

Financial Service

Part-A

1. What is Financial Service?

Services offered by banking and financial companies are called 'financial services'. Banking and financial companies include both Asset Management Companies and Liability Management Companies.

2. Define Financial Services,

Financial services are an important component of the financial system. Financial services through the network of elements such as financial institutions, financial markets and financial instruments, serve the needs of individuals, institutions and corporate.

3. List any four Financial Services?

1. Merchant Banking 2. Factoring 3. Leasing 4. Hire purchase.

4. What is Merchant Banking?

Merchant Banking is on prior to the enactment of the Indian companies Act, 1956, managing agencies acted as an issue house for securities. They have National Grindlays bank in India initiated Merchant banking services in 1969. The Citibank followed it in 1970. The state bank of India was the first Indian commercial bank to set up a separate Merchant banking division in 1973.

5. When and whom started Merchant Banking in India?

SBI in 1973.

6. Define Mutual Fund.

The Securities and Exchange Board of India (Mutual Fund) Regulations, 1993 defines a Mutual Fund as a fund established in the form of a trust by a sponsor, to raise monies by the trustees through the sale units to the public, under one or more schemes, for investing in securities in accordance with these regulations.

7. What is NAV

Net Asset Value of fund

$$\text{NAV} = \frac{\text{Net Asset Value of fund}}{\text{Number of outstanding units}}$$

8. What is meant by close-ended Mutual Fund?

A Close-Ended Mutual fund has its Mutual Fund open for a fixed period and whatever money invested forms the basis for investment in various securities. These Mutual Funds have fixed maturity period, ranging from 2 to 15 years. EX: UTI Master Share, 1986.

9. What is AMC?

The Asset Management Company actually manages the funds of the various schemes. The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. Infact, the success of any Mutual Fund depends upon the efficiency of this AMC.

10. What is Leasing?

Most of the leasing agreements are modified according to the requirements of the lessee. The lessee is able to derive the benefits out of the asset without owning it. The lessee is able to save considerable amount of capital which otherwise will be locked up in the asset.

11. Write the types of Leasing?

1. Financial Lease. 2. Operating Lease. 3. Leveraged and Non-Leveraged Lease. 4. Conveyance type lease. 5. Sale and lease pack. 6. Full and non pay-out lease. 7. Specialised service lease. 8. Net and non-net lease. 9. Sales and lease. 10. Cross border lease. 11. Tax oriented lease. 12. Import Leasing, 13. International lease.

12. What is NIM?

NIM also known as 'Primary Market' is a market, which is characterized by the presence of a set of all institutions, structures, people, procedures, services, and practices involved in raising of fresh capital funds by both new and existing companies.

13. What are the terms used in Leasing?

There are basically two parties involved in a leasing contract, lessor and lessee. Lessor is a person who is leasing the equipment to the lessee, whereby the lessee becomes the bailee, as he is in possession of the equipment and is using it in production.

14. What is Balanced Fund?

The Mutual Fund that maintains a balanced portfolio, generally 60% bonds or preferred stocks and 40% common stocks is known as Balanced Fund.

15. What is Factoring?

Factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor: (1) Finance, (2) Maintenance of Accounts, (3) Collection of debts and (4) Protection against Credit Risks.

16. List out the 4 Factor system?

1. Two factor system. 2. Single Factor System. 3. Direct Export system 4. Direct Import Factor System.

17. What are the components of Hire Purchase Price?

Hire Purchase contract, we have two important components:

1. interest and Finance charges.
2. Principal amount.

The interest component is based on a flat rate of interest. The hire purchaser has the option of paying earlier the balance amount and avail some concession on the interest rate. The principal amount is payable on equal installment basis along with the interest amount.

PART-B

1. Origin of Merchant Banking in INDIA?

Prior to the enactment of the Indian Companies Act, 1956, managing agencies acted as an issue house for securities. They evaluated the projects before promoting them. They designed the capital structures. They provided the venture capital in a small way. Few share broking firms functioned as merchant bankers with small capital base.

National Grind lays Bank in India initiated Merchant Banking services in 1969. the Citibank followed it in 1970. the State Bank of India was the first Indian commercial bank to set up a separate Merchant Banking Division in 1973. ICICI followed it in 1974. both these Indian Merchant Bankers emerged as leaders in merchant banking having done significant business during the period 1974-85 in comparison to foreign banks. A Number of commercial banks, financial institutions and other organizations are now engaged in providing merchant banking services. The merchant banks in India operate as issue houses rather than full-fledged merchant banks.

Somewhere above, you have read that there is no difference between the functions of merchant banking and commercial banking. What makes the difference between these two terms? A well-timed question. A few differences are given for clarity purpose.

2. Difference between NIM & Secondary Market?

NIM is different from the secondary market in the following respects:

S.NO	Feature	NIM	Secondary Market
1	Issue of securities	NIM deals only with new or fresh issue of securities. Issues are considered fresh or new provided such issues are made for the first time either by the existing company or by the new company	Deals in existing securities.
2.	Location	No fixed geographical location needed	Needs a fixed place to house the secondary market activities, viz.,

			trading.
3	Transfer of securities	Securities are created and transferred from corporates to investors for the first time.	Securities are transferred from one investor to another through the stock exchange mechanism.
4	Entry	All companies are make fresh issue or securities	For the securities to enter the portals of stock exchanges for the purpose of trading, listing is mandatory.
5	Administration	Has no tangible form of administrative set-up	Has a definite administrative set-up that facilitates trading in securities
6	Regulation	Subject to regulations mostly from outside the company- SEBI, stock Exchange, companies Act, etc.,	Subject to regulation both from within and outside the stock exchange framework.
7	Aim	Creating long-term instruments for borrowings	Providing liquidity through marketability of those instruments.
8	Price Movement	Stock Price movement in secondary market influences pricing of new issues	Both macro and micro factors influence the stock price movement.
9	Depth	Depends on number and the volume of issue	Depth depends upon the activities of the primary market as it brings into the fore more corporate entities and more instruments to raise funds.

3. Difference between Commercial Bank & Merchant bank?

Merchant banking is the forerunner of modern commercial banking. Its foundational value is being increasingly recognized and its resurrection seriously considered. The proof is that this ancient form of merchant banking has begun to make a comeback in the UK and the USA. Particularly when the limitations of contemporary commercial banks are gradually showing through in the face of certain practical problems of present-day commercial banking.

1. the basic difference between Merchant Banking and Commercial banking is that the Merchant bank offers mainly finance advice and services for a fee. It also collects deposits through the non-

cash mode of finance, i.e., security papers. Commercial banks accept deposits and lend money in the mode of cash.

2. The Merchant bank offers portfolio services to its customers (individuals and corporate). The Commercial bank provides retail trade banking services to its customers.
3. The regulatory body for commercial banks in the India is ministry of Finance/Reserve Bank of India. The Banking Regulation Act has also guided those banks. On the other hand, the regulatory body for merchant banks in India is the Securities Exchange Board of India (SEBI). They define merchant banking as follows.

Merchant banks mostly provide advisory services, issue management, portfolio management and underwriting which require less capital but generate more income (non-interest income) Since these services require fewer funds, Commercial banks could opt to provide these services side by side with their traditional services/functions. Merchant banking services reduce the pressure of supervision/monitoring activities that reduce the related cost.

4. Merchant banks invest their funds mostly in project-oriented and security papers. These security papers are encashable in the stock market. This will solve the liquidity crises of merchant banker. The liquidity problems of commercial banks cannot easily be solved as they lend their funds to the trading or commercial houses in the form of Term Loan, Working Capital, etc.,

4. Advantages and Disadvantages of Leasing?

Advantages:

1. Most of the leasing agreements are modified according to the requirements of the lessee.
2. The lessee is able to derive the benefits out of the asset without owning it.
3. The lessee is able to save considerable amount of capital which otherwise will be locked up in the asset.
4. Leasing is the cheapest and fast mode of acquiring an asset. From the creditors' point of view, it is the safest method of finance as they have a good security in the form of asset.
5. Capital projects can be financed by leasing method and hence most of the financial institutions have started entering leasing business.
6. Because of leasing the lessee is able to have better debt-equity ratio. He can also go for additional borrowings in case of business requirements.

7. it is only by leasing method, 100 % finance is available for buying equipment.
8. Equipment which are likely to be obsolete very soon can be acquired under operating leasing.
9. Small scale industries will be benefited by leasing as they can go for modernization of production.
10. Technocrats will get more benefits by leasing as the promoters will find it difficult to contribute margin money.
11. The lease charge forms a part of P & L A/C and does not appear in the balance sheet. Hence, the return on investment for the investment capital.
12. Tax benefits are available to both lessor and lessee in leasing.
13. Leasing is the best method available to monopoly companies to escape MRTP Act. They are able to operate within restricted capital and thereby do not come under control of Monopoly commission.

Disadvantages:

1. The lessee has to pay the rent immediately on acquiring the asset. This will be a burden as the lessee would not have experienced benefit of the asset leased. Hence, it will be an extra cash outflow.
2. The lessor may sue the lessee in case of damages to the leased goods. Any default by the lessor or owner of the asset will also affect the lessee.
3. Compared to term loan by banks, lease finance is costlier. If there is no investment allowance, the lease transactions bring tax loss. At the termination of the lease agreement the asset is taken by the lessor and the lessee will lose the residual value.
4. In case of damage due to natural calamities, the lessor may be indemnified by the insurance company but not the lessee who suffers the loss due to the loss of production.

5. What are the Legal aspects involved in leasing?

Legal Aspects involved in Leasing:

There are basically two parties involved in a leasing contract, lessor and lessee. Lessor is a person who is leasing the equipment to the lessee, whereby the lessee becomes the bailee,. As he is in possession of the equipment and is using it in production. In the case of financial lease,. The lessee will become the owner after paying the full value of the lease equipment. For this purpose, an agreement will be entered into under the Indian Contract Act between the lessor and lessee. Such a contract will contain the following details.

1. Details of contracting parties i.e., lessor and lessee.
2. Details of the asset or equipment or property which is leased.

3. **Terms of Lease:** Terms of lease which deal about the period for which the agreement will remain in force and provisions for either reducing or increasing the period. In some cases, the period may be renewed or it may be curtailed.
4. **Rent as part of lease:** Here, the lease rent has to be clearly mentioned and it forms the consideration in the contract.
5. **Termination of lease:** The agreement should clearly mention details on termination of the lease, about various conditions and also how the ownership of the asset or equipment will be treated at the point of termination of the contract.

Legally speaking it is the Indian Contract Act, 1872 which regulates leasing agreement. At the same time, where the leasing involves vehicles, it is the Motor Vehicles Act, applicable to NBFCs also regulates lease contracts.

6., What are the Types of Leasing?

a. Financial Lease: it is a contract involving payment over a longer period. It is a long-term lease and the lessee will be paying much more than the cost of the property or equipment to the lessor in the form of lease charges. It is irrevocable in this type of leasing the lessee has to bear all costs and the lessor does not render any service.

b. Operating Lease: The lessee uses the asset for a specific period. The lessor bears the risk of obsolescence and incidental risks. There is an option to either party to terminate the lease after giving notice.

c. Leaveraged and non-leaveraged leases: The value of the asset leased may be of a huge amount which may not be possible for the lessor to finance. So, the lessor involves one more financier who will have charge over the leased asset.

d. Conveyance type lease: Here, the lease will be for a long-period with a clear intention of conveying the ownership of title on the lessee.

e. Sale and lease pack: Here, a company owning the asset sells it to the lessor. The lessor pays immediately for the asset but leases the asset to the seller. Thus the seller of the asset becomes the lessee. The asset remains with the seller who is a lessee but the ownership is with the lessor who the buyer is. This arrangement is done so that the selling company obtains finance for running the business along with the asset.

f. Full and non pay-out lease: A full pay-out lease is one in which the lessor recovers the full value of the leased asset by way of leasing. In case of a non pay-out lease, the lessor leases out the same asset over and over again.

g. Specialized service lease: The lessor or the owner of the asset is a specialist of the asset which he is leasing out. He not only lease out but also gives specialized personal service to the lessee. Examples are electronic goods, automobiles, air-conditioners, etc.,

h. Net and non-net lease: In non-net lease, the lessor is in charge of maintenance insurance and other incidental expenses. In a net lease, the lessor is not concerned with above maintenance expenditure. The lessor confines only to financial service.

i. Sales aid lease: In case, the lessor enters into any tie up arrangement with manufacturer for the marketing, it is called sales aid lease.

j. Cross border lease: Lease across national frontiers is called cross border lease. Shipping, air service, etc., will come under this category.

k. Tax oriented lease: Where the lease is not a loan on security but qualifies as a lease, it will come under this category.

l. Import Leasing: Here, the company providing equipment for lease may be located in a foreign country but the lessor and the lessee may belong to the same country. The equipment is more or less imported.

m. International lease: Here, the parties to the lease transactions may belong to different countries which is almost similar to cross border lease.

7. What are the features of Hire Purchase Agreement?

1. The Seller contacts a finance company to finance a hire purchase deal.
2. The customer selects the goods and expresses his desire to acquire them on hire purchase basis.
3. The customer makes the down payment after filling up the proposal form. The down payment amount will be retained by the seller on account of the price to be paid by him to the finance company.
4. The seller sends the documents to the finance company, requesting it to purchase the goods and accept the hire purchase transactions.
5. The finance company signs the agreement and sends a copy of the agreement to the purchaser/hirer along with instructions with regard to payment of installments. The seller is also informed by the finance company and is instructed to deliver the goods to the purchaser/hirer.
6. The seller delivers the goods to the purchaser/hirer and the ownership now gets transferred to the finance company.
7. The Purchaser/hirer makes payment in the form of instalments periodically as per the
8. On payment of the last installment or on completion of the hire term, the ownership is transferred to the purchaser on issue of completion certificate by the finance company.

8. Write about the Hire Purchase companies in India?

The Hire Purchase Act was passed in 1972, which is controlling the hire purchase transactions. The hire purchase finance companies come under non banking finance companies (NBFCs) and are subject to the regulations of Reserve Bank of India Act (section 45 (i)). Earlier, these NBFCs were accepting deposits from the public by offering attractive interest rates and were collecting higher interest rates from the buyers of durable goods on hire purchase. But in 1998 certain restrictions

ere imposed on the acceptance of deposits by non banking finance companies involved in hire purchase finance. Since then the acceptance of deposits by these companies has been curtailed as a result of which there has been some decline in the hire purchase activities in our country.

To overcome the above handicap, many automobile companies such as Marti Udyog Limited and Tata's have themselves promoted their own hire purchase finance companies. Ashok Leyland finance has been there already in the market. The foreign banking companies are also undertaking hire purchase finance and they are a big competitor to the Indian hire purchase finance companies.

Of late, Housing Finance has been taken up on hire purchase by most of the commercial banks and with the introduction of floating interest rate. It is picking up both in urban and rural areas. The floating rate of interest is beneficial to the customer as long as the interest is beneficial to the customer as long as the interest rate is declining. Even banks are allowing the swapping of the interest rate. By this the old loan with the higher interest rate is repaid and it is replaced by a new loan with a lower rate of interest. Thus, in India hire purchase finance is mainly encouraged by the middle income group consumers in the purchase of houses and durable goods, whereas in industries, it is leasing which is becoming very popular.

9. Write the contents of Hire purchase Agreement?

An Hire Purchase agreement has the following clauses:

1. Agreement: Containing details such as nature and, term of the agreement. Also commencement of the agreement period.
2. Delivery of the goods: Here, the mode of delivery, place and time and the details of expenses to be borne by the purchaser (or buyer or the hirer) with regard to the delivery of goods are mentioned.
3. Place: This refers to the place where the goods, bought under hire purchase have to be kept.
4. Inspection: Contains details that the purchaser has inspected the goods before purchase.
5. Hire Charges: This contains details such as (a) instalment amount (monthly or fortnightly) which includes interest, (b) time schedule: and (c) in case of delay, any penalty.
6. Repair: The purchaser/buyer/hirer will bear the cost of repair. He will obtain an insurance policy on the equipment and will hand over the insurance policy in the owners/sellers.
7. Alteration of agreement: No alteration can be made by the purchaser/hire without the consent of the seller/owner.
8. Termination of contract: In the event of the hirer violating any of the provisions, such as non payment or misuse of the product, the contract may be terminated.

9. Promissory note: The agreement is usually accompanied by a promissory note signed by the purchaser/hirer for the amount which includes interest and other financial charges.
10. Tax Implications: Tax benefits can be had in hire purchase transactions from three angles. They can be had in (a) Income Tax (b) Sales Tax and (c) Interest Tax.

10., What are the benefits in Factoring?

There are two factoring 1. Financial Factoring 2. Non-Financial factoring.

Benefits of Financial Factoring:

1. It provides liquidity to the supplier as the tied up receivable is released.
2. Capital, locked up in outstanding is available for use in the business. As a result of this, all sales become cash sales, either directly or indirectly.
3. The funds released by the factoring agencies facilitate more investment in fixed assets and thereby increase the degree of operational leverage and maximum return.
4. Factoring agreement minimizes bad debts as the factor chooses the correct party or whose bills are taken for providing advances to the supplier.

Benefits of Non-financial factoring:

1. In non recourse factoring, the supplier is provided credit security.
2. The Money supplier is relieved of the botheration of administering sales ledger and control of debts.
3. As the factor adopts a professional approach for collection of debts, the consumer is disciplined and it helps the supplier to improve his sales. Thus, these customers become permanent asset to the supplier.

11., Difference between Hire Purchase and Instalment?

	Hire Purchase	Instalment
1.	There are 3 parties in H.P trade namely the seller, the financier and the buyer.	There are only 2 parties, seller and buyer.
2	There are 3 agreements, namely between the (a) seller and financier, (b) financier and buyer and (c) buyer and seller.	There is only one agreement between the buyer and seller.
3	It is an agreement to hire and later to buy.	It is an agreement to buy.

4	The ownership transfers from the seller to the financier and then to the buyer on the payment of the last instalment.	The ownership transfers on the first instalment from the seller to buyer.
5	On default, the financier will take back the goods from the buyer.	On default, the seller cannot take back the goods, but can only sue the buyer.
6	Any damage to the goods will only lead to claiming of insurance by the financier from the insurance company since the ownership has not been transferred.	Any damage to the goods will be claimed by the buyer from the insurance company.
7	Buyer cannot sell the goods to any third party until he pays the last instalment to the financier.	Buyer can sell any third party s he is the owner of the goods.
8	The interest rate will be on a flat rate basis and is included in the instalment and recovered as equated monthly instalment (EMI). Ex: Car finance by Sundaram finance.	The interest rate is on a declining basis as every instalment paid will reduce the principal amount and hence the total interest payable is lesser than H.P scheme. Ex: Bank finance for purchase, of consumer goods.

12. Reasons for the Slow Growth of Mutual Fund in India?

In India, the Mutual Fund industry has been monopolized by the Unit Trust of India ever since 1963. now the commercial banks like the State Bank of India, Canara Bank, Indian Bank, Bank of India and the Punjab National Bank hve entered into the field. To add to the list are the LIC of India and the private sector banks and other financial institutions. These institutions have successfully launched a variety of schemes to meet the diverse needs of millions of small investors. The unit Trust of India has introduced ghuge portfolio of schemes like Unit 64, Mastergain, Mastershare etc. it is the country largest mutual fund company with over 25 Million investors and a corpus exceeding Rs. 55,000 crores, accounting for nearly 10% of the country stock market capitalization. The total corpus of the 13 other mutual funds in the country is less than Rs, 15,000 crore. The SBI fund has a corpus of Rs. 2925 crore deployed in its 16 schemes servicing over 2.5 million shareholders.

There are also mutual funds with investments sourced abroad called offshore funds they have been established for attracting NRI investments to the capital market in India. The India Fund Unit scheme 1986 traded in the London Stock Exchange and the India Fund unit scheme 1988 traded in the New York Stock Exchange were floated by the Unit Trust of India and the India Magnum Fund was floated by the State Bank of India. At present, there are 16 different offshore Indian funds which have brought about \$2.7 billion to the Indian market.

Besides the above, the LIC and GIC have also entered into the market. Again many private organizations have entered into the field. Most of the schemes have declared a dividend ranging between 13.5% and 17%. In most of the cases it is around 14 % only.

The recent trend in the mutual fund industry is to go for tie-up arrangements with foreign collaborators. We find Tatas tying up with Kleinworth Benson; GIC with George Soros; Credit Capital with Lazard Brothers; Kothari with Pioneer; ICICI with JP Morgan; 20th century with Morgan and so on. Ofcourse, these tie-ups would bring in new perspective, systems and technology and this very foreign tag may add credit to the institutions.

The private sector which entered the arena in 1993 is concentrating on the primary market. It is so because, investments in new shares fetch appreciation between 30 and 1500 per cent in a very short period. Promoters to give preferential treatment to mutual funds because it reduce their marketing cost. Again, they go for fund-participation in a venture even before it goes public. They see potential for immense appreciation in unlisted securities which intend to go to public with a short period of one year.

In India, Mutual funds have been preferred as a avenue for investment by the household savers only from 1990s. the sales of units of UTI which were Rs. 890 crores in 1985-86 those to Rs. 4,100 crores in 1990-91 and Rs. 9,500 crores in 1993-94. the public sector mutual funds were able to collect Rs. 3,800 crores in 1990-91. however, they could collect only Rs. 400 crores in 1993-94. the private sector mutual funds mobilized Rs. 1,700 crores in 1993-94. on the whole, the mutual fund industry was able to mobilize approximately Rs. 12,000 crores in 1993-94 which amounts to 8 % of the gross domestic householding savings in the country. As on 31 Jan 2007 there were 30 Mutual Funds with 66 schemes in India. Rs. 2,31,862 crore of assets were under the management of Mutual funds on 31 Jan 2007. it is a good going indeed. However, the rate of growth is comparatively slow and not very satisfactory. Today Mutual Funds have started laying a positive role in the country's saving revolution.

