, IFSC code, signature) take place.

Step 3: The branch scans the Instruction slip and sends it to the RTGS Central Team.

Step 4: The branch will file the slip to maintain records.

Step 5: The RTGS Central Team executes the transaction in Finacle and Participant Interface (PI) of RTGS.

Step 6: Then the message moves to the Reserve Bank of India (RBI) Server.

Step 7: The bank's RTGS Settlement Account is debited, and the beneficiary Bank's RTGS Settlement Account is credited.

Step 8: The beneficiary Bank passes the credit to the beneficiary customer's account.

IMPS - Immediate Payment Service was introduced in the year 2010 by the Indian government and is facilitated by the National Payment Corporation of India (NPCI). It is a service which enables you to make payments using your mobile number and completes the transactions immediately Also known for being one of the popular and fastest methods of fund transfer, IMPS is used widely across most banks. Unlike other methods of fund transfer that become unavailable on bank holidays and during off working hours, IMPS functions 24/7 allowing a fund transfer at any time of the day. Similar to NEFT, IMPS also allow transfer of low value-funds but what makes it unique is, it immediately settles the funds.

The Benefits of IMPS

The benefits of IMPS given to the consumers are as follows:

- The fund transfer can be done using MMID, Aadhaar number and mobile number.
- IMPS serve you with the Debit and Credit Confirmation by SMS immediately.
- Using IMPS, the money will be credited in the beneficiary's account within a few seconds.
- IMPS is safe, secure and cost-effective.
- IMPS have no minimum amount limit on transactions of funds.
- IMPS is available for 24 hours in a day and even on holidays.
- The customer can make intrabank as well as interbank payments.
- IMPS can be used on a mobile phone, internet banking and even ATMs.
- In IMPS it is not compulsory to know about beneficiary's Account number and IFSC.

Enabling IMPS

- If the customer wants to transfer the fund through IMPS using mobile, then you are supposed to register for the mobile banking.
- Some banks register customer mobile number for mobile banking at the time of opening your account while others want a separate application to activate the mobile banking.

- However, the customer can use IMPS through the net banking, ATM and branch without activating your mobile banking.
- If you are going to receive money through the IMPS method, the money would be credited to your account, and you will get SMS in your mobile. However, you can also get MMID from your bank to receive money quickly. MMID can be used instead of the bank account number and IFSC or Aadhaar number.

ECS (Electronic Clearing Service)

Electronic Clearing System (ECS) is an electronic method of fund transfer from one bank account to another. It is generally used for bulk transfers performed by institutions for making payments like dividend, interest, salary, pension, etc. ECS can also be used to pay bills and other charges such as payments to utility companies such as telephone, electricity, water, or for making equated monthly instalments payments on loans as well as SIP investments.

Types of ECS

ECS can be used for both ECS credit and ECS debit.

1. **ECS Credit**

ECS credit is used for allowing credit to a large number of beneficiaries by raising a single debit to the customer's account, such as dividend, interest or salary payment.

Advantages

The benefits of ECS credit given to the clients are as follows:

- The end beneficiary need not make frequent visit to his bank for depositing the physical paper instruments.
- Delay in the realisation of proceeds, which used to happen in the receipt of the paper instrument, is eliminated.
- The ECS user helps to save on administrative machinery for printing, dispatch and reconciliation.
- Provides the ability to make payment and ensure that the beneficiaries account gets credited on a designated date.

Working of ECS Credit System

ECS payments can be performed by any institution (ECS user) that has to make bulk or repetitive payments to a number of recipients or beneficiaries. They initiate the transactions after registering themselves with an approved clearinghouse. ECS users also have to obtain a consent such as the account particulars of the beneficiaries for engaging in the ECS clearings.

Under the scheme, the beneficiaries of the repetitive or regular payments can also require the paying institution to make ECS (credit) for payment. The ECS users expect to effect payments and to present the data in a prescribed format to any one of the recognized clearinghouses. The clearinghouse will debit the account of the ECS user through the user's bank on a particular day and credit the accounts of the recipient banks, for providing onward credit to the accounts of the ultimate beneficiaries.

ECS Debit

ECS debit is used for raising debits to a number of accounts of consumers or account holders for affording a single credit to a particular institution, in cases such as utility payments like electricity bills and telephone bills.

Advantages to Clients

The benefits of ECS debit given to the clients are as follows:

- Trouble-free: Eliminates the need to go to the collection centres or banks and the need to stand in long queues for payment.
- Easy to track: Customers are not required to track down payments by last dates. The ECS users would monitor the debts. The ECS user saves on administrative machinery for collecting the cheques by monitoring their realisation and reconciliation.
- Better cash management: Chances of frauds due to fraudulent access to paper instruments and encashment are avoided.
- The realisation of payments on a single date is enabled instead of fractured receipt of payments.

Working of ECS Debit System

ECS debit is a scheme in which an account holder can authorize an ECS user to recover a prescribed amount by raising a debit on his account. The ECS user has to receive an authorization which is called ECS mandate for raising such debts. These mandates have to be approved by the bank branch maintaining the account.

Any ECS user participating in the scheme has to register with an approved clearinghouse, an ECS user should receive the mandate forms from the participating destination account holders with the bank's acknowledgement. A certified copy of the mandate should be available with the drawee bank. The ECS user has to submit the data in a specified form through the sponsor bank to the clearinghouse. The clearinghouse would pass on the debit to the destination account holder through the clearing system and credit the sponsor bank's account for onward crediting the ECS user. All the unprocessed debits have to be returned to the sponsor bank's account for onward crediting the ECS user. All the unprocessed debits have to be returned to the sponsor bank, within the time frame specified. Banks treat the electronic instructions received through the clearing system at par with the physical cheques.

ATM

The automated teller machine (ATM) is an automatic banking machine (ABM) that allows the customer to complete basic transactions without any help from bank representatives. There are two types of automated teller machines (ATMs). The basic one allows the customer to only draw cash and receive a report of the account balance. Another one is a more complex machine that accepts the deposit, provides credit card payment facilities and reports account information.

Advantages of Automated Teller Machine:

- The ATM provides 24 hours service
- The ATM provides privacy in banking communications
- The ATMs reduce the workload banks staff
- The ATM may give customer new currency notes
- The ATMs are convenient for banks customers
- The ATM is very beneficial for travellers
- The ATM provides services without any error

Features of Automated Teller Machine:

- Transfer funds between linked bank accounts
- Receive account balance
- Prints recent transactions list
- Change your pin
- Deposit your cash
- Prepaid mobile recharge
- Bill payments
- Cash withdrawal
- Perform a range of features in your foreign language.

The design of each ATM is different, they all contain the same basic parts:

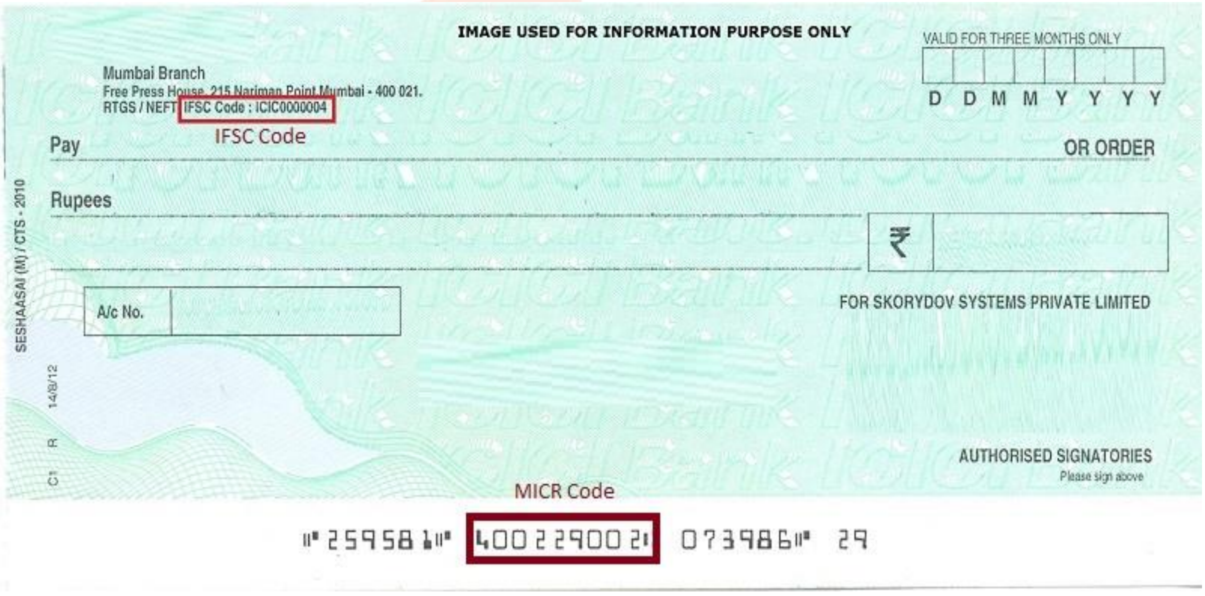
- **Card reader**: This part reads the chip on the front of the card or the magnetic stripe on the back of the card.
- **Keypad**: The keypad is used by the customer to input information, including personal identification number (PIN), the type of transaction required, and the amount of the transaction.
- **Cash dispenser**: Bills are dispensed through a slot in the machine, which is connected to a safe at the bottom of the machine.
- **Printer**: If required, consumers can request receipts that are printed here. The receipt records the type of transaction, the amount, and the account balance.
- **Screen**: The ATM issues prompts that guide the consumer through the process of executing the transaction. Information is also transmitted on the screen, such as account information and balances.

MICR

The term magnetic ink character recognition (MICR) refers to the line of numbers that appears at the bottom of a check. The MICR line is a group of three numbers, which are the check number, account number, and bank routing number. The MICR number includes the magnetic ink character recognition line printed using technology that allows certain computers to read and process the printed information.

MICR comprises of 3 parts:

- The first three digits represent the city (City Code). They are aligned with the PIN code we use for postal addresses in India.
- The next 3 digits represent the bank (Bank Code)
- The last 3 digits represent the branch (Branch Code



OCR

OCR (optical character recognition) is the use of technology to distinguish printed or handwritten text characters inside digital images of physical documents, such as a scanned paper document. The basic process of OCR involves examining the text of a document and translating the characters into code that can be used for data processing. OCR is sometimes also referred to as text recognition.

Process of OCR

The process of OCR is most commonly used to turn hard copy legal or historic documents into PDFs. Once placed in this soft copy, users can edit, format and search the document as if it was created with a word processor.

Optical character recognition works

The first step of OCR is using a scanner to process the physical form of a document. Once all pages are copied, OCR software converts the document into a two-colour, or black and white, version. The scanned-in image or bitmap is analysed for light and dark areas, where the dark areas are identified as characters that need to be recognized and light areas are identified as background.

The dark areas are then processed further to find alphabetic letters or numeric digits. OCR programs can vary in their techniques, but typically involve targeting one character, word or block of text at a time. Characters are then identified using one of two algorithms:

Pattern recognition- OCR programs are fed examples of text in various fonts and formats which are then used to compare, and recognize, characters in the scanned document.

Feature detection- OCR programs apply rules regarding the features of a specific letter or number to recognize characters in the scanned document. Features could include the number of angled lines, crossed lines or curves in a character for comparison. For example, the capital letter “A” may be stored as two diagonal lines that meet with a horizontal line across the middle.

Benefits of optical character recognition

The main advantages of OCR technology are:

- saved time, decreased errors and minimized effort.
- It also enables actions that are not capable with physical copies such as compressing into ZIP files, highlighting keywords, incorporating into a website and attaching to an email.
- While taking images of documents enables them to be digitally archived, OCR provides the added functionality of being able to edit and search those documents.

OMR

Optical mark recognition (OMR) is an electronic method of gathering human-handled data by identifying certain markings on a document. Usually the optical mark recognition process is achieved with the aid of a scanner that checks the transmission or reflection of light through the paper; places having markings will reflect less light than the blank paper, resulting in less contrasting reflectivity.

Functions of Optical Mark Reader

- Optical Mark Reader is an OMR scanner that reads the mark of pencils made on predefined positions on the OMR sheets.
- The best OMR software can be paired with any normal scanner and have inbuilt sensors that are efficient in detecting dark pencil marked areas present on the OMR form.
- There are approx. 48 sensors that work together to make the scanning of OMR sheets possible. Once the scanning is complete the information is converted to a computer data file.

DATANET,

- DataNet's communications solutions meet the networking needs of the financial sector by supporting real-time business critical applications; from cloud-based services, ATMs, credit cards services, branch bank automation, secure financial transactions, electronic transfers, online banking, micro-finance, mobile money services and smartphone mobile transactions.
- At DataNet, Banks design, implement and maintain secure effective communications networks.

Petty Cash

- Petty cash is the small amount of cash that is kept on hand by a company to pay for minor, inexpensive purchases during the normal course of operations.
- Petty cash is often used to pay for postage, small office supplies, and other small purchases.