

JEBA51 –FINANCIAL SERVICES



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SYLLABUS

JEBA51 – FINANCIAL SERVICES

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II	Merchant Banking – Functions – Issue management – Managing of new issues – Underwriting – Capital market – Role of SEBI
III	Leasing and Hire purchase – Evaluation of leasing - features – Types of lease Accounts.- Merits and Demerits - Evolution of Hire purchase - concepts - Hire Purchase in India - Leasing vs. Hire Purchase
IV	Venture Capital – Features and types of venture capital - Growth of venture capital in India - Financing pattern under venture capital - legal aspects and guidelines for venture capital
V	Mutual Funds: Meaning – Types - Objectives – Functions – Advantages - Mutual funds in India - Introduction to digital payments- crypto currency.

	References Books
1	Financial Services –M.Y.Khan
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3	Law of Insurance – Dr.M.N.Mishra
4	Indian Financial System – H.r.Machiraju
5	A Review of current Banking Theory and Practice – S.K.Basu.

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Unit – I

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- 1.1 Introduction to Financial Services**

The Indian financial services industry has undergone a metamorphosis since 1990. Before its emergence the commercial banks and other financial institutions dominated the field and they met the financial needs of the Indian industry. It was only after the economic liberalisation that the financial service sector gained some prominence. Now this sector has developed into an industry. In fact, one of the world's largest industries today is the financial services industry. Financial service is an essential segment of financial system. Financial services are the

foundation of a modern economy. The financial service sector is indispensable for the prosperity of a nation.

1.2 Meaning of Financial Services

In general, all types of activities which are of financial nature may be regarded as financial services. In a broad sense, the term financial services means mobilisation and allocation of savings.

Thus, it includes all activities involved in the transformation of savings into investment.

Financial services refer to services provided by the finance industry. The finance industry consists of a broad range of organisations that deal with the management of money. These organisations include banks, credit card companies, insurance companies, consumer finance companies, stock brokers, investment funds and some government sponsored enterprises.

Financial services may be defined as the products and services offered by financial institutions for the facilitation of various financial transactions and other related activities.

Financial services can also be called financial intermediation. Financial intermediation is a process by which funds are mobilised from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers. There are various institutions which render financial services. Some of the institutions are banks, investment companies, accounting firms, financial institutions, merchant banks, leasing companies, venture capital companies, factoring companies, mutual funds etc. These institutions provide variety of services to corporate enterprises. Such services are called financial services. Thus, services rendered by financial service organisations to industrial enterprises and to ultimate consumer markets are called financial services. These are the services and facilities required for the smooth

operation of the financial markets. In short, services provided by financial intermediaries are called financial services.

1.3 Functions of financial services

- ✓ Facilitating transactions (exchange of goods and services) in the economy.
- ✓ Mobilizing savings (for which the outlets would otherwise be much more limited).
- ✓ Allocating capital funds (notably to finance productive investment).
- ✓ Monitoring managers (so that the funds allocated will be spent as envisaged).
- ✓ Transforming risk (reducing it through aggregation and enabling it to be carried by those more willing to bear it).

1.4 Characteristics or Nature of Financial Services

From the following characteristics of financial services, we can understand their nature:

i) Intangibility

Financial services are intangible. Therefore, they cannot be standardized or reproduced in the same form. The institutions supplying the financial services should have a better image and confidence of the customers. Otherwise, they may not succeed. They have to focus on quality and innovation of their services. Then only they can build credibility and gain the trust of the customers.

ii) Inseparability

Both production and supply of financial services have to be performed simultaneously. Hence, there should be perfect understanding between the financial service institutions and its customers.

iii) Perishability

Like other services, financial services also require a match between demand and supply. Services cannot be stored. They have to be supplied when customers need them.

iv) Variability

In order to cater a variety of financial and related needs of different customers in different areas, financial service organisations have to offer a wide range of products and services. This means the financial services have to be tailor-made to the requirements of customers. The service institutions differentiate their services to develop their individual identity.

v) Dominance of Human Element:

Financial services are dominated by human element. Thus, financial services are labour intensive. It requires competent and skilled personnel to market the quality financial products.

vi) Information based:

Financial service industry is an information based industry. It involves creation, dissemination and use of information. Information is an essential component in the production of financial services.

1.5 Importance of Financial Services

The successful functioning of any financial system depends upon the range of financial services offered by financial service organisations. The importance of financial services may be understood from the following points:

i) Economic Growth:

The financial service industry mobilises the savings of the people, and channels them into productive investments by providing various services to people in general and corporate enterprises in particular. In short, the economic growth of any country depends upon these savings and investments.

ii) Promotion of Savings:

The financial service industry mobilises the savings of the people by providing transformation services. It provides liability, asset and size transformation service by providing huge loan from small deposits collected from a large number of people. In this way financial service industry promotes savings.

iii) Capital Formation:

Financial service industry facilitates capital formation by rendering various capital market intermediary services. Capital formation is the very basis for economic growth.

iv) Creation of Employment Opportunities:

The financial service industry creates and provides employment opportunities to millions of people all over the world.

v) Contribution to GNP:

Recently the contribution of financial services to GNP has been increasing year after year in almost countries.

vi) Provision of liquidity:

The financial service industry promotes liquidity in the financial system by allocating and reallocating savings and investment into various avenues of economic activity. It facilitates easy conversion of financial assets into liquid cash.

1.6 Types of Financial Services

Financial service institutions render a wide variety of services to meet the requirements of individual users. These services may be summarized as below:

i) Provision of Funds:

- (a) Venture capital
- (b) Banking services
- (c) Asset financing
- (d) Trade financing
- (e) Credit cards
- (f) Factoring and forfaiting

ii) Managing Investible Funds:

- (a) Portfolio management
- (b) Merchant banking
- (c) Mutual and pension funds

iii) Risk Financing:

- (a) Project preparatory services
- (b) Insurance
- (c) Export credit guarantee

iv) Consultancy Services:

- (a) Project preparatory services
- (b) Project report preparation
- (c) Project appraisal
- (d) Rehabilitation of projects

- (e) Business advisory services
- (f) Valuation of investments
- (g) Credit rating
- (h) Merger, acquisition and reengineering

v) Market Operations:

- (a) Stock market operations
- (b) Money market operations
- (c) Asset management
- (d) Registrar and share transfer agencies
- (e) Trusteeship
- (f) Retail market operation
- (g) Futures, options and derivatives

vi) Research and Development:

- (a) Equity and market research
- (b) Investor education
- (c) Training of personnel
- (d) Financial information services

1.7 Financial Services and Economic and Technological Environment

The **financial services sector** acts as the backbone of a nation's economy, facilitating the flow of capital and promoting growth, while simultaneously undergoing a profound transformation driven by the **economic environment** and rapid **technological advancements**.

The Role of Financial Services in the Economic Environment

Financial services play a crucial role in the broader economic environment by facilitating several key functions:

i) Mobilization of Savings and Investment:

Financial institutions gather savings from individuals and channel them into productive investments, which is essential for capital formation and overall economic expansion.

ii) Provision of Liquidity and Credit:

They enhance market liquidity by allowing easy conversion of financial assets into cash and offering various credit facilities (loans, mortgages, etc.) to businesses and consumers, thereby stimulating consumption and entrepreneurial activity.

iii) Risk Management:

Services like insurance and derivative markets enable businesses and individuals to pool, price, and exchange risks, providing stability and security against potential losses.

iv) Economic Growth and Inclusion:

An efficient financial system accelerates GDP growth and promotes financial inclusion, especially in underserved areas, by providing accessible and affordable services through initiatives like digital banking and government-backed schemes.

The overall economic environment, encompassing factors like GDP growth, interest rates, inflation, and government policies, directly influences the performance of the financial services sector. Favorable conditions and supportive regulations encourage investment and innovation within the industry.

The Impact of Technology on Financial Services

Technology, or "fintech" (financial technology), is fundamentally reshaping the financial services industry, leading to greater efficiency, accessibility, and new business models.

Key technological developments and their impacts include:

i) Digital Payments:

Innovations like the Unified Payments Interface (UPI) in India have revolutionized transactions, making them seamless, accessible to millions, and helping to bring the informal economy into the financial mainstream.

ii) Artificial Intelligence (AI) and Machine Learning (ML):

AI and ML are used for enhanced credit assessment, fraud detection, customer support (chatbots), and portfolio optimization. This can cut operational timelines and boost security.

iii) Blockchain and Distributed Ledger Technology (DLT):

This technology offers more transparent and secure transaction processing. For example, a consortium of Indian banks uses blockchain to process letters of credit within hours, a process that traditionally took several days, also mitigating fraud risk.

iv) Cloud Computing and Data Analytics:

Financial institutions use cloud services to manage large amounts of data efficiently, reduce costs, and improve scalability and security, which in turn enables better data analytics for deeper business insights.

v) Robo-Advisors and Neobanks:

Algorithmic platforms provide automated wealth management and investment advice at a low cost, while digital-only banks (neobanks) offer services entirely online without physical branches, appealing to tech-savvy demographics.

The convergence of financial services, the economic environment, and technology is creating a more dynamic, competitive, and inclusive financial landscape, though it also introduces new challenges related to cybersecurity, data privacy, and the need for adaptable regulatory frameworks.

1.8 Introduction to Financial System

The financial system plays the key role in the economy by stimulating economic growth, influencing economic performance of the actors, affecting economic welfare. This is achieved by financial infrastructure, in which entities with funds allocate those funds to those who have potentially more productive ways to invest those funds. A financial system makes it possible a more efficient transfer of funds. As one party of the transaction may possess superior information than the other party, it can lead to the information asymmetry problem and inefficient allocation of financial resources. By overcoming asymmetry problem, the financial system facilitates balance between those with funds to invest and those needing funds.

1.9 Meaning of Financial System

Financial system is a set of complex and closely-connected or intermixed institutions, agents, practices, markets, claims, and so on in an economy. It can also be defined as a set of institutions, instruments and markets which promotes savings and channels them to their most efficient use. It consists of individuals (savers), intermediaries, markets and users of savings (investors). Financial system is divided into formal as well as informal. The informal financial system is a sector of the economy that consists of financial activities that take place outside of regulatory authorities.

1.10 Functions of a Financial System

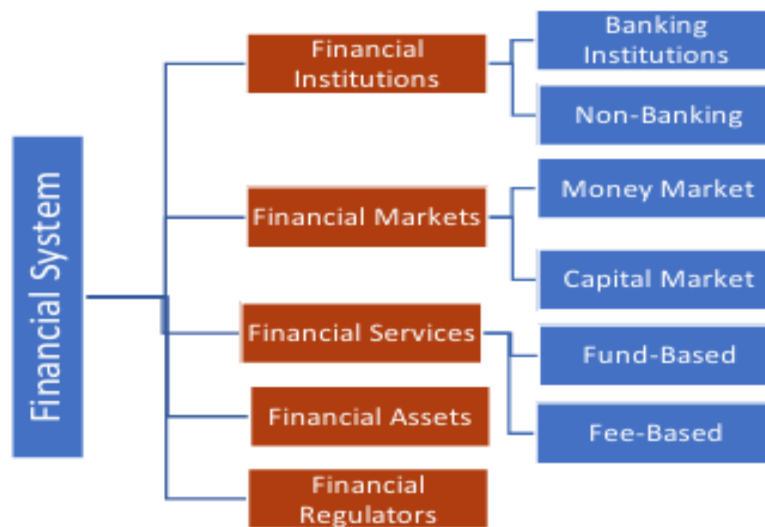
Important functions of financial system are as follows:

- i) **Mobilise and Allocate Savings:** Financial system links the savers and investors and help in mobilizing and allocating the savings efficiently and effectively.
- ii) **Monitor Corporate Performance:** Financial markets and institutions help to monitor corporate performance and exert corporate control through the threat of hostile takeovers for underperforming firms.
- iii) **Provide Payment and Settlement Systems:** It provides a payment mechanism for the exchange of goods and services and transfer of economic resources through time and across geographic regions and industries. The clearing and settlement mechanism of the stock markets is done through depositories and clearing operations.
- iv) **Optimum Allocation of Risk-Bearing and Reduction:** It reduces risk by laying down the rules governing the operation of the system. This is also achieved through holding of diversified portfolios.
- v) **Disseminate Price-Related Information:** It acts as an important tool for taking economic and financial decisions and take an informed opinion about investment, disinvestment, reinvestment or holding of any particular asset.
- vi) **Lower the Cost of Transactions:** It helps in the creation of a financial structure that lowers the cost of transactions.
- vii) **Promote the Process of Financial Deepening and Broadening:** It promotes financial deepening and broadening through a well-functional financial system. Financial deepening refers to an increase of financial assets as a percentage of GDP. Financial depth is an important measure of financial system.

1.11 Components of Financial System

There are five main components of the Indian Financial System. This includes:

- i) Financial Institutions
- ii) Financial Markets
- iii) Financial Services
- iv) Financial Instruments
- v) Financial Regulators



i) Financial Institutions

Financial Institutions are the business organizations that act as mobilisers of savings, and as purveyors of credit or finance. Their main activities are:

- ✓ They provide various financial services to the community.
- ✓ They are business organizations dealing in financial resources.
- ✓ They collect resources by accepting deposits from individuals and institutions and lend them to trade, industry and others.

- ✓ This means financial institutions mobilize the savings of savers and give credit or finance to the investors.

Financial institutions may be classified into two broad categories:

a) Banking Financial Institutions and

b) Non-banking Financial Institutions

Financial institutions can also be classified as term-finance institutions such as the Industrial Development Bank of India (IDBI), the Industrial Credit and Investment Corporation of India (ICICI), the Industrial Financial of India (IFCI), the Small Industries Development Bank of India (SIDBI), and the Industrial Investment Bank of India (IIBI).

Financial institutions can be specialized finance institutions like the Export Import Bank of India (EXIM), the Tourism Finance Corporation of India (TFCI), ICICI Venture, the Infrastructure Development Finance Company (IDFC), and sectoral financial institutions such as the National Bank for Agricultural and Rural Development (NABARD) and the National Housing Bank (NHB).

There are state-level financial institutions such as the State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs) which are owned and managed by the State governments.

a) Banking Financial Institutions

- ✓ Banking institutions mobilize the savings of the people.
- ✓ They provide a mechanism for the smooth exchange of goods and services.
- ✓ They extend credit while lending money.
- ✓ They not only supply credit but also create credit.
- ✓ Mobilize financial resources directly or indirectly from the people.

b) Non-banking Financial Institutions

Non-banking financial institutions can be categorized as investment companies, housing companies, leasing companies, hire purchase companies, specialized financial institutions.

ii) Financial Markets

Financial markets are an important component of the financial system. They are a mechanism for the exchange trading of financial products under a policy framework. The participants in the financial markets are the borrowers (issuers of securities), lenders (buyers of securities), and financial intermediaries. Financial markets are the centres or arrangements that provide facilities for buying and selling of financial claims and services. They create financial assets.

- ✓ Financial markets exist wherever financial transactions take place.
- ✓ Financial transactions include issue of equity shares by a company, purchase of bonds in the secondary market, deposit of money in a bank account, transfer of funds from a current account to a savings account etc.

The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is called a financial market.

The financial market can be further divided into four types:

a) Money Market:

Mostly dominated by Government, Banks and other Large Institutions, the type of market is authorised for small-term investments only. It is a wholesale debt market which works on low-risk and highly liquid instruments. The money market can further be divided into two types:

- ✓ Organised Money Market

- ✓ Unorganised Money Market

b) Capital Market:

Designed to finance the long-term investment, the Capital market deals with transactions which are taking place in the market for over a year. The capital market can further be divided into three types:

- ✓ Corporate Securities Market
- ✓ Government Securities Market
- ✓ Long-Term Loan Market

c) Foreign exchange Market:

One of the most developed markets across the world, the foreign exchange market, deals with the requirements related to multi-currency. The transfer of funds in this market takes place based on the foreign currency rate.

d) Credit Market:

A market where short-term and long-term loans are granted to individuals or Organisations by various banks and Financial and Non-Financial Institutions is called Credit Market.

iii) Financial Services

Financial services are those that help with borrowing and funding, lending and investing, buying and selling securities, making and enabling payments and settlements, and managing risk exposures in financial markets. The term 'financial services' in a broad, sense means "mobilizing and allocating savings". Thus, it includes all activities involved in the transformation of savings into investment. Financial services can also be called 'financial intermediation'. Financial

intermediation is a process by which funds are mobilizing from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers.

Financial Services may be classified into two broad categories:

- ✓ Fee based services: Leasing, hire purchase, factoring, credit financing and house financing
- ✓ Fund based services: Issue management, portfolio management, corporate counselling, merchant banking and credit rating.

iv) Financial Instruments

A financial instrument is a claim against a person or an institution for payment, at a future date, of a sum of money and/or a periodic payment in the form of interest or dividend. Financial instruments represent paper wealth shares, debentures, like bonds and notes. Many financial instruments are marketable as they are denominated in small amounts and traded in organized markets. This distinct feature of financial instruments has enabled people to hold a portfolio of different financial assets which, in turn, helps in reducing risk.

Different types of financial instruments can be designed to suit the risk and return preferences of different classes of investors. Savings and investments are linked through a wide variety of complex financial instruments known as 'securities.

- ✓ They represent claims on a stream of income and/or assets of another economic unit and are held as a store of value and for the return that is expected.
- ✓ The maturity and sophistication of the financial system, indeed, depends on the prevalence of a variety of securities/ financial assets to suit the investment requirements of heterogeneous investors.

- ✓ Ordinary/equity shares, preference shares, debentures/bonds including innovative debt instruments.
- ✓ Treasury bills, gilt-edge securities, state government and public sector instruments, commercial paper, certificate of deposit, commercial bills etc.

v) Financial Regulators

Financial Regulators in India

- ✓ **SEBI:** The market regulator in the Indian capital market is the Securities and Exchange Board of India (SEBI).
- ✓ **IRDAI:** The Insurance Regulatory and Development Authority (IRDA) does the same for the insurance sector.
- ✓ **RBI:** Reserve Bank of India (RBI) conducts the country's monetary policy.
- ✓ **PFRDA:** Pension Funds Regulatory and Development Authority (PFRDA) regulates pensions.
- ✓ **MCA:** Ministry of Corporate Affairs (MCA) regulates the corporate sector.

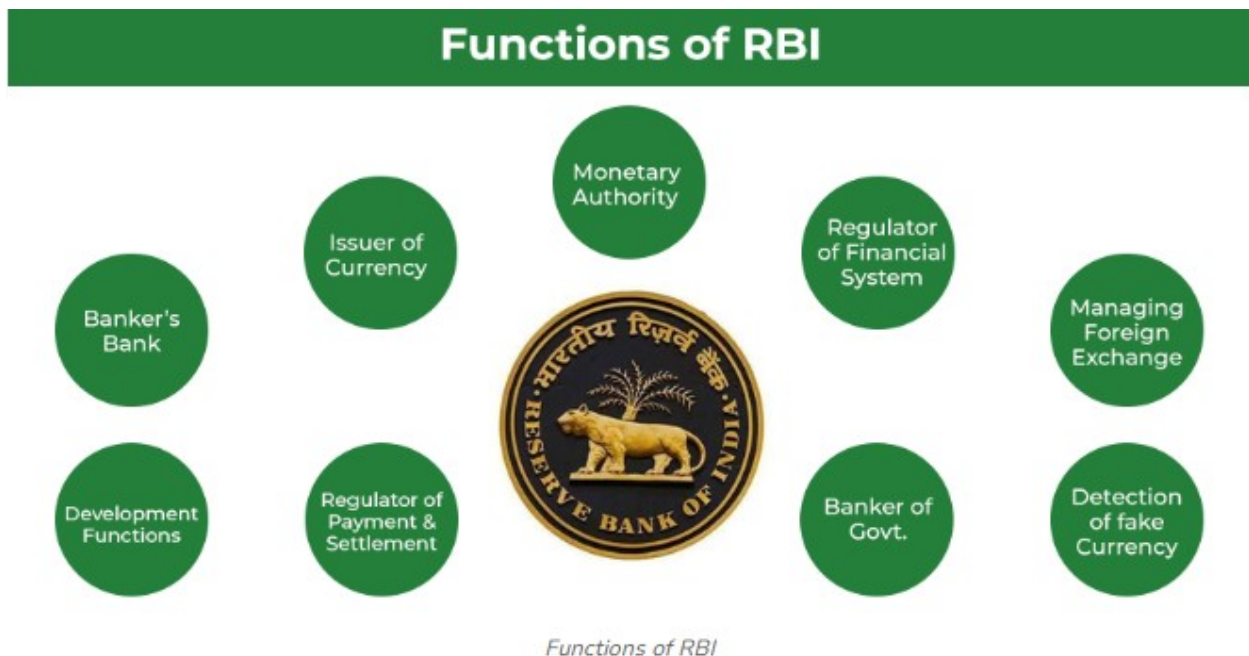
1.12 Reserve Bank of India (RBI) And Its Functions

RBI (Reserve Bank of India) is the **central bank of India** and a statutory body responsible for multiple tasks like printing the currency notes, controlling monetary policy and acting as a custodian to other primary banks of the nation. The RBI was established on April 1, 1935 under the Reserve Bank of India Act, 1934 on the recommendation of the Hilton-Yong-Commission or commonly referred to as Royal Commission on Indian currency and finance. It is headquartered in Mumbai. The main motive behind setting up RBI was to separate the currency control from the government and provide other banking facilities. The Reserve Bank of India was nationalized with effect from 1st January, 1949 on the basis of the Reserve Bank

of India (Transfer to Public Ownership) Act, 1948. The working of RBI is regulated by the RBI governor appointed by the central government of India and the Governor acts as the main decision-maker in RBI.

The RBI role is responsible for the design, production, distribution and the overall management of the nation's currency.

1.13 Functions of RBI



i) Issue of Currency:

The Reserve Bank of India has the sole authority to issue currency notes in India, except for one-rupee notes and coins which are issued by the Government of India. RBI ensures an adequate supply of clean and genuine currency to meet the needs of the economy.

ii) Banker to the Government:

RBI acts as a banker, agent, and financial advisor to the Central and State Governments. It maintains government accounts, receives and makes payments on their behalf, and manages public debt.

iii) Banker's Bank:

The RBI acts as a bank for all commercial banks. Commercial banks keep a portion of their reserves with RBI, and RBI provides financial assistance to them during emergencies or liquidity shortages.

iv) Controller of Credit:

RBI regulates the supply of credit in the economy to control inflation and promote economic growth. It uses monetary policy tools such as repo rate, reverse repo rate, CRR, SLR, and open market operations for this purpose.

v) Custodian of Foreign Exchange:

RBI manages the country's foreign exchange reserves and oversees foreign exchange transactions. It works to maintain stability in the foreign exchange market and supports India's external trade.

vi) Clearing House Function:

RBI acts as a clearing house for banks by settling interbank claims and payments. This helps in smooth, quick, and efficient transfer of funds among banks.

vii) Regulator and Supervisor of Banks:

RBI regulates and supervises banks and financial institutions to ensure their stability and protect depositors' interests. It issues guidelines, conducts inspections, and enforces banking laws.

viii) Custodian of Cash Reserves:

Commercial banks are required to keep a certain portion of their cash reserves with RBI. This helps RBI control credit creation and ensures the safety and liquidity of the banking system.

1.14 Commercial Banks

An institution that provides its customers with services like accepting deposits, providing loans, and making investments, with the objective of earning profits is known as a **Commercial Bank**. The two main characteristics of commercial banks are lending and borrowing. They make money from a variety of fees and by earning interest income from loans. For this, the bank charges interest on lending and borrowing. The two main types of rates are the Borrowing Rate and Lending Rate. The rate offered by commercial banks to depositors for depositing money is called the **borrowing rate**. The rate charged by commercial banks for lending money to investors is known as the **lending rate**. The difference between the borrowing rate and the lending rate is known as **Spread**. It is the profit earned by commercial banks.

1.15 Functions of Commercial Bank

Commercial Banks perform various functions which can be categorised into two broad categories; viz., Primary Functions and Secondary Functions.

A) Primary Functions

Accepting Deposits and Advancing of Loans are the two primary functions performed by commercial banks.

i) Accepting Deposits

One of the most essential functions of commercial banks is accepting deposits. Commercial banks accept deposits from their customers in different forms based on the requirements of different sections of society. The main types of deposits include:

- ✓ **Demand Deposits or Current Account Deposits:** The deposits which are repayable on demand by the banks are known as demand deposits or current account deposits. In

general, these kinds of deposits are maintained by businessmen to make transactions with these deposits. One can get the amount deposited as demand deposits by a cheque without any restriction. Besides, commercial banks do not pay any interest to the depositors on these accounts; instead, they charge some amount as a service charge for running these accounts.

- ✓ **Fixed Deposits or Time Deposits:** The deposits in which the depositor, deposits money with the bank for a fixed time period are known as fixed deposits or time deposits. These deposits do not enjoy a cheque facility and carry a high interest rate.
- ✓ **Saving Deposits:** The deposits, which include combined features of demand deposits and fixed deposits are known as saving deposits. The depositors have the cheque facility to withdraw money from their accounts, but there are some restrictions on the number and amount of withdrawals. The restrictions are imposed to discourage the frequent use of saving deposits. Besides, the interest rate on saving deposits is less than the interest rate on fixed deposits.

ii) Advancing of Loans

The banks are not allowed to keep the amount deposited with them, idle. Therefore, commercial banks have to keep some amount of the total deposits as cash reserves and lend the rest of the balance to needy borrowers and charge interest from them. The interest received by commercial banks from advancing loans is the main source of their income. Some of the different types of loans and advances made by commercial banks are:

- ✓ **Cash Credit:** The loan given to the borrowers against their current assets like stocks, bonds, shares, etc., is known as cash credit. For this, a credit limit is sanctioned to the borrower, and money is credited to this account. The borrower can now withdraw any

amount at any time within his credit limit. Interest is charged from the borrower on the amount actually withdrawn by him.

- ✓ **Demand Loans**: The loans given by the banks which they can recall at any time on demand are known as demand loans. The entire amount of the demand loan is credited to the borrower's account, and interest is charged on that amount.
- ✓ **Short-term Loans**: Personal loans given to borrowers against some collateral security are known as short-term loans. The amount taken as a loan is credited to the account of the borrower, and he can withdraw that money from his account. Interest is charged on the entire sum of the loan granted.

B) Secondary Functions

Besides primary functions, commercial banks also perform some secondary functions.

i) Overdraft Facility

A facility that allows the customer to overdraw from the amount of his current account upto an agreed limit is known as an overdraft facility. In general, an overdraft facility is given to respectable and reliable customers for a short period. Besides, the customers have to pay interest on the amount overdrawn by them.

ii) Discounting Bills of Exchange

A facility in which the holder of a bill of exchange, before its maturity date can get the bill discounted with the bank. The bank pays the amount to the holder after deducting some amount as commission. Now, on the date of maturity, the party which has accepted the bill pays back the money to the bank.

iii) Agency Functions

There are some agency functions performed by commercial banks for which they charge some commission from their clients. Some of these functions are:

- ✓ **Transfer of Funds:** With the help of instruments like mail transfers, demand drafts, etc., commercial banks provide their customers with the facility of easy and economical remittance of funds from one place to another.
- ✓ **Collection and Payment of Various Items:** Commercial banks provide their customers with the service of collecting bills, interest, subscriptions, rents, and other periodical receipts on their behalf. They also make payments for insurance premiums, taxes, etc., on their customer's standing instructions.
- ✓ **Purchase and Sale of Foreign Exchange:** The central bank gives authority to commercial banks to deal in foreign exchange. Commercial banks, on the behalf of their customers, buy and sell foreign exchange and also helps in promoting international trade.
- ✓ **Purchase and Sale of the Securities:** Commercial banks on behalf of their customers, purchase and sell government securities and stocks and shares of private companies.
- ✓ **Income Tax Consultancy:** Commercial banks provide advice to their customers related to income tax. They also help them in the preparation of their income tax returns.
- ✓ **Trustee and Executor:** Commercial banks play the role of a trustee and preserve the will of their customers and as an executor, execute the will after their death.
- ✓ **Letters of Reference:** Commercial banks provide information about the economic position of their customers to the traders and vice-versa.

iv) General Utility Functions

Some of the general utility functions performed by commercial banks are:

- ✓ **Locker Facility:** Commercial banks provide their customers with the facility of lockers or safety vaults so they can keep their valuable things in safe custody.
- ✓ **Traveller's Cheques:** To avoid the risk of taking cash on their journey, commercial banks provide their customers with the facility of traveller's cheques.
- ✓ **Letter of Credit:** Sometimes people need to show their creditworthiness for various reasons. Commercial banks certify the creditworthiness of their customers whenever required.
- ✓ **Underwriting Securities:** Commercial banks also performs the function of underwriting securities. And as the public has full faith in the bank's creditworthiness, they do not hesitate in purchasing the securities which are underwritten by banks.
- ✓ **Collection of Statistics:** Commercial banks advice their customers on financial matters by collecting and publishing statistics related to commerce, trade, and industry.

1.16 Importance of Commercial Banks

Commercial banks play a crucial role in the economic development of a country. The banks help in the acceleration of a country's economic growth in the following ways:

i) **Help Consumers:** Commercial banks help consumers in purchasing durable consumer goods like Air Conditioners, Refrigerators, T.V., etc., which are out of their paying capacity limit, by advancing credit to them. By doing so, commercial banks create demand for these consumer goods.

ii) Provision of Finance and Credit: Commercial banks play an essential role as a source of finance and credit for industry and trade. These banks not only perform activities that are confined to domestic trade and commerce but are also extended to foreign trade.

iii) Accelerating the Rate of Capital Formation: Commercial banks encourage people's habit of thrift and mobilise their savings which are then allocated effectively among the ultimate users of funds; i.e., the investors for productive investment. Therefore, savings made by people result in capital formation forming the basis of economic development.

iv) Promoting Balanced Regional Development: Commercial banks play an essential role by providing credit facilities to rural people by opening up their branches in backward areas. These banks use the funds collected in the developed regions to channelise investment in the under developed regions of the country. By doing so, commercial banks bring out more balanced regional development.

v) Developing Entrepreneurship: Commercial banks promote entrepreneurship by way of underwriting shares of new and existing companies and also, grant assistance for the promotion of new ventures or for financing promotional activities. These banks provide finance to the loss-making/sick industries to make them viable units.

1.17 Financial Institutions in India

Financial Institutions in India play a vital role in economic growth. Know their types, regulation, Basel norms, initiatives, and key government policies.

Financial institutions play a pivotal role in India's economic development. They serve as intermediaries between savers and borrowers, mobilizing funds and channeling them into productive sectors. Beyond providing loans and credit, these institutions facilitate investment, implement monetary policy, and support financial inclusion. Their operations strengthen the

financial system, promote economic growth, and ensure stability. Both banking and non-banking institutions together contribute to national development.

In India, financial institutions are broadly categorized into banking institutions and non-banking financial institutions (NBFIs). Banking institutions, including commercial banks, cooperative banks, and regional rural banks, focus on deposits, loans, and payment services. NBFIs, including insurance companies, mutual funds, pension funds, development banks, and microfinance institutions, provide long-term finance and specialized services. Collectively, these institutions ensure smooth credit flow, mobilize savings, and support sectors ranging from agriculture and industry to infrastructure, exports, and social welfare schemes.

1.18 Financial Institutions in India History

India's financial institutions have evolved over centuries, shaped by colonial legacies and post-independence reforms:

- ✓ Pre-Independence Era: Banks like State Bank of India (SBI), Allahabad Bank, and Punjab National Bank offered basic banking services, primarily to urban areas.
- ✓ Post-Independence (1947-1991): Nationalization of 14 banks in 1969 and 6 banks in 1980 expanded credit to rural and priority sectors.
- ✓ Liberalization Era (1991 onwards): Private sector banks and foreign banks entered, modernizing the banking system with technology-driven services.

1.19 Types of Financial Institutions in India

Financial institutions in India can be classified as follows:

i) Banking Institutions (Depository)

These institutions accept deposits from the public and provide loans and payment services. They are primarily categorized based on ownership and function:

- ✓ **Public Sector Banks (PSBs):** The majority of equity is held by the government. Major examples include the State Bank of India (SBI), Punjab National Bank (PNB), and Bank of Baroda.
- ✓ **Private Sector Banks:** These are owned by private corporations or individuals. Key examples include HDFC Bank, ICICI Bank, and Axis Bank.
- ✓ **Regional Rural Banks (RRBs):** Established to provide credit to agriculture and rural sectors, they are jointly owned by the Central Government, State Government, and a sponsor bank.
- ✓ **Cooperative Banks:** These are established on a cooperative basis to provide rural and micro-financing. They are registered under the Cooperative Societies Act, 1912.
- ✓ **Small Finance Banks & Payments Banks:** Specialized banks aimed at furthering financial inclusion by offering basic banking activities to underserved sections and restricting activities mainly to demand deposits and remittance services, respectively.

ii) Non-Banking Financial Institutions (Non-Depository)

These institutions offer specialized financial services but generally cannot accept demand deposits from the public in the same way commercial banks do.

- ✓ **Development Financial Institutions (DFIs):** Provide long-term finance for specific sectors. Examples include NABARD (agriculture and rural development), SIDBI (MSMEs), EXIM Bank (international trade), NHB (housing finance), and NaBFID (infrastructure financing).
- ✓ **Insurance Companies:** Offer risk coverage and mobilize savings through premiums, such as Life Insurance Corporation (LIC).

- ✓ **Mutual Funds:** Pool investor resources for diversified investments in capital markets, managed by Asset Management Companies and regulated by SEBI.
- ✓ **Non-Banking Financial Companies (NBFCs):** Engage in activities like loans and advances but without a full banking license.

1.20 Regulatory Bodies

The Indian financial system is regulated by several key authorities:

- ✓ **Reserve Bank of India (RBI):** Regulates monetary policy, banks, and NBFCs.
- ✓ **Securities and Exchange Board of India (SEBI):** Regulates capital markets, including mutual funds and stock exchanges.
- ✓ **Insurance Regulatory and Development Authority of India (IRDAI):** Regulates the insurance sector.
- ✓ **Pension Fund Regulatory and Development Authority (PFRDA):** Oversees pension funds and the National Pension System (NPS).

1.21 National Stock Exchange

National Stock Exchange (NSE) is India's largest stock market, offering transparent trading in equities, derivatives, currency and bonds, driving economic growth.

The National Stock Exchange of India (NSE) stands as the foremost stock exchange in India and a key component of its financial architecture. Established in 1992 and beginning operations in 1994, NSE was created to bring transparency, efficiency and nationwide access to stock trading. Headquartered in Mumbai, the NSE introduced an automated, screen-based trading system, replacing the out-dated manual processes of the past. By mobilising capital, offering investment opportunities and enabling corporate growth, NSE plays a pivotal role in India's economic development.

The NSE is a regulated stock exchange, officially recognised under the Securities Contracts (Regulation) Act, 1956. It provides a platform for trading in equities (shares), derivatives (futures, options), currency & commodity products, and debt (securities). The NSE is owned by major financial institutions, banks and insurers, and is regulated by the Securities and Exchange Board of India (SEBI). Its mission is to ensure transparent, fair, efficient and robust markets, accessible to both retail and institutional investors.

1.22 National Stock Exchange Structure

The structure for the organization and regulation of the National Stock Exchange has been listed below:

Shareholders include major institutions such as Life Insurance Corporation (LIC), State Bank of India (SBI), ICICI Bank, GIC etc.

- ✓ Managed by a Board of Directors, executive leadership and key functional departments (trading, clearing, settlement, surveillance).
- ✓ Regulated by SEBI under multiple statutes: Companies Act, SEBI Act, Securities Contract (Regulation) Act, Depositories Act.
- ✓ The Clearing and Settlement is handled by NSE Clearing Limited while depository services are through National Securities Depository Limited (NSDL).
- ✓ The functioning of NSE is governed by:
 - Securities Contracts (Regulation) Act, 1956
 - Companies Act, 2013
 - SEBI Act, 1992
 - Depositories Act, 1996

1.23 National Stock Exchange Market Segments

The major segments of the National Stock Exchange Market has been listed below:

i) Capital Market (Equities)

Investors buy and sell shares of listed companies. NSE lists over 2,200 companies (as of 2024-25) making it India's largest exchange by listing numbers and trade volume.

ii) Derivatives Market

NSE is the world's largest derivatives exchange (by number of contracts traded) according to its 2022-23 annual report. Products include index futures, index options, stock futures, stock options, currency futures & options.

iii) Currency & Debt Market

NSE offers currency derivatives (since 2008) and a wholesale debt market (WDM) for trading in government securities and corporate bonds.

iv) Other Services

The NSE also provides infrastructure for mutual funds via Mutual Fund Service System (MFSS), SME listing platform (NSE EMERGE), corporate bonds platform, and foreign investor access via FPI routes.

1.24 National Stock Exchange Features

Key features of the NSE has been listed below:

- ✓ Fully automated, screen-based trading system connecting brokers across India, ensuring equal access.
- ✓ Nationwide network (via remote terminals) allows even smaller towns to participate.
- ✓ Rapid clearing and settlement, advanced infrastructure via NSE Clearing.

- ✓ Risk management and surveillance systems to monitor trading anomalies, reduce fraud & insider trading.
- ✓ Innovation in technology: co-location centres, high-frequency trading infrastructure, internet-based trading, mobile platforms. For instance, NSE expanded its co-location data centre to over 1,200 racks as of January 2025, making it one of the largest globally.
- ✓ Transition to T+1 settlement cycle (from earlier T+2) enhances efficiency and reduces counter-party risk.

1.25 National Stock Exchange Indices

The performance is analysed through the indices as given below:

- ✓ NIFTY 50: Flagship index tracking 50 large-cap stocks across 13 sectors.
- ✓ NIFTY Next 50: 50 companies next in line after NIFTY 50.
- ✓ Sectoral indices such as NIFTY Bank, NIFTY IT, NIFTY FMCG, NIFTY Auto provide focus on specific industries.
- ✓ Midcap and Smallcap indices broaden investor access to smaller companies and growth sectors.

1.26 National Stock Exchange Role in Indian Economy

NSE has several impact on the Indian Economy with respect to the financial mobilisation, liquidity, investment, etc as discussed here:

- ✓ **Capital mobilisation:** Companies raise equity (and sometimes debt) via NSE, supporting expansion and economic growth.
- ✓ **Savings channel:** Enables retail and institutional savings to enter productive investment through shares and derivatives.

- ✓ **Liquidity & price discovery:** Large trading volumes ensure ease of entry/exit, efficient pricing and appropriate returns.
- ✓ **Employment & supporting services:** Brokers, analysts, IT infrastructure, clearing & settlement services generate jobs.
- ✓ **Foreign investment:** NSE helps attract Foreign Portfolio Investors (FPIs) enabling inflow of global capital; data on FII/FPI flows show significant activity.

1.27 National Stock Exchange Recent Developments

NSE has shown a great extent of advancement in the recent days as discussed here:

- ✓ **T+1 Settlement Cycle:** From 27 January 2023, all equities on NSE moved to a T+1 rolling settlement cycle, reducing the time between trade execution and settlement from T+2 to T+1. This faster settlement reduces risk of non-payment/delivery and improves liquidity.
- ✓ **Digital & Market Infrastructure Reforms:** In its July 2024 report, NSE noted that “Indian capital markets: transformative shifts achieved ... including ASBA for secondary market, T+1 settlement, shorter MF redemption, faster IPO listing” could yield about INR 3,900 crore efficiency savings.
- ✓ **Increased Retail Participation:** As of July 2025, NSE reported unique trading accounts crossing 23 crore (230 million) in three months, indicating rapid growth of retail investor participation.
- ✓ **Global Rankings:** According to a 2023 futures industry review, the NSE Group processed over 84.8 billion contracts, ranking it #1 globally in derivatives by volume.
- ✓ **Cybersecurity and Infrastructure:** NSE faces significant cybersecurity challenges, with reports of up to 170 million daily cyber-attacks targeting it in late 2025, prompting

continuous investment in cybersecurity and digital resilience. This underscores the importance of robust tech infrastructure.

1.28 National Stock Exchange Achievements

Some of the major achievements of NSE include:

- ✓ First exchange in India to introduce a nationwide electronic trading system.
- ✓ Launch of NIFTY 50 Index in 1996.
- ✓ Establishment of NSCCL for clearing and settlement.
- ✓ Introduction of Internet-based trading in 2000.
- ✓ Launch of Currency Derivatives in 2008.
- ✓ Ranked among the top 5 exchanges globally by number of trades in equity derivatives (as per World Federation of Exchanges, 2023).

1.29 Bombay Stock Exchange (BSE)

The **Bombay Stock Exchange (BSE)** is one of the oldest and most important stock exchanges in India, located in Mumbai. Established in **1875**, it provides a platform for buying and selling shares, bonds, and other securities. BSE plays a key role in India's financial system by helping companies raise capital and allowing investors to trade securities in a regulated manner. Its benchmark index, the **Sensex**, tracks the performance of 30 major companies and is widely used to measure the overall health of the Indian stock market. BSE is known for its transparency, efficiency, and contribution to the growth of the Indian economy.

1.30 Bombay Stock Exchange Structure

The **Bombay Stock Exchange (BSE) structure** refers to the organizational and operational framework through which the exchange functions. At the top level, BSE is governed by a **Board of Directors**, which includes public interest directors, shareholder directors, and a

managing director to ensure transparency and proper regulation. The exchange operates under the supervision of **SEBI (Securities and Exchange Board of India)**, which regulates all stock exchanges in India.

Operationally, BSE is divided into various departments such as **listing, trading, clearing and settlement, surveillance,** and **investor services**. Trading is conducted electronically through the **BSE Online Trading (BOLT)** system, while clearing and settlement are handled by **Indian Clearing Corporation Limited (ICCL)**. This structured setup helps BSE maintain fair trading practices, protect investors, and ensure smooth functioning of the securities market.

1.31 Bombay Stock Exchange Market Segments

The **Bombay Stock Exchange (BSE) market segments** are designed to cater to different types of securities and investors. The **Equity Segment** is the main market where shares of listed companies are traded, including large, mid, and small-cap stocks. The **Derivatives Segment** allows trading in futures and options based on stocks and indices, helping investors manage risk. BSE also has a **Debt Market Segment**, where government securities, corporate bonds, and money market instruments are traded.

In addition, BSE operates the **Currency Derivatives Segment**, which enables trading in currency futures and options, and the **SME (Small and Medium Enterprises) Platform**, which supports smaller companies in raising capital. These market segments together make BSE a comprehensive exchange serving the diverse needs of the Indian financial market.

1.32 Bombay Stock Exchange Features

The **Bombay Stock Exchange (BSE)** has several important features that make it a key part of India's financial system. It is one of the **oldest stock exchanges in Asia**, established in 1875, and operates under the regulation of **SEBI**, ensuring transparency and investor protection.

BSE uses a fully **electronic trading system (BOLT)**, which allows fast, efficient, and secure trading across the country.

Its benchmark index, the **Sensex**, reflects the performance of major Indian companies and serves as an indicator of market trends. BSE also offers multiple market segments such as equity, derivatives, debt, currency, and SME platforms, providing wide investment opportunities. Additionally, it has a strong **clearing and settlement system**, ensuring safe and timely completion of trades.

1.33 Bombay Stock Exchange Indices

The **Bombay Stock Exchange (BSE) indices** are statistical measures that reflect the overall performance of the stock market or specific sectors. The most well-known index is the **Sensex**, which tracks **30 of the largest and most actively traded companies** on the exchange, providing a snapshot of market trends. BSE also has other indices like the **BSE 100, BSE 200, and BSE 500**, which cover a broader range of companies to give a more comprehensive view of the market. Additionally, there are **sectoral indices** such as BSE IT, BSE Bankex, and BSE Pharma, which monitor the performance of specific industries. These indices help investors, analysts, and policymakers understand market movements, make informed decisions, and compare performance over time.

1.34 Bombay Stock Exchange Role in Indian Economy

The **Bombay Stock Exchange (BSE)** plays a vital role in the growth and development of the Indian economy. It provides a **platform for companies to raise capital** by issuing shares and bonds, which helps businesses expand and create employment. By enabling investors to buy and sell securities, BSE **mobilizes savings and channels them into productive investments**, supporting industrial and economic growth. Its transparent and regulated environment builds

investor confidence, encouraging both domestic and foreign investments. Additionally, BSE's indices, like the Sensex, serve as **barometers of economic health**, helping policymakers and analysts track market trends and make informed decisions. Overall, BSE contributes significantly to **financial stability, wealth creation, and economic development** in India.

1.35 Bombay Stock Exchange Recent Developments

The **Bombay Stock Exchange (BSE)** has seen several important developments recently. The exchange has been actively monitoring unusual price movements in certain stocks and addressing sudden spikes in trading volume to ensure transparency and protect investors. It is also expanding its offerings by launching new monthly index options and updating key indices like BANKEX to improve liquidity and market participation. At the same time, BSE has strengthened its regulatory measures by tightening surveillance on volatile stocks, helping curb excessive price fluctuations. Financially, the exchange reported strong quarterly results in early 2025–26, showing growth in revenue, net profit, and overall operational performance.

1.36 Bombay Stock Exchange Achievements

The **Bombay Stock Exchange (BSE)** has achieved several milestones that highlight its importance in India's financial system. Established in **1875**, it is one of the **oldest stock exchanges in Asia**. BSE was the **first exchange in India to introduce electronic trading** through its BOLT system, ensuring fast and transparent transactions. Its benchmark index, the **Sensex**, has become a key indicator of India's economic health. BSE has also created **specialized platforms**, such as the SME (Small and Medium Enterprises) platform, to help smaller companies raise capital. Additionally, it has consistently maintained **robust surveillance and investor protection mechanisms**, earning global recognition for its efficiency and reliability.

Through these achievements, BSE has played a crucial role in modernizing India's capital markets and supporting economic growth.

Check Your Progress

Choose the Correct Answer:

1. What are financial services?

- A) Services that manufacture goods
- B) Services that deal with money management, investment, and finance
- C) Services related to health care
- D) Services related to education

Answer: B) Services that deal with money management, investment, and finance

2. Which of the following is NOT a type of financial service?

- A) Insurance
- B) Mutual Funds
- C) Transportation
- D) Leasing

Answer: C) Transportation

3. Why are financial services important for the economy?

- A) They reduce taxation
- B) They provide infrastructure for business, trade, and investment
- C) They improve literacy
- D) They control weather conditions

Answer: B) They provide infrastructure for business, trade, and investment

4. Which financial institution regulates and controls the monetary policy in India?

- A) Commercial Banks
- B) Reserve Bank of India (RBI)
- C) National Stock Exchange
- D) Insurance Companies

Answer: B) Reserve Bank of India (RBI)

5. What is the primary function of commercial banks?

- A) Manufacturing goods
- B) Accepting deposits and providing loans
- C) Conducting stock market trading
- D) Regulating government policies

Answer: B) Accepting deposits and providing loans

6. Which of the following is a financial institution that facilitates trading of shares?

- A) National Stock Exchange (NSE)
- B) Insurance Company
- C) Commercial Bank
- D) Reserve Bank of India

Answer: A) National Stock Exchange (NSE)

7. The Bombay Stock Exchange (BSE) is important because:

- A) It prints currency notes
- B) It provides a platform for buying and selling shares
- C) It issues government bonds only
- D) It provides banking services

Answer: B) It provides a platform for buying and selling shares

8. Which of the following is a financial service provided to help businesses manage risk?

- A) Mutual Funds
- B) Insurance
- C) Leasing
- D) Investment Banking

Answer: B) Insurance

9. How do technological developments impact financial services?

- A) They reduce the number of financial institutions
- B) They enable faster, safer, and more efficient financial transactions
- C) They eliminate the need for RBI
- D) They stop investments in the stock market

Answer: B) They enable faster, safer, and more efficient financial transactions

10. Financial services are closely related to the economic environment because:

- A) They determine political policies
- B) They help mobilize savings and facilitate investments for economic growth
- C) They control natural resources
- D) They manufacture goods

Answer: B) They help mobilize savings and facilitate investments for economic growth

Small Questions – LOCF Mapping Table

S.No	Small Question	CO	Bloom's Level	PO
1	What is the meaning of financial services?	CO1	Remember	PO1
2	List the types of financial services.	CO2	Remember	PO2
3	Explain the importance of financial services in the economy.	CO2	Understand	PO2
4	Name the key financial institutions in India.	CO3	Remember	PO3
5	What are the roles of RBI, Commercial Banks, NSE, and BSE in the financial system?	CO3	Understand	PO3

Big Questions – LOCF Mapping Table

S.No	Big Question	CO	Bloom's Level	PO
1	Explain the meaning and importance of financial services in the economy.	CO1	Understand	PO1
2	Discuss the different types of financial services with examples.	CO2	Analyze	PO2
3	Explain how financial services are influenced by economic and technological environments.	CO2	Analyze	PO2
4	Describe the structure of the financial system in India.	CO3	Understand	PO3
5	Explain the roles of RBI, Commercial Banks, NSE, and BSE in the Indian financial system.	CO3	Evaluate	PO3

UNIT – II

Structure:

- 2.1 Introduction to Merchant Banking**
- 2.2 Meaning and Definition of Merchant Banking**
- 2.3 Difference between Merchant Bank and Commercial Bank**
- 2.4 Functions of Merchant Banking**
- 2.5 Issue Management**
- 2.6 Key Activities in Issue Management**
- 2.7 Managing of New Issues**
- 2.8 Underwriting**
- 2.9 Objectives of Underwriting**
- 2.10 Need for Underwriting**
- 2.11 Parties Involved in Underwriting**
- 2.12 Types of Underwriting**
- 2.13 Advantages of Underwriting**
- 2.14 Disadvantages of Underwriting**
- 2.15 Capital Market**
- 2.16 Objectives and Importance**
- 2.17 Characteristics of Capital Market**
- 2.18 Functions of Capital Market**
- 2.19 Major constituents of the capital market**
- 2.20 Segments of Capital Market**
- 2.21 Difference between Primary Market and Secondary Market**

2.22 SEBI

2.23 Key Functions & Objectives

2.24 Role of SEBI (Securities and Exchange Board of India)

2.1 Introduction to Merchant Banking

The word ‘merchant banking’ was originated among the Dutch and Scottish traders. Later on it was developed and professionalised in the UK and the USA. Now this has become popular throughout the world.

Merchant Banking is a specialized segment of the financial services industry that primarily provides financial and advisory services to corporate clients rather than individual customers. Merchant banks play a crucial role in assisting companies with raising capital through equity, debt, or hybrid instruments, and they often act as underwriters, guaranteeing the purchase of shares or bonds issued by firms. In addition to capital raising, merchant banks provide expert advice on mergers, acquisitions, corporate restructuring, and investment planning, helping businesses make strategic financial decisions. They also manage portfolios and handle issue management, including public issues, rights issues, and private placements, ensuring smooth operations in the capital markets. Merchant banking has become increasingly important in the modern economy as it supports business growth, modernization, and expansion, while also facilitating the efficient mobilization of funds in the market. With the integration of technology, merchant banks now offer faster, more secure, and efficient services, further strengthening their role as financial facilitators and trusted advisors to corporations. Overall, merchant banking acts as a bridge between businesses and financial markets, promoting economic development by enabling companies to access the capital they need to grow and compete.

2.2 Meaning and Definition of Merchant Banking

Merchant banking is non-banking financial activity. But it resembles banking function. It is a financial service. It includes the entire range of financial services.

The term merchant banking is used differently in different countries. So there is no universal definition for merchant banking. We can define merchant banking as a process of transferring.

Capital from those who own it to those who use it. According to Random House Dictionary, “merchant bank is an organization that underwrites securities for corporations, advises such clients on mergers and is involved in the ownership of commercial ventures. These organizations are sometimes banks which are not merchants and sometimes merchants who are not bankers and sometimes houses which neither merchants nor banks”. According to SEBI (Merchant Bankers) Rules 1992, “A merchant banker has been defined as any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant advisor or rendering corporate advisory services in relation to such issue management”. In short, “merchant bank refers to an organization that underwrites securities and advises such clients on issues like corporate mergers, involving in the ownership of commercial ventures”.

Thus merchant banking involves a wide range of activities such as management of customer services, portfolio management, credit syndication, acceptance credit, counseling, insurance, preparation of feasibility reports etc. It is not necessary for a merchant banker to carry out all the above mentioned activities. A merchant banker may specialise in one activity, and take up other activities, which may be complementary or supportive to the specialized activity.

In short, merchant banking involves servicing any financial need of the client.

2.3 Difference between Merchant Bank and Commercial Bank

Merchant banks are different from commercial banks. The following are the important differences between merchant banks and commercial banks:

- ✓ Commercial banks basically deal in debt and debt related finance. Their activities are clustered around credit proposals, credit appraisal and loan sanctions. On the other hand, the area of activity of merchant bankers is equity and equity related finance. They deal with mainly funds raised through money market and capital market.
- ✓ Commercial banks' lending decisions are based on detailed credit analysis of loan proposals and the value of security offered. They generally avoid risks. They are asset oriented. But merchant bankers are management oriented. They are willing to accept risks of business.
- ✓ Commercial banks are merely financiers. They do not undertake project counselling, corporate counselling, managing public issues, underwriting public issues, advising on portfolio management etc. The main activity of merchant bankers is to render financial services for their clients. They undertake project counselling, corporate counselling in areas of capital restructuring, mergers, takeovers etc., discounting and rediscounting of short-term paper in money markets, managing and underwriting public issues in new issue market and acting as brokers and advisors on portfolio management.

2.4 Functions of Merchant Banking

Merchant banks have been playing an important role in procuring the funds for capital market for the corporate sector for financing their operations. They perform some valuable functions. The functions of merchant banks in India are as follows:

i) Corporate counseling: One of the important functions of a merchant banker is corporate counseling. Corporate counseling refers to a set of activities undertaken to ensure efficient functioning of a corporate enterprise through effective financial management. A merchant banker guides the client on aspects of organizational goals, vocational factors, organization size, choice of product, demand forecasting, cost analysis, allocation of resources, investment decisions, capital and expenditure management, marketing strategy, pricing methods etc. The following activities are included in corporate counseling:

- (a) Providing guidance in areas of diversification based on the Government's economic and licensing policies.
- (b) Undertaking appraisal of product lines, analyzing their growth and profitability and forecasting future trends.
- (c) Rejuvenating old-line companies and ailing sick units by appraising their technology and process, assessing their requirements and restructuring their capital base.
- (d) Assessment of the revival prospects and planning for rehabilitation through modernization and diversification and revamping of the financial and organizational structure.
- (e) Arranging for the approval of the financial institutions/banks for schemes of rehabilitation involving financial relief, etc.
- (f) Monitoring of rehabilitation schemes.
- (g) Exploring possibilities for takeover of sick units and providing assistance in making consequential arrangements and negotiations with financial institutions/banks and other interests/authorities involved.

ii) Project counseling: Project counseling relates to project finance. This involves the study of the project, offering advisory services on the viability and procedural steps for its implementation.

Project counseling involves the following activities:

- (a) Undertaking the general review of the project ideas/project profile.
- (b) Providing advice on procedural aspects of project implementation.
- (c) Conducting review of technical feasibility of the project on the basis of the report prepared by own experts or by outside consultants.
- (d) Assisting in the preparation of project report from a financial angle, and advising and acting on various procedural steps including obtaining government consents for implementation of the project.
- (e) Assisting in obtaining approvals/licenses/permissions/grants, etc from government agencies in the form of letter of intent, industrial license, DGTD registration, and government approval for foreign collaboration.
- (f) Identification of potential investment avenues.
- (g) Arranging and negotiating foreign collaborations, amalgamations, mergers, and takeovers.
- (h) Undertaking financial study of the project and preparation of viability reports to advise on the framework of institutional guidelines and laws governing corporate finance.
- (i) Providing assistance in the preparation of project profiles and feasibility studies based on preliminary project ideas, covering the technical, financial and economic aspects of the project from the point of view of their acceptance by financial institutions and banks.
- (j) Advising and assisting clients in preparing applications for financial assistance to various national financial institutions, state level institutions, banks, etc.

iii) Pre-investment studies: Another function of a merchant banker is to guide the entrepreneurs in conducting pre investment studies. It involves detailed feasibility study to evaluate investment avenues to enable to decide whether to invest or not. The important activities involved in preinvestment studies are as follows:

(a) Carrying out an in-depth investigation of environment and regulatory factors, location of raw material supplies, demand projections and financial requirements in order to assess the financial and economic viability of a given project.

(b) Helping the client in identifying and short-listing those projects which are built upon the client's inherent strength with a view to promote corporate profitability and growth in the long run.

(c) Offering a package of services, including advice on the extent of participation, government regulatory factors and an environmental scan of certain industries in India.

iv) Loan syndication: A merchant banker may help to get term loans from banks and financial institutions for projects. Such loans may be obtained from a single financial institution or a syndicate or consortium. Merchant bankers help corporate clients to raise syndicated loans from commercial banks. The following activities are undertaken by merchant bankers under loan syndication:

(a) Estimating the total cost of the project to be undertaken.

(b) Drawing up a financing plan for the total project cost which conforms to the requirements of the promoters and their collaborators, financial institutions and banks, government agencies and underwriters.

(c) Preparing loan application for financial assistance from term lenders/financial institutions/banks, and monitoring their progress, including pre-sanction negotiations.

- (d) Selecting institutions and banks for participation in financing.
- (e) Follow-up of term loan application with the financial institutions and banks, and obtaining the approval for their respective share of participation.
- (f) Arranging bridge finance.
- (g) Assisting in completion of formalities for drawing of term finance sanctioned by institutions by expediting legal documentation formalities, drawing up agreements etc. as prescribed by the participating financial institutions and banks.
- (h) Assessing working capital requirements.

v) Issue management: Issue management involves marketing of corporate securities by offering them to the public. The corporate securities include equity shares, preference shares, bonds, debentures etc. Merchant bankers act as financial intermediaries. They transfer capital from those who own it to those who need it. The security issue function may be broadly classified into two – pre-issue management and post-issue management. The pre-issue management involves the following functions:

- (a) Public issue through prospectus.
- (b) Marketing and underwriting.
- (c) Pricing of issues.

These may be briefly discussed as follows:

(a) Public issue through prospectus: To bring out a public issue, merchant bankers have to coordinate the activities relating to issue with different government and public bodies, professionals and private agencies. First the prospectus should be drafted. The copies of consent of experts, legal advisor, attorney, solicitor, bankers, and brokers to the issue, brokers and underwriters are to be obtained from the company making the issue. These copies are to be filed

along with the prospectus to the Registrar Companies. After the prospectus is ready, it has to be sent to the SEBI for clearance. It is only after clearance by SEBI, the prospectus can be filed with the Registrar. The brokers to the issue, principal agent and bankers to issue are appointed by merchant bankers.

(b) Marketing and underwriting: After sending prospectus to SEBI, the merchant bankers arrange a meeting with company representatives and advertising agents to finalise arrangements relating to date of opening and closing of issue, registration of prospectus, launching publicity campaigns and fixing date of board meeting to approve and pass the necessary resolutions. The role of merchant banker in publicity campaigns to help selecting the media, determining the size and publications in which the advertisement should appear. The merchant bank shall decide the number of copies to be printed, check accuracy of statements made and ensure that the size of the application form and prospectus are as per stock exchange regulations. The merchant banker has to ensure that the material is delivered to the stock exchange at least 21 days before the issue opens and to the brokers to the issue, and underwriters in time.

(c) Pricing of issues: Pricing of issues is done by companies themselves in consultation with the merchant bankers. An existing listed company and a new company set up by an existing company with 5 year track record and existing private closely held company and existing unlisted company going in for public issues for the first time with 2 ½ years track record of constant profitability can freely price the issue. The premium can be determined after taking into consideration net asset value, profit earning capacity and market price. The price and premium has to be stated in the prospectus. Post-issue management consists of collection of application forms and statement of amount received from bankers, screening applications, deciding

allotment procedures, mailing of allotment letters, share certificates and refund orders. Merchant bankers help the company by co-ordinating the above activities.

vi) Underwriting of public issue: In underwriting of public issue the activities performed by merchant bankers are as follows:

- (a) Selection of institutional and broker underwriters for syndicating/ underwriting arrangements.
- (b) Obtaining the approval of institutional underwriters and stock exchanges for publication of the prospectus.
- (c) Co-ordination with the underwriters, brokers and bankers to the issue, and the Stock Exchanges.

vii) Portfolio management: Merchant bankers provide portfolio management service to their clients. Today every investor is interested in safety, liquidity and profitability of his investment. But investors cannot study and choose the appropriate securities. Merchant bankers help the investors in this regard. They study the monetary and fiscal policies of the government. They study the financial statements of companies in which the investments have to be made by investors. They also keep a close watch on the price movements in the stock market.

The merchant bankers render the following services in connection with portfolio management:

- (a) Undertaking investment in securities.
- (b) Collection of return on investment and re-investment of the same in profitable avenues, investment advisory services to the investors and other related services.
- (c) Providing advice on selection of investments.
- (d) Carrying out a critical evaluation of investment portfolio.
- (e) Securing approval from RBI for the purchase/sale of securities (for NRI clients).
- (f) Collecting and remitting interest and dividend on investment.

(g) Providing tax counseling and filing tax returns through tax consultants.

viii) Merger and acquisition: A merger is a combination of two or more companies into a single company where one survives and others lose their corporate existence. A take over refers to the purchase by one company acquiring controlling interest in the share capital of another existing company. Merchant bankers are the middlemen in setting negotiation between the offeree and offeror. Being a professional expert they are apt to safeguard the interest of the shareholders in both the companies. Once the merger partner is proposed, the merchant banker appraises technical merger/takeover proposal with respect to financial viability and feasibility. He negotiates purchase consideration and mode of payment. He gets approval from the government/RBI, drafts scheme of amalgamation and obtains approval from financial institutions.

ix) Foreign currency financing: The finance provided to fund foreign trade transactions is called 'Foreign Currency Finance'. The provision of foreign currency finance takes the form of exportimport trade finance, euro currency loans, Indian joint ventures abroad and foreign collaborations. The main areas that are covered in this type of merchant activity are as follows:

- (a) Providing assistance for carrying out the study of turnkey and construction contract projects.
- (b) Arranging for the syndication of various types of guarantees, letters of credit, pre-shipment credit, deferred post-shipment credit, bridge loans, and other credit facilities.
- (c) Providing assistance in opening and operating bank accounts abroad.
- (d) Arranging foreign currency loans under buyer's credit scheme for importing goods.
- (e) Arranging deferred payment guarantees under suppliers credit scheme for importing capital goods.

(f) Providing assistance in obtaining export credit facilities from the EXIM bank for export of capital goods, and arranging for the necessary government approvals and clearance.

(g) Undertaking negotiations for deferred payment, export finance, buyers credits, documentary credits, and other foreign exchange services like packing credit, etc.

x) Working capital finance: The finance required for meeting the day-to-day expenses of an enterprise is known as 'Working Capital Finance'. Merchant bankers undertake the following activities as part of providing this type of finance:

(a) Assessment of working capital requirements.

(b) Preparing the necessary application to negotiations for the sanction of appropriate credit facilities.

xi) Acceptance credit and bill discounting: Merchant banks accept and discount bills of exchange on behalf of clients. Merchant bankers give loans to business enterprises on the security of bill of exchange. For this purpose, merchant bankers collect credit information relating to the clients and undertake rating their creditworthiness.

xii) Venture financing: Another function of a merchant banker is to provide venture finance to projects. It refers to provision of equity finance for funding high-risk and high reward projects.

xiii) Lease financing: Leasing is another function of merchant bankers. It refers to providing financial facilities to companies that undertake leasing. Leasing involves letting out assets on lease for a particular period for use by the lessee. The following services are provided by merchant bankers in connection with lease finance:

(a) Providing advice on the viability of leasing as an alternative source for financing capital investment projects.

(b) Providing advice on the choice of a favourable rental structure.

(c) Providing assistance in establishing lines of lease for acquiring capital equipment, including preparation of proposals, documentations, etc.

xiv) Relief to sick industries: Merchant bankers render valuable services as a part of providing relief to sick industries.

xv) Project appraisal: Project appraisal refers to evaluation of projects from various angles such as technology, input, location, production, marketing etc. It involves financial appraisal, marketing appraisal, technical appraisal, economic appraisal etc. Merchant bankers render valuable services in the above areas. The functions of merchant banker can be summarized as follows:

- (a) Issue management.
- (b) Underwriting of issues.
- (c) Project appraisal.
- (d) Handling stock exchange business on behalf of clients.
- (e) Dealing in foreign exchange.
- (f) Floatation of commercial paper.
- (g) Acting as trustees.
- (h) Share registration.
- (i) Helping in financial engineering activities of the firm.
- (j) Undertaking cost audit.
- (k) Providing venture capital.
- (l) Arranging bridge finance.
- (m) Advising business customers (i.e. mergers and takeovers).
- (n) Undertaking management of NRI investments.

- (o) Large scale term lending to corporate borrowers.
- (p) Providing corporate counseling and advisory services.
- (q) Managing investments on behalf of clients.
- (r) Acting as a stock broker.

2.5 Issue Management

Issue management is a core function of **merchant banking** that involves guiding companies through the entire process of raising capital by issuing securities like shares and debentures to the public or existing investors. This comprehensive process is highly regulated (e.g., by the Securities and Exchange Board of India (SEBI) in India) and is broadly divided into pre-issue and post-issue activities.

2.6 Key Activities in Issue Management

Merchant bankers act as the lead managers and "financial architects" of an issue, coordinating all involved agencies (underwriters, registrars, brokers, bankers, etc.) to ensure a successful and compliant offering.

i) Pre-Issue Management (Planning & Preparation)

Before an issue opens, the merchant banker performs extensive preparatory work:

- ✓ **Advisory Services:** Advising the client company on the appropriate timing, size, and pricing of the issue, and designing an optimal capital structure.
- ✓ **Regulatory Compliance & Documentation:** Preparing the draft prospectus or letter of offer, ensuring all disclosures meet regulatory guidelines (like SEBI's Disclosure and Investor Protection norms), and filing the documents with the relevant regulatory bodies and stock exchanges.

- ✓ **Due Diligence:** Conducting thorough due diligence on the company's financials, management, and project viability, and submitting a due diligence certificate to the regulators.
- ✓ **Appointing Intermediaries:** Selecting and coordinating with other essential parties like underwriters, registrars, bankers to the issue, and advertising agencies.
- ✓ **Marketing & Underwriting:** Planning the marketing strategy and publicity campaigns, and arranging for the underwriting of the issue to guarantee minimum subscription levels.

ii) Post-Issue Management (Execution & Follow-up)

After the issue closes, the merchant banker's role shifts to execution and compliance:

- ✓ **Collection and Allotment:** Coordinating the collection of applications and application monies, and finalizing the basis of allotment of securities in a fair manner.
- ✓ **Refunds and Despatch:** Ensuring the timely despatch of share certificates to successful allottees and refund orders to unsuccessful applicants within the prescribed time limits to avoid interest penalties.
- ✓ **Listing and Trading:** Completing all formalities for listing the securities on the specified stock exchanges and obtaining trading permissions.
- ✓ **Investor Grievance Redressal:** Actively monitoring and ensuring the redressal of investor complaints regarding allotment or refunds.
- ✓ **Reporting:** Submitting various post-issue monitoring reports (e.g., 3-day and 78-day reports in India) and a final due diligence certificate to the regulatory body (SEBI).

2.7 Managing of New Issues

The new issues management refers to the comprehensive process of assisting companies in raising capital by issuing new securities (shares, debentures, bonds) to the public in the primary market. Merchant bankers, also known as lead managers or book running lead managers (BRLMs), plan, coordinate, and control the entire issue activity while ensuring compliance with regulatory bodies like the Securities and Exchange Board of India (SEBI). The process is generally divided into pre-issue and post-issue activities:

i) Pre Issued Management:

It consists of the following three aspects discussed here.

a) Public Issue through prospectus:

The most common method of public issue is through prospectus. To bring out a public issue, merchant bankers have to coordinate the activities relating to issue with different government and public bodies, professionals and private agencies. They have to ensure that the information required by the companies Act and SEBI are furnished in the prospectus and get it verified by reputed solicitor. The copies of consent of experts, legal adviser, attorney, solicitor, bankers to the issue, brokers and under writers are to be obtained from the company making the issue, to be filed along with prospectus to the Registrar of companies. After the prospectus is ready, it has to be sent to SEBI for vetting. It is only after clearance by SEBI, the prospectus can be filed with the Registrar of companies.

Brokers to the issue canvass subscription by mailing the literature to the clients and undertaking wide publicity. Members of stock exchange are appointed as brokers to issue. They devise strategy for success of the public issue, keep liaison between merchant bankers and stock exchanges. Sometimes, they also undertake centralised mailing of prospectus, application forms

and other publicity material at the instance of merchant bankers. Bankers to the issue accept applications along with subscriptions tendered at their designated branches and forward them to the registrar.

b) Marketing and Underwriting:

After dispatch of prospectus to SEBI, the merchant bankers arrange a meeting with company representatives and advertising agents to finalise arrangements relating to date of opening and closing of issue, registration of prospectus, launching publicity campaign and fixing date of board meeting to approve and sign prospectus and pass the necessary resolutions. Publicity campaign covers the preparation of all publicity material and brochures, prospectus, announcement, advertisement in the Press, Radio, TV, investors conference etc. The merchant bankers help choosing the media, determining the size and publications in which the advertisement should appear.

The Merchant banker's role is limited to deciding the number of copies to be printed, checking accuracy of statements made and ensure that the size of the application form and prospectus conform to the standard prescribed by the stock exchange. The Merchant banker has to ensure that the material is delivered to the stock exchange atleast 21 days before the issue opens and to brokers to the issue, branches of brokers to the issue and underwriters on time.

Security issues are underwritten to ensure that in case of under subscription the issues are taken up by the underwriters. SEBI has made underwriting mandatory for issues to the public. The underwriting arrangement should be filed with the stock exchange particulars of underwriting arrangement should be mentioned in the prospectus. The various activities connected with pre issue are a time bound programme which has to be promptly attended to. The execution of the activities with clock work efficiency would lead to a successful issue.

c) Pricing of Issues:

The SEBI guidelines 1992 for capital issues have opened the capital market to free pricing of issues. Pricing of issues is done by companies themselves in consultation with the merchant bankers. Pricing of issue is part of pre issue management. An existing listed company and a new company set up by an existing company with five year track record and existing private closely held company and existing unlisted company going in for public issues of the first time with two and half years track record of constant profitability can freely price the issue. The premium has to be decided after taking into account net asset value, profit earning capacity and market price. Justification of price has to be stated and included in the prospectus.

ii) Post Issue Management:

The post issue management consists of collection of application forms and statement of amount received from bankers, screening applications, deciding allotment procedure, mailing of allotment letters, share certificates and refund orders.

Registrars to the issue play a major role in the post management. They receive the applications, verify them and submit the basis of allotment to the stock exchange. After the basis of allotment is approved by the stock exchange and allotted by the board, the auditor/company secretary has to certify that the allotment has been made by the company as per the basis of allotment approved by the exchange. Registrars have to ensure that the applications are processed and allotment/refund orders are sent within 70 days of the close of the issue. The time limit of 70 days has proved difficult to adhere and applicants have to wait for anytime between 90 to 180 days. Merchant bankers assist the company by coordinating the above activities.

2.8 Underwriting

Underwriting is a contract between a company and an underwriter under which the underwriter agrees to **buy the unsubscribed portion of shares or debentures** of the company's public issue. This ensures that the company raises the **minimum required capital** even if the public response is poor.

2.9 Objectives of Underwriting

The main objectives of underwriting are:

- ✓ **Ensuring full subscription** of the issue
- ✓ **Reducing risk** of failure of the issue
- ✓ **Providing confidence** to the issuing company
- ✓ **Improving investor confidence** in the securities
- ✓ **Stabilizing capital market operations**

2.10 Need for Underwriting

Underwriting is needed because:

- ✓ Public response to new issues is uncertain
- ✓ Market conditions may not be favorable
- ✓ Companies need assurance of funds
- ✓ Investors trust issues backed by underwriters

2.11 Parties Involved in Underwriting

- ✓ **Issuing Company** – Offers securities to the public
- ✓ **Underwriters** – Banks, financial institutions, merchant bankers, brokers
- ✓ **Investors** – Apply for shares or debentures

2.12 Types of Underwriting

(a) Firm Underwriting

The underwriter agrees to purchase a **fixed number of securities** regardless of public subscription.

(b) Conditional Underwriting

The underwriter's liability arises **only if the issue is not fully subscribed.**

(c) Sub-Underwriting

The main underwriter distributes risk by appointing **sub-underwriters.**

2.13 Advantages of Underwriting

i) To the Company

- ✓ Guarantees minimum funds
- ✓ Reduces risk of issue failure
- ✓ Helps in planning and expansion

ii) To Investors

- ✓ Creates confidence in the issue
- ✓ Ensures professional scrutiny

iii) To the Capital Market

- ✓ Encourages new issues
- ✓ Promotes stability

2.14 Disadvantages of Underwriting

- ✓ Increases cost of raising capital
- ✓ Company may depend too much on underwriters
- ✓ Not suitable for very small issues

2.15 Capital Market

The term capital market refers to the institutional arrangements for facilitating the borrowing and lending of long-term funds. It is concerned with those private savings, individuals as well as corporate, that is turned into investments through new capital issues and also new public loans floated by government and semi government bodies.

A capital market may be defined as an organised mechanism for effective and efficient transfer of money capital or financial resources from investing parties, i.e, individuals or institutional savers to the entrepreneurs engaged in industry or commerce in the business either be in the private or public sectors of an economy.

2.16 Objectives and Importance

An efficient capital market is a pre-requisite of economic development. An organised and well developed capital market operating in a free market economy.

Ensures best possible coordination and balance between the flow of savings on the one hand and flow of investment leading to capital formation on the other.

Directs the flow of savings into most profitable channels and thereby ensures optimum utilisation of financial resources.

2.17 Characteristics of Capital Market

The following are the important features of a developed capital market

- ✓ Market for long term funds.
- ✓ Important component of financial system.
- ✓ Facilitates borrowing and lending of funds.
- ✓ Helps in raising capital.
- ✓ Involves both individual and institutional investors.

- ✓ Meets demand and supply of long term capital.
- ✓ Involves intermediaries.
- ✓ Deals in marketable and non-marketable securities.

2.18 Functions of Capital Market

- ✓ Helps in capital formation.
- ✓ Act as a link between savers and investors
- ✓ Helps in increasing national income
- ✓ Facilitates buying and selling.
- ✓ Channelizes funds from unproductive to productive resources.
- ✓ Minimizes speculative activities.
- ✓ Brings stability in value of stocks
- ✓ Promotes economic growth
- ✓ Play important role in underdeveloped country.

2.19 Major constituents of the capital market

- ✓ SEBI (regulator)
- ✓ Stock exchanges
- ✓ Clearing corporations (cc)/ clearing houses (ch)
- ✓ Depositories and depository participants
- ✓ Custodians
- ✓ Stockbrokers and their sub-brokers
- ✓ Mutual funds
- ✓ Merchant bankers
- ✓ Credit rating agencies

- ✓ Financial institutions
- ✓ Foreign institutional investors
- ✓ Non-banking institutions
- ✓ Issuers/ registrar and transfer agents
- ✓ Investors

2.20 Segments of Capital Market

a) Primary Market

A primary market is a market where buying and selling of new securities take place for the first time. In other words, the market where the first public offering of equity shares or convertible securities by a company takes place, which is followed by the listing of a company's shares on a stock exchange is called a primary market. It is also known as 'initial public offering' (IPO). The issue of further capital by companies whose shares are already listed on the stock exchange also comes within the ambit of Primary market.

There are different types of intermediaries operating in this segment of the capital market providing a variety of services. For example, merchant bankers, brokers, bankers to issues, debenture trustees, portfolio managers, registrars to issues and share transfer agents, etc. They are also regulated by SEBI. Their contribution is immense in the development of capital markets.

Features of a Primary Market:

i) New Issue of Securities

- ✓ **Initial Public Offerings (IPOs):** Companies issue shares to the public for the first time.
- ✓ **Seasoned Equity Offerings (SEOs):** Companies that are already public issue additional shares.

ii) Raising Capital

- ✓ **Equity Financing:** Issuing shares of stock to raise capital.
- ✓ **Debt Financing:** Issuing bonds or other debt instruments.

iii) Participants

- ✓ **Issuers:** Corporations, governments, or other entities that need to raise capital.
- ✓ **Investors:** Individuals, institutional investors, mutual funds, etc., who buy the new securities.

iv) Underwriting

- ✓ **Role of Investment Banks:** Investment banks underwrite the issuance, meaning they guarantee a certain amount of capital to the issuer by purchasing the securities and then reselling them to the public.
- ✓ **Underwriting Syndicate:** A group of investment banks that share the risk and reward of underwriting a large issue.

v) Pricing of Securities

- ✓ **Fixed Price Offer:** The price at which the securities will be sold is determined beforehand.
- ✓ **Book Building Process:** Investors bid for the shares, and the final price is determined based on these bids.

vi) Regulatory Framework

- ✓ **Prospectus:** Issuers must provide a detailed prospectus that discloses financial information, risks, and other important details.
- ✓ **Securities and Exchange Commission (SEC):** In the United States, the SEC regulates the issuance of securities to protect investors.

b) Secondary Market

A secondary market is a market in which the purchase and sale of securities which are already issued to the public for the first time and listed on the stock exchange takes place. Therefore, secondary markets are called stock exchanges and the over-the-counter market. When the securities are transferred from the first holder to another, the securities are said to be traded in the secondary market.

Features of a Secondary Market:

- i) Liquidity:** The secondary market provides liquidity to investors, allowing them to buy and sell securities quickly and easily. This liquidity ensures that assets can be converted into cash with minimal price impact.
- ii) Price Discovery:** Prices in the secondary market are determined by supply and demand dynamics. This price discovery mechanism reflects the collective information, expectations, and sentiments of all market participants.
- iii) Trading Volume:** The secondary market typically exhibits high trading volumes. This high volume indicates market depth, meaning there are many buyers and sellers, which helps to stabilize prices and reduce volatility.
- iv) Market Efficiency:** Secondary Markets tend to be more efficient compared to primary markets. Information is rapidly disseminated and reflected in security prices, leading to fewer opportunities for arbitrage.
- v) Regulation and Transparency:** Secondary Markets are usually subject to regulatory oversight to ensure fair trading practices, protect investors, and maintain market integrity. Regulations require transparency in trading activities, including the disclosure of trade prices and volumes.

vi) **Variety of Instruments:** The secondary market includes a wide range of financial instruments beyond just stocks and bonds. This variety allows investors to diversify their portfolios and manage risk more effectively.

2.21 Difference between Primary Market and Secondary Market

Basis	Primary Market	Secondary Market
Meaning	A market in which securities are sold for the first time is known as a Primary Market.	A market in which the sale and purchase of newly issued securities and second-hand securities are made is known as a Secondary Market.
Types of Securities	In the primary market, the sale of new securities takes place.	In the secondary market, the sale and purchase of existing or second-hand securities take place.
Issued by	In the primary market, the securities and bonds are directly issued by companies.	In the secondary market, the securities and bonds are transferred between the investors only.
Capital Formation	A primary market directly contributes to the capital of a company as it involves the transfer of funds from surplus units to deficit units.	A secondary market indirectly contributes to the capital of a company as it involves an exchange of funds between surplus units only.
Entry	The companies enter a primary market for raising capital for their operations.	The securities of listed companies only are bought and sold in this market.
Geographical Location	There is no fixed geographical location of a primary market. Every bank, institution, foreign investor, etc., contribute to this market.	There is a fixed geographical location of a secondary market and it also has fixed working hours.
Price	The price of securities in a primary market is fixed by the management of the company issuing them.	The price of securities in a secondary market is fixed by the demand and supply of the stock exchange market.

2.22 SEBI

SEBI (Securities and Exchange Board of India) is India's primary regulator for the securities market, established to protect investors, promote market development, and regulate trading activities, essentially acting as the watchdog for Indian stock markets to ensure fairness, transparency, and prevent malpractices like insider trading. It's a statutory body under the Ministry of Finance, giving it quasi-legislative, quasi-judicial, and quasi-executive powers to oversee brokers, mutual funds, and companies.

2.23 Key Functions & Objectives

i) Investor Protection:

Safeguards investors from unfair practices, provides accurate information, and educates them.

ii) Market Regulation:

Sets rules for intermediaries (brokers, merchant bankers) and regulates company takeovers, mutual funds, and stock exchanges.

iii) Market Development:

Promotes growth and efficiency, introducing reforms like electronic settlements (T+1).

iv) Prohibits Malpractice:

Bans price manipulation, insider trading, and fraudulent activities.

2.24 Role of SEBI (Securities and Exchange Board of India)

SEBI is the regulatory authority for India's securities market. Its main roles are:

i) Protecting investors

- ✓ Safeguards investors from fraud and unfair practices
- ✓ Ensures transparency and proper disclosure by companies

ii) Regulating the securities market

- ✓ Oversees stock exchanges, brokers, mutual funds, and other intermediaries
- ✓ Frames rules and guidelines for smooth functioning of markets

iii) Promoting market development

- ✓ Encourages growth of capital markets
- ✓ Introduces reforms to improve efficiency and innovation

iv) Preventing unfair practices

- ✓ Checks insider trading, price manipulation, and market abuse
- ✓ Takes action against violators

v) Registering and monitoring intermediaries

- ✓ Registers brokers, merchant bankers, portfolio managers, etc.
- ✓ Monitors their activities to ensure compliance

vi) Educating investors

- ✓ Promotes investor awareness and financial literacy

Check Your Progress

Choose the Correct Answer:

1. Which of the following is a primary function of a merchant banker?

- A) Accepting deposits from the public
- B) Providing loans to farmers
- C) Managing new issues of shares
- D) Regulating the stock market

Answer: C) Managing new issues of shares

2. Issue management by a merchant banker involves:

- A) Auditing company accounts
- B) Planning, promoting, and managing new securities issues
- C) Collecting taxes
- D) Providing personal loans

Answer: B) Planning, promoting, and managing new securities issues

3. Underwriting in the context of new issues means:

- A) Auditing financial statements
- B) Guaranteeing subscription to a share or debenture issue
- C) Selling insurance policies
- D) Providing legal advice to companies

Answer: B) Guaranteeing subscription to a share or debenture issue

4. Which of the following is a service provided by a merchant banker?

- A) Portfolio management
- B) Stock exchange regulation

- C) Foreign trade management
- D) Real estate brokerage

Answer: A) Portfolio management

5. The primary objective of the capital market is to:

- A) Facilitate long-term funds for businesses
- B) Provide short-term loans to farmers
- C) Regulate the banking system
- D) Control government expenditures

Answer: A) Facilitate long-term funds for businesses

6. SEBI was established mainly to:

- A) Provide loans to companies
- B) Regulate and develop the securities market and protect investors
- C) Collect taxes from companies
- D) Issue government bonds

Answer: B) Regulate and develop the securities market and protect investors

7. Which of the following is NOT a function of SEBI?

- A) Regulating stock exchanges
- B) Protecting investor interests
- C) Issuing company shares directly
- D) Promoting capital market development

Answer: C) Issuing company shares directly

8. Merchant bankers are required to get registered with:

- A) RBI
- B) SEBI
- C) Stock Exchange
- D) Ministry of Finance

Answer: B) SEBI

9. Managing of new issues by merchant bankers includes:

- A) Drafting prospectus and marketing the issue
- B) Granting bank loans
- C) Conducting company audits
- D) Printing currency notes

Answer: A) Drafting prospectus and marketing the issue

10. Which type of capital market deals with long-term finance?

- A) Money market
- B) Secondary market
- C) Primary market
- D) Commodity market

Answer: C) Primary market

Small Questions – LOCF Mapping Table

S.No	Small Question	CO	Bloom's Level	PO
1	What is merchant banking?	CO1	Remember	PO1
2	List the main functions of a merchant bank.	CO1	Remember	PO1
3	What is issue management in merchant banking?	CO2	Understand	PO2
4	Explain the concept of underwriting in the capital market.	CO2	Understand	PO2
5	What is the role of SEBI in regulating merchant banking activities?	CO3	Remember	PO3

Big Questions – LOCF Mapping Table

S.No	Big Question	CO	Bloom's Level	PO
1	Explain the concept of merchant banking and its importance in financial markets.	CO1	Understand	PO1
2	Discuss the main functions of a merchant bank with examples.	CO1	Analyze	PO1
3	Explain the process of issue management and managing new issues by merchant banks.	CO2	Analyze	PO2
4	Describe underwriting in the capital market and its significance.	CO2	Understand	PO2
5	Explain the role of SEBI in regulating merchant banking and protecting investors.	CO3	Evaluate	PO3

UNIT – III

Structure:

3.1 Leasing

3.2 Meaning of Leasing

3.3 Definitions of Leasing

3.4 Evolution of Leasing

3.5 Features of Leasing

3.6 Types of Leasing

3.7 Advantages of Leasing

3.8 Disadvantages of Leasing

3.9 Hire Purchase

3.10 Meaning of Hire Purchase

3.11 Definitions of Hire Purchase

3.12 Evolution of Hire Purchase

3.13 Features of Hire Purchase:

3.14 Hire Purchase in India:

3.15 Difference between Hire Purchasing and Leasing

3.1 Leasing

A Lease occurs when an asset owned by one party (the lessor) is rented to another (the lessee) for a predetermined amount of time. Despite not becoming the owner, the lessee makes recurring payments to use the asset. Lessees can utilize assets without having to pay for them upfront when they lease them. Property, machinery, automobiles, and technology are examples of common leased assets. To give both parties flexibility based on their needs, leasing agreements might vary in length, conditions, and terms.

The working of Leasing is as follows:

- ✓ **Selection of Asset:** The lessee selects the asset they wish to use from the lessor. This could include equipment, machinery, vehicles, real estate, or other tangible assets.
- ✓ **Negotiation of Lease Terms:** The lessor and lessee negotiate the terms of the lease agreement, including the lease duration, rental payments, and any additional terms or conditions.
- ✓ **Periodic Rental Payments:** The lessee makes periodic rental payments to the lessor for the use of the asset. These payments are typically made monthly or quarterly and are determined based on factors, such as the value of the asset, the lease duration, and any associated costs or fees.
- ✓ **Use of the Asset:** The lessee has the right to use the asset for the duration of the lease term, subject to the terms and conditions outlined in the lease agreement.
- ✓ **Maintenance and Insurance:** Depending on the terms of the lease agreement, the lessee may be responsible for maintaining and insuring the leased asset during the lease term.

✓ **End of Lease Options:** At the end of the lease term, the lessee typically has three options:

- **Renew the Lease:** The lessee may have the option to renew the lease for an additional period, subject to negotiation with the lessor.
- **Return the Asset:** The lessee can return the asset to the lessor at the end of the lease term.
- **Purchase the Asset:** In some lease agreements, the lessee may have the option to purchase the asset from the lessor at a predetermined price, often referred to as the residual value.

3.2 Meaning of Leasing

Leasing means an arrangement where one person or company (**the lessor**) allows another person or company (**the lessee**) to use an asset—such as a house, land, car, or equipment—for a fixed period of time in return for regular payments called **rent or lease payments**.

In simple words:

Leasing = **using something you don't own by paying for it over time**

Example:

- ✓ Renting a house
- ✓ Using a car from a company for monthly payments
- ✓ Using machinery for a business without buying it

3.3 Definitions of Leasing

According to Philip Kotler: “Leasing is a contractual arrangement whereby one party (the lessor) grants another party (the lessee) the right to use an asset in return for periodic payments.”

According to Weston and Brigham: “A lease is a contract whereby the owner of an asset grants the right to use the asset to another party for a specified period in exchange for rental payments.”

According to J.C. Van Horne: “Leasing is a form of financing whereby the lessee acquires the right to use an asset without owning it, in return for lease rentals.”

According to the Equipment Leasing Association: “Leasing is a process by which a firm can obtain the use of a certain fixed asset for which it must pay a series of contractual, periodic, tax-deductible payments.”

3.4 Evolution of Leasing

The evolution of leasing traces a path from ancient, informal arrangements for land and equipment use to a modern, sophisticated financial industry driven by technology, regulatory changes, and a focus on flexible asset utilization and sustainability.

i) Ancient Origins and Early Use

The core concept of leasing—separating asset ownership from its use in exchange for periodic payments—dates back thousands of years.

- ✓ **Ancient Civilizations (c. 2000 BCE):** Evidence from ancient Sumeria and Babylonia shows agricultural tools, land, and livestock were leased, with the Code of Hammurabi including laws governing these practices.
- ✓ **Middle Ages:** Feudal lords leased land to peasants for a share of crops, while maritime leasing (chartering ships) was common for trade expeditions.
- ✓ **Industrial Revolution:** The need for expensive heavy machinery spurred the growth of modern equipment leasing. Specialized leasing companies and financial institutions emerged to help businesses acquire assets without large upfront investments.

ii) The 20th Century: Formalization and Growth

The 20th century saw leasing transform into a major, structured financial service, often influenced by tax laws and new asset classes.

- ✓ **Early 1900s:** The rise of automobiles and aircraft led to the development of vehicle and aviation leasing. Manufacturers used installment sales, which were later sold to banks, a precursor to receivables financing.
- ✓ **Mid-Century Boom (1950s-1970s):** Favorable tax laws, such as accelerated depreciation and the Investment Tax Credit (ITC) in the US, made leasing an attractive option for businesses. The **US Leasing Corporation** was established in 1954 as the first general equipment leasing company of its kind. In 1963, a ruling allowed national banks to enter the leasing business, further boosting the industry.
- ✓ **Late 20th Century:** The rapid pace of technological advancement, particularly in computers and IT equipment, made leasing an ideal solution for companies needing to regularly upgrade technology without the risk of obsolescence.

iii) Modern Era: Technology and Regulation

The 21st century is defined by the integration of technology, significant regulatory shifts, and a focus on flexibility and sustainability.

- ✓ **Regulatory Shifts:** The introduction of new accounting standards like **IFRS 16** (internationally) and **ASC 842** (in the US) fundamentally changed how companies report leases, requiring most to be placed on the balance sheet to ensure greater transparency.
- ✓ **Technological Integration:** Digital platforms, AI, and data analytics have streamlined lease management, from initial contract signing to end-of-lease processes.

- ✓ **New Trends:** Modern leasing has diversified beyond traditional equipment into real estate, software, and even renewable energy assets (e.g., solar panels, electric vehicles). The emphasis is on flexibility, subscription models, and aligning with environmental, social, and governance (ESG) goals.

Today, leasing is a vital, globally recognized financial tool that allows businesses to manage cash flow, adapt to changing needs, and acquire essential assets without the burdens of outright ownership.

3.5 Features of Leasing

i) Flexibility:

Terms and payment schedules for leasing can be adjusted to meet the specific needs of both lessors and lessees. Conditions can be adjusted to accommodate funding constraints, project timelines, or equipment lifecycles.

ii) Capital Preservation:

By avoiding the significant down payments typically needed when buying items, leasing enables enterprises to save their money. This guarantees that money will be available for investments or other business endeavours.

iii) Access to Cutting-Edge Technology:

By removing the obligations linked with ownership, leasing provides access to the newest machinery and technology. This eliminates the need for ongoing capital investments and allows enterprises to use cutting-edge machinery and technologies to stay competitive.

iv) Tax Benefits:

Depending on the regulations and terms of the lease, there may be tax benefits associated with leasing. A company's taxable income is reduced by the fact that lease payments are frequently deductible as operating expenditures.

v) Optimising Balance Sheets:

By using operating leases, companies can remove leased assets from their balance sheets. Financial ratios may be enhanced, and borrowing may become simpler, as a result.

vi) Maintenance and Support:

Lease agreements may specify that the lessor will pay for upkeep, repairs, and other expenses about the leased property. This absolves the lessee of these additional costs and obligations.

vii) Smarter Asset Management:

Leasing enables companies to manage their assets effectively. At the end of the lease, they may simply update, replace, or get rid of them, saving them the trouble of ownership.

viii) Decreased Risks:

Leasing helps lower the risks associated with asset ownership, such as the possibility of depreciation, obsolescence, or changes in the market. Businesses that lease the assets benefit from more stability because lessors frequently assume some of these risks.

3.6 Types of Leasing

i) Operating Lease:

Under an operating lease, the lessor maintains ownership of the real estate. Like a rental agreement, its duration is usually shorter. These types of leases are typical for machinery that needs to be updated or altered frequently.

ii) Capital Lease (Capital Lease):

In a finance lease, the tenant receives most ownership rights and benefits. A financing lease, in contrast to an operational lease, is often longer in duration and looks more like a purchase agreement. Insurance, asset upkeep, and other costs are usually covered by the renter.

iii) Sale and Leaseback:

In a sale and leaseback, businesses can sell a piece of equipment to a lessor and then lease the item back to them for ongoing usage. This releases the asset's capital. Financing for equipment and real estate is a common usage for this arrangement.

iv) Single Investor Lease:

Here, the lease is financed by a single lessor. This is typically applied to large-scale assets and infrastructure initiatives for which the necessary funding can be provided by a single investor.

v) Leveraged Lease:

A leveraged lease involves three parties: a lender, the lessee (the person who uses the asset), and the lessor (the person who owns the asset). The lessor can pay for a portion of the asset's cost thanks to a loan from the lender. The lessor can purchase the asset with a lower down payment and less equity commitment if they borrow a portion of the cash.

Other types of leasing:

i) First Amendment Lease:

The first amendment lease gives the lessee a purchase option at one or more defined points with a requirement that the lessee renew or continue the lease if the purchase option is not exercised. The option price is usually either a fixed price intended to approximate fair market

value or is defined as fair market value determined by lessee appraisal and subject to a floor to insure that the lessor's residual position will be covered if the purchase option is exercised.

ii) Full Payout Lease:

A lease in which the lessor recovers, through the lease payments, all costs incurred in the lease plus an acceptable rate of return, without any reliance upon the leased equipment's future residual value.

iii) Guideline Lease:

A lease written under criteria established by the IRS to determine the availability of tax benefits to the lessor.

iv) Net Lease:

A lease wherein payments to the lessor do not include insurance and maintenance, which are paid separately by the lessee.

v) Open-end Lease:

A conditional sale lease in which the lessee guarantees that the lessor will realize a minimum value from the sale of the asset at the end of the lease.

vi) Sales-type Lease:

A lease by a lessor who is the manufacturer or dealer, in which the lease meets the definitional criteria of a capital lease or direct financing lease.

vii) Synthetic Lease:

A synthetic lease is basically a financing structured to be treated as a lease for accounting purposes, but as a loan for tax purposes. The structure is used by corporations that are seeking off-balance sheet reporting of their asset based financing, and that can efficiently use the tax benefits of owning the financed asset.

viii) Tax Lease:

A lease wherein the lessor recognizes the tax incentives provided by the tax laws for investment and ownership of equipment. Generally, the lease rate factor on tax leases is reduced to reflect the lessor's recognition of this tax incentive.

ix) True Lease:

A type of transaction that qualifies as a lease under the Internal Revenue Code. It allows the lessor to claim ownership and the lessee to claim rental payments as tax deductions.

3.7 Advantages of Leasing

i) Save Money:

Leasing enables companies to acquire equipment without having to pay a large sum of money all at once. This implies that they have more money to spend on other expenses or make investments.

ii) Acquire the Best Tools:

By leasing, companies may afford to acquire the newest and greatest tools without having to pay for them upfront. They can outperform the competitors and operate more effectively as a result.

iii) Be Adaptable:

Lease agreements can be tailored to a company's exact requirements, including length of lease, payment schedule, and termination clause.

iv) Tax Savings:

Since rental charges are typically included in operational expenditures, they might help reduce a company's taxable income. Certain leasing agreements also provide tax benefits, such as the ability to remove the financing from the balance sheet or accelerate depreciation.

v) Lower hazards:

Leasing helps lower the hazards that come with owning assets like value decreases, outmoded technology, and shifts in the market. Some of these hazards can be assumed by lessors, providing renters with greater security and stability.

vi) Asset Management Streamlining:

By assigning maintenance, repairs, and upgrades to the lessor, leasing assists companies in managing their property and equipment. Businesses can easily return or update the asset after the lease expires, saving them the trouble of having to dispose of it.

vii) Faster Approval Process:

Compared to other funding options, lease financing frequently offers a quicker approval process. This makes it possible for companies to quickly acquire necessary resources, reducing downtime and increasing output.

viii) Protect Against Inflation:

Because lease payments are fixed for the duration of the agreement, leasing provides insurance against growing costs. Because of this stability, businesses can more readily plan their budgets and maintain financial stability even in unpredictable economic times.

3.8 Disadvantages of Leasing

i) Concerns On Total Cost:

Over time, leasing may prove to be more expensive than purchasing. This is so that lessees don't acquire ownership or stock in the asset. Rather, they're only paying to use it for a short time.

ii) Lack of Ownership:

When lessees lease something, they don't own it. Lessees will not own the asset at the end of the lease, nor will they receive any financial benefit from its worth.

iii) Payment Obligations:

Regardless of whether the leased item is underutilised or performs poorly, lessees are required by lease agreements to make monthly payments over the lease term. If the lessee experiences cash flow problems or the asset ages out of date, this could put pressure on their finances.

iv) Limited Adaptability:

Restrictions and limitations, such as usage restrictions for equipment or mileage limits for automobiles, are commonly included in lease agreements. These limitations may make it more difficult for the lessee to adapt to changing operational requirements or commercial needs.

v) Hidden Fees in Lease Agreements:

In addition to the monthly rent, leases may contain other costs. These can include upkeep and maintenance payments, insurance to guard against damage, early termination penalties, and fees for using the rented item beyond what is permitted. For this reason, it is essential to carefully go over the lease to identify all possible expenses and obligations.

vi) Lessees' Risk of Depreciation:

The lessor is often in charge of the asset's depreciation in finance leases. Lessees may still incur losses, though, if the asset's value drastically drops over time. Lessee's expectations on using the asset and receiving a return on investment may be lowered as a result.

vii) Return of Leased Asset:

Taking into account typical wear and tear, lessees are required to return leased assets in good condition after the lease. Penalties or additional costs could result from returning the object outside of the required condition.

viii) Restricted Control:

Because the lessor retains ownership and decision-making authority over leased assets, lessees' control over them is restricted. This restricted power may make it more difficult for the lessee to modify the asset to suit their requirements or tastes.

3.9 Hire Purchase

Hire purchase is a method of purchasing goods in which a buyer obtains the right to use the goods immediately by paying a part of the total price upfront, known as a **down payment**, and agrees to pay the remaining balance in **fixed installments** over a specified period of time. Although the buyer has possession and use of the goods from the beginning, **legal ownership remains with the seller** until the final installment is paid.

This system is commonly used for buying **high-value goods** such as motor vehicles, machinery, furniture, and electronic appliances. The total hire purchase price is usually higher than the cash price because it includes **interest** charged on the outstanding balance.

Under hire purchase, if the buyer fails to pay the installments as agreed, the seller has the legal right to **repossess the goods**. Once all installments are paid, ownership of the goods is automatically transferred to the buyer without any further payment.

Hire purchase benefits buyers by allowing them to spread the cost of expensive items over time, while sellers benefit by earning interest and increasing sales. However, buyers must

be careful to meet payment obligations, as failure to do so may result in loss of the goods and payments already made.

The working of Hire Purchasing is as follows:

- ✓ **Selection of Asset:** The hirer chooses the asset they wish to acquire and negotiates the terms of the hire purchase agreement with the seller.
- ✓ **Initial Payment:** The hirer pays an initial deposit or down payment, which is usually a percentage of the total purchase price.
- ✓ **Installment Payments:** The remaining purchase price is divided into equal installments to be paid over a specified period, typically monthly or quarterly.
- ✓ **Use of the Asset:** While the hirer makes installment payments, they have the right to use the asset for their business or personal use.
- ✓ **Ownership Transfer:** Ownership of the asset remains with the seller until the final installment is paid. Once all installments, including any interest charges, are completed, ownership of the asset transfers to the hirer.
- ✓ **Legal Obligations:** Throughout the hire purchase agreement, the hirer is legally obligated to make timely payments according to the terms of the agreement. Failure to make payments can result in repossession of the asset by the seller.

3.10 Meaning of Hire Purchase

Hire purchase means a transaction where goods are purchased and sold on the terms that:

- ✓ Payment will be made in installments,
- ✓ The possession of the goods is given to the buyer immediately,
- ✓ The property (ownership) in the goods remains with the vendor till the last installment is paid,

- ✓ The seller can repossess the goods in case of default in payment of any installment, and
- ✓ Each installment is treated as hire charges till the last installment is paid.

Hire purchase is a system of buying goods in which a person takes possession of the goods immediately and agrees to pay the total price in installments over a period of time, while ownership of the goods is transferred only after the final installment is paid.

3.11 Definitions of Hire Purchase

According to L. D. S. Merchant: "Hire purchase is a contract whereby the buyer pays for goods in installments and becomes the owner only when the last installment is paid."

According to Avtar Singh: "Hire purchase is a contract in which the seller lets the buyer take possession of goods on payment of an initial deposit, with the balance paid in installments, and ownership passes only after the full payment is made."

According to R. S. Sayers: "Hire purchase is a system under which the purchaser hires goods from the seller and agrees to buy them by paying in installments, the ownership remaining with the seller until the last installment is paid."

3.12 Evolution of Hire Purchase

Hire purchase, as a concept, evolved gradually over time to meet the growing needs of consumers and businesses for purchasing expensive goods without paying the full amount upfront. Its evolution can be divided into several stages:

i) Early Beginnings (Mid-19th Century)

- ✓ The idea of hire purchase first appeared in **Britain** around the **mid-1800s**.
- ✓ Initially, it was used for **household goods, sewing machines, furniture, and other durable items**.

- ✓ Customers who could not afford the cash price could **hire the goods and pay in small amounts**, usually weekly or monthly.
- ✓ Ownership of goods remained with the seller until full payment was made.
- ✓ At this stage, the system was mostly **informal**, based on **trust** between the seller and the buyer.

ii) Legal Recognition and Formalization (Late 19th – Early 20th Century)

- ✓ As installment buying grew popular, there was a need for **formal legal agreements** to protect buyers and sellers.
- ✓ Contracts were standardized to include:
 - **Down payment** or deposit.
 - **Installment schedule.**
 - **Conditions of ownership transfer** (only after the last installment).
- ✓ The **Hire-Purchase Act 1904** in the UK was one of the earliest laws regulating hire purchase transactions.
- ✓ This period established the **legal foundation** of hire purchase and made it safer for both parties.

iii) Expansion and Industrial Adoption (Early to Mid-20th Century)

- ✓ Hire purchase became increasingly popular in industries with **high-value goods**:
 - Automobiles, machinery, and electrical appliances.
- ✓ Large companies, such as **Ford Motors**, introduced hire purchase schemes in the 1920s to make cars affordable to middle-class customers.
- ✓ Financial institutions and banks began offering **hire purchase loans** to support businesses and consumers.

- ✓ This helped in **industrial growth**, as more people could buy machinery and vehicles without paying large sums upfront.

iv) Modern Hire Purchase (Late 20th Century – Present)

- ✓ Today, hire purchase is a **fully regulated financial system** in most countries.
- ✓ Modern hire purchase agreements include:
 - **Principal amount and interest rate.**
 - **Insurance and maintenance clauses** (especially for vehicles).
 - **Repossession terms** if installments are not paid.
- ✓ It is widely used for **cars, industrial equipment, electronics, and furniture.**
- ✓ Legal systems ensure both **consumer protection** and **seller rights**, making hire purchase a safer and more reliable method of financing.

3.13 Features of Hire Purchase:

The main features of a hire purchase agreement are as below:

- ✓ The payment is to be made by the hirer (buyer) to the hiree, usually the vendor, in installments over a specified period of time.
- ✓ The possession of the goods is transferred to the buyer immediately.
- ✓ The property in the goods remains with the vendor (hiree) till the last installment is paid. The ownership passes to the buyer (hirer) when he pays all installments.
- ✓ The Hiree or the vendor can repossess the goods in case of default and treat the amount received by way of installments as hire charged for that period.
- ✓ The installments in hire purchase include interest as well as repayments of principal.
- ✓ Usually, the hiree charges interest on flat rate.

3.14 Hire Purchase in India:

Hire purchase (HP) in India is a popular method to buy expensive goods (like vehicles, appliances) by paying a down payment and then installments, with ownership transferring only after the last payment, making it a bailment with an option to buy, governed by the **Hire Purchase Act, 1972**, differing from immediate installment sales where ownership transfers sooner. It allows spreading costs, gives the buyer possession but not ownership initially, and lets the seller repossess the item on default.

Key Features

- ✓ **Bailment with Option:** It's a contract where goods are hired (bailed) with the *option* to purchase, not a direct sale.
- ✓ **Possession vs. Ownership:** The buyer (hirer) gets possession immediately but remains a bailee; the seller (owner) retains legal title until all installments are paid.
- ✓ **Installments:** An initial deposit is made, followed by regular payments covering principal, interest, and charges.
- ✓ **Default & Repossession:** If payments stop, the seller can repossess the goods, and the hirer can often terminate the agreement.
- ✓ **Transfer of Ownership:** Property (ownership) passes to the hirer only after the final installment (hire-purchase price) is fully paid.

How it Works in India

- ✓ **Agreement:** Buyer signs an HP agreement, pays a deposit, and takes the goods (e.g., a car).
- ✓ **Payments:** Buyer pays monthly installments (hire charges).

- ✓ **Ownership Transfer:** Once the *last* installment is cleared, ownership officially transfers from the seller to the buyer.
- ✓ **Governing Law:** The **Hire Purchase Act, 1972** controls these agreements in India, offering specific rights and obligations.

Hire Purchase vs. Installment Sale

- ✓ **HP:** Seller retains ownership until final payment; buyer has the right to return goods; default allows repossession.
- ✓ **Installment Sale:** Ownership transfers to the buyer upfront (or soon after) with the first payment; buyer is the owner from the start.

The following illustration explains the method of split of hire purchase installment into interest and principal repayments:

Illustration 1: A company purchased an equipment costing Rs. 5,00,000 on hire purchase basis payable in 4 equal year end installments of Rs. 2,05,000 each. Split of the Installments into interest and principal repayments.

Solution:

In the above Illustration, the total amount payable is Rs. 8,20,000-5,00,000.

The interest can be allocated as below:

Instalment 1	$3,20,000 \times \frac{1}{100}$	₹ 1,28,000	
Instalment 2	$3,20,000 \times \frac{2}{100}$	₹ 96,000	
Instalment 3	$3,20,000 \times \frac{3}{100}$	₹ 64,000	
Instalment 4	$3,20,000 \times \frac{4}{100}$	₹ 32,000	
Split of H.P. Instalment can be computed as below :			
Year	H.P. Instalment (₹)	Interest (₹)	Repayment (₹)
1	2,05,000	1,28,000	77,000
2	2,05,000	96,000	1,09,000
3	2,05,000	64,000	1,41,000
4	2,05,000	32,000	1,73,000

3.15 Difference between Hire Purchasing and Leasing

Basis	Hire Purchasing	Leasing
Meaning	Hire Purchasing involves acquiring an asset through a series of installment payments over a specified period.	Leasing involves renting an asset from the owner (lessor) for a specified period in exchange for periodic payments.
Duration	Duration of hire purchasing are longer months to years.	Duration of leasing are shorter and customizable.
Ownership Transfer	In hire purchasing, the buyer gets ownership of the asset after completing paying installments.	In leasing, the owner remains the same throughout the lease period.
Payment Structure	With hire purchasing, the buyer pays installments until they own the asset.	In leasing, the lessee makes regular payments to use the asset for a set time.
Maintenance and Insurance	In hire purchasing, the buyer is responsible for maintenance and insurance.	In leasing, the owner usually handles maintenance and upkeep.
Flexibility	Hire purchasing terms are often fixed once agreed upon, offering less flexibility.	Leasing is more flexible; lessees can often change terms or upgrade assets.
Tax Treatment	Interest portion of hire purchase payments may be eligible for tax deductions as a business expense.	Lease payments may be treated as operating expenses and deducted from taxable income.
End of Term Options	With hire purchasing, ownership is gained, and no more payments are needed.	Leasing allows options like buying, returning, or renewing the lease at the end.
Risk Exposure	In hire purchasing, the buyer takes on the risk of asset depreciation or damage.	In leasing, the owner retains ownership and risk.
Contract Termination	Hirer purchase can terminate before ownership (subject to fees).	Breaking a lease can have legal consequences.

Check Your Progress

Choose the Correct Answer:

1. In a lease, the ownership of the asset is:

- A) Immediately with lessee
- B) With lessor
- C) Shared equally
- D) Not defined

Answer: B) With lessor

2. Which type of lease involves long-term use and lessee bears most risks?

- A) Operating lease
- B) Finance lease
- C) Service lease
- D) Short-term lease

Answer: B) Finance lease

3. One of the main advantages of leasing is:

- A) Immediate ownership
- B) Preserves capital
- C) No periodic payments
- D) Reduced asset cost

Answer: B) Preserves capital

4. Hire Purchase is governed in India by:

- A) Companies Act, 2013
- B) Hire Purchase Act, 1972

- C) Indian Contract Act, 1872
- D) Income Tax Act, 1961

Answer: B) Hire Purchase Act, 1972

5. In hire purchase, ownership of goods is transferred:

- A) Immediately on signing
- B) After last installment
- C) After half installments
- D) Only if lessee requests

Answer: B) After last installment

6. Which of the following is a disadvantage of leasing?

- A) Risk of ownership
- B) High long-term cost
- C) Immediate asset ownership
- D) Encourages consumption

Answer: B) High long-term cost

7. A short-term lease where lessor bears risks is called:

- A) Finance lease
- B) Operating lease
- C) Hire purchase
- D) Capital lease

Answer: B) Operating lease

8. Hire purchase differs from leasing mainly in:

- A) Periodic payments

- B) Ownership transfer
- C) Maintenance responsibility
- D) Asset type

Answer: B) Ownership transfer

9. The primary objective of hire purchase is:

- A) Rent assets temporarily
- B) Provide installment facility to buy assets
- C) Avoid paying taxes
- D) Avoid ownership responsibilities

Answer: B) Provide installment facility to buy assets

10. Which of the following is true for a finance lease?

- A) Lessor bears all risks
- B) Lease term is shorter than asset life
- C) Lessee enjoys most benefits and risks
- D) Asset is returned after lease

Answer: C) Lessee enjoys most benefits and risks

Small Questions – LOCF Mapping Table

S.No	Small Question	CO	Bloom's Level	PO
1	What is leasing and what are its key features?	CO1	Remember	PO1
2	List and explain the types of leases.	CO2	Understand	PO2
3	What are the merits and demerits of leasing?	CO2	Understand	PO2
4	Explain the concept and evolution of hire purchase.	CO3	Understand	PO3
5	Differentiate between leasing and hire purchase.	CO3	Analyze	PO3

Big Questions – LOCF Mapping Table

S.No	Big Question	CO	Bloom's Level	PO
1	Explain the concept of leasing and discuss its key features.	CO1	Understand	PO1
2	Discuss the different types of leases and their applications in business.	CO2	Analyze	PO2
3	Explain the merits and demerits of leasing for businesses and investors.	CO2	Evaluate	PO2
4	Describe the concept, evolution, and features of hire purchase.	CO3	Understand	PO3
5	Compare and contrast leasing and hire purchase with suitable examples.	CO3	Analyze	PO3

UNIT – IV

Structure:

4.1 Introduction to Venture Capital

4.2 Origin/History of Venture Capital

4.3 Meaning of Venture Capital

4.4 Definitions of Venture Capital

4.5 How Does a Venture Capital Fund Work?

4.6 Who is a Venture Capitalist (VC)?

4.7 Characteristics of Venture Capital

4.8 Features of Venture Capital

4.9 Types of Venture Capital

4.10 Benefits of Venture Capital Funding

4.11 Challenges in Venture Capital Funding

4.12 Growth of Venture Capital in India

4.13 Methods or Modes of Venture Financing (Funding Pattern)/Dimensions of Venture Capital

4.14 Stages of Venture Capital Financing

4.15 Legal Aspects of Venture Capital

4.16 Guidelines for the Venture Capital Companies

4.1 Introduction to Venture Capital

There are some businesses that involve higher risks. In the case of newly started business, the risk is more. The new businesses may be promoted by qualified entrepreneurs. They lack necessary experience and funds to give shape to their ideas. Such high risk, high return ventures

are unable to raise funds from regular channels like banks and capital markets. Generally people would not like to invest in new high risk companies. Some people invest money in such new high risk companies. Even though the risk is high, there is a potential of getting a return of ten times more in less than five years. The investors making such investments are called venture capitalists. The money invested in new, high risk and high return firms is called venture capital. Venture capitalists not only provide money but also help the entrepreneur with guidance in formalizing his ideas into a viable business venture. They get good return on their investment. The percentage of the profits the venture capitalists get is called the carry.

Venture Capital Funding is a source of financing primarily used by startups and early-stage companies to raise capital for growth and development. Venture Capital investors typically participate in management and help the young company's executives in making decisions to drive growth. Venture capital investors get equity or any other ownership stake in the start-ups in exchange for their funds.

4.2 Origin/History of Venture Capital

In the 1920's and 1930's, the wealthy families of individual investors provided the start-up money for companies that would later become famous. Eastern Airlines and Xerox are the more famous ventures they financed. Among the early VC fund set-ups was the one by the Rockefeller family which started a special fund called Venrock in 1950, to finance new technology companies. General Georges Doriot (the father of venture capital), a professor at Harvard Business School, in 1946 set up the American Research and Development Corporation (ARD). ARD's approach was a classic VC in the sense that it used only equity, invested for long term. ARD's investment in Digital Equipment Corporation (DEC) in 1957 was a watershed in the history of VC financing. While in its early years VC may have been associated with high

technology, over the years, the concept has undergone a change and, as it stands today, it implies pooled investment to unlisted companies.

4.3 Meaning of Venture Capital

The term venture capital comprises of two words, namely, 'venture' and 'capital'. The term 'venture' literally means a 'course' or 'proceeding', the outcome of which is uncertain (i.e., involving risk). The term capital refers to the resources to start the enterprise. Thus venture capital refers to capital investment in a new and risky business enterprise. Money is invested in such enterprises because these have high growth potential.

A young hi-tech company that is in the early stage of financing and is not yet ready to make a public issue may seek venture capital. Such a high risk capital is provided by venture capital funds in the form of long term equity finance with the hope of earning a high rate of return primarily in the form of capital gain. In fact, the venture capitalist acts as a partner with the entrepreneur.

Venture capital is the money and resources made available to start up firms and small business with exceptional growth potential (e.g., IT, infrastructure, real estate etc.). It is fundamentally a long term risk capital in the form of equity finance for the small new ventures which involve risk. But at the same time, it has the strong potential for the growth. It thrives on the concept of high risk high return. It is a means of equity financing for rapidly growing private companies.

Venture capital can be visualized as 'your ideas and our money' concept of developing business. It is 'patient' capital that seeks a return through long term capital gain rather than immediate and regular interest payments as in the case of debt financing.

When venture capitalists invest in a business, they typically require a seat on the company's board of directors. But professional venture capitalists act as mentors and provide support and advice on a number of issues relating to management, sales, technology etc. They assist the company to develop its full potential. They help the enterprise in the early stage until it reaches the stage of profitability. When the business starts making considerable profits and the market value of the shares go up to considerable extent, venture capitalists sell their equity holdings at a high value and thereby make capital gains.

In short, venture capital means the financial investment in a highly risk project with the objective of earning a high rate of return.

4.4 Definitions

According to Paul A. Gompers & Josh Lerner “Venture capital is professionally managed equity investment in young, high-growth companies with high risk and high return potential”.

According to William A. Sahlman “Venture capital refers to financial investments made by specialized firms in early-stage companies, where investors also provide strategic and managerial support”.

According to European Venture Capital Association (EVCA) (now Invest Europe) “Venture capital is a form of private equity focused on investing in innovative, fast-growing companies at early stages of development”.

According to National Venture Capital Association (NVCA) “Venture capital is investment in startup and small businesses with long-term growth potential, typically in exchange for equity ownership”.

According to Andrew Metrick & Ayako Yasuda “Venture capital involves pooled investment funds that acquire ownership stakes in private companies with the aim of exiting profitably through acquisition or public offering”.

According to William D. Bygrave & Jeffrey A. Timmons “Venture capital is risk capital invested in new ventures that show strong potential for rapid growth and competitive advantage”.

4.5 How Does a Venture Capital Fund Work?

Venture capital firms fuel innovation by providing funding to promising young companies with high growth potential. These companies are typically in industries experiencing rapid change and have the potential to disrupt existing markets. Venture capitalists (VCs) carefully assess these companies and invest in those with strong leadership and a clear path to success. In exchange for funding, VCs receive ownership stakes in the companies and work closely with them to achieve their goals.

This mutually beneficial relationship between VCs and entrepreneurs fosters invention and drives economic growth. VCs provide the resources and expertise that startups need to thrive, while entrepreneurs bring their fresh ideas and passion to the table. By working together, they can turn groundbreaking ideas into successful businesses that change the world. Venture capital examples are Sequoia Capital, Kleiner Perkins, Andreessen Horowitz, Benchmark Capital, and NEA (New Enterprise Associates).

4.6 Who is a Venture Capitalist (VC)?

Venture Capitalist (VC) is defined as an investor in private equity who lends money to companies with strong development potential in exchange for a stake in the company. A venture capital investment could include backing startup projects or assisting small businesses that want to grow but lack access to equity markets.

4.7 Characteristics of Venture Capital

The important characteristics of venture capital finance are outlined as bellow:

- ✓ It is basically equity finance.
- ✓ It is a long term investment in growth-oriented small or medium firms.
- ✓ Investment is made only in high risk projects with the objective of earning a high rate of return. In addition to providing capital, venture capital funds take an active interest in the management of the assisted firm. It is rightly said that, “venture capital combines the qualities of banker, stock market investor and entrepreneur in one”.
- ✓ The venture capital funds have a continuous involvement in business after making the investment.
- ✓ Once the venture has reached the full potential, the venture capitalist sells his holdings at a high premium. Thus his main objective of investment is not to earn profit but capital gain.

4.8 Features of Venture Capital

Venture capital differs from other sources of finance due to its very unique principles and processes. Among its foremost strengths, venture capital comes in because the investors do not just invest money; they build the business alongside the founders. The following are the most important elements:

i) High-Risk, High-Reward Approach

Investors in this space actually seek out businesses with great potential but whose outcomes are fairly uncertain. This risk appetite is quite rare in traditional financing models. This works to the advantage of startups because it gives them room to innovate without the pressure of immediate profitability, clearly reflecting the advantages and disadvantages of venture capital.

ii) Equity-Based Funding

In return for investing in a business, venture capitalists typically receive equity. As a part-owner, they are genuinely invested in helping the company be successful, since returns are made only when a startup grows, gets acquired, or goes public.

iii) Active Participation and Mentorship

Beyond capital, venture funds bring industry expertise, operational guidance, connections, and strategic inputs; to many founders, these are one of the biggest benefits of venture capital.

iv) Long-Term Growth Focus

Venture capitalists are not interested in quick wins; rather, they build value in the long term and can stay in a company for five to ten years. This gives a startup stability to test, iterate, and refine its business models for startups.

v) Staged Investment Model

Most investors follow a staged or milestone-based format, rather than offering the entire investment at once. Funding is released as the company proves progress and shows scalability. This system protects both parties and encourages disciplined growth.

vi) Strategic Influence in Decision-Making

Venture capitalists commonly take board seats or advisory roles. Such involvement guarantees founders the guidance and advice of seasoned professionals who have overcome similar challenges.

4.9 Types of Venture Capital Funds

VC funds focus on specific investment stages, aligning with a startup's growth trajectory. Here's a breakdown of the main funding stages:

i) Seed Funding: This is the earliest stage, where you have a promising idea but might still be forming a company. Seed funding helps validate your concept and develop a prototype.

ii) Early-Stage Funding (Series A, B): Now you have a minimum viable product (MVP) and initial traction. Early-stage funding helps you refine your product, build your team, and scale your customer base.

iii) Expansion/Growth Stage (Series C, D, and beyond): Your business is gaining momentum, and you need capital to expand into new markets, acquire competitors, or prepare for an Initial Public Offering (IPO).

There are other types of funding stages, VC firms often specialize in specific industries (e.g., biotech, fintech) or business models (e.g., software-as-a-service, SaaS). This industry focus allows VCs to provide valuable mentorship and connections beyond just capital. Securing Venture Capital funding can be a game-changer for your startup.

4.10 Benefits of Venture Capital Funding

i) Access to Capital: Venture capital provides startups with substantial financial resources to scale their business operations.

ii) Expertise and Guidance: Venture capitalists often bring valuable industry expertise, connections, and strategic guidance to help the startup succeed.

iii) Validation and Credibility: A venture capital investment can validate a startup's potential, enhancing its reputation and attractiveness to other investors and partners.

iv) Network Expansion: Through venture capital, startups gain access to a network of experienced entrepreneurs and professionals, which can lead to new opportunities.

v) Accelerated Growth: With sufficient funds, startups can grow rapidly and capture market share more quickly.

4.11 Challenges in Venture Capital Funding

- i) Loss of Control:** Venture capitalists typically require a significant ownership stake, leading to a loss of control for the startup's founders.
- ii) High Expectations:** VC investors often have high return expectations, which can lead to intense pressure on the startup to perform.
- iii) Long-Term Commitment:** Venture capital funding may require a long-term commitment, potentially limiting exit options for founders.
- iv) Focus on Growth Over Profitability:** VC-funded startups are often pressured to prioritise growth over profitability, which may not align with the founder's vision.
- v) Risk of Failure:** The demands and expectations of venture capitalists can be demanding, and if the startup fails to meet them, it may lead to conflicts or even closure.
- vi) Dilution of Ownership:** To secure multiple rounds of funding, founders may experience significant dilution of their ownership stake, reducing their future gains.
- vii) Selective Funding:** Not all startups are suitable for venture capital, as VCs tend to focus on high-growth, tech-oriented businesses, leaving other industries with limited options.

4.12 Growth of Venture Capital in India

In India, the venture capital plays a vital role in the development and growth of innovative entrepreneurs. Venture capital activity in the past was possibly done by the developmental financial institutions like IDBI, ICICI and state financial corporations. These institutions promoted entities in the private sector with debt as an instrument of funding.

For a long time, funds raised from public were used as a source of venture capital. And with the minimum paid up capital requirements being raised for listing at the stock exchanges, it became difficult for smaller firms with viable projects to raise funds from the public.

In India, the need for venture capital was recognised in the 7 five-year plan and long term fiscal policy of the Government of India. In 1973, a committee on development of small and medium enterprises highlighted the need to foster VC as a source of funding new entrepreneurs and technology. VC financing really started in India in 1988 with the formation of Technology Development and Information Company of India Ltd. (TDICI) – promoted by ICICI and UTI.

The first private VC fund was sponsored by Credit Capital Finance Corporation (CEF) and promoted by Bank of India, Asian Development Bank and the Commonwealth Development Corporation, namely, Credit Capital Venture Fund. At the same time, Gujarat Venture Finance Ltd. and AFIDC Venture Capital Ltd. were started by state-level financial institutions. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net worth individuals.

Venture capital (VC) in India has seen significant growth, evolving from a nascent stage (pre-2000s) into a robust ecosystem, especially post-2004, with major booms driven by tech/internet companies (fintech, SaaS, consumer tech), attracting both global and domestic funds, leading to record investments and the emergence of numerous unicorns, solidifying India's position as a top global startup hub with increasing focus on deep-tech and diverse sectors.

Key Phases & Growth Drivers:

- ✓ **Early Stages (1970s-1990s):** Initial groundwork laid, but constrained by policy; early foreign investment trickled in.
- ✓ **Post-Dot-Com (2004-2010s):** Maturity with global firms entering, focusing on growth-stage investments in IT, media, pharma, driving significant capital inflow.
- ✓ **Unicorn Era (2016-Present):** Explosion of billion-dollar startups (Byju's, Swiggy), massive capital deployment, positioning India as a top 3 global startup ecosystem.

- ✓ **Recent Resurgence (2024-2025):** Funding rebounded strongly after a dip, with increased deal volumes, particularly in small-ticket deals and megadeals, highlighting resilience and attracting global capital.

Dominant Sectors:

- ✓ **Consumer Tech & Internet:** Consistently the largest recipient of funds.
- ✓ **Fintech & SaaS:** Strong focus areas.
- ✓ **Deep-Tech:** A rapidly growing frontier, attracting substantial capital for sectors like AI, space, and climate tech.
- ✓ **Healthcare & Education:** Also key investment areas.

Key Trends:

- ✓ **Foreign Capital Dominance:** Historically driven by offshore funds, with increasing presence of domestic capital over time.
- ✓ **Rise of Domestic VCs:** Growth of local funds and entrepreneurial wealth recycling.
- ✓ **Sector Diversification:** Beyond IT, growing investments in deep-tech, fintech, and other high-potential sectors.
- ✓ **Policy Support:** Evolving regulations creating a favorable investment climate.

In essence, India's VC landscape has matured from early skepticism to a dynamic, internationally recognized market, fueled by technological adoption, strong consumer demand, and a diverse startup ecosystem, making it a critical global investment destination.

4.13 Methods or Modes of Venture Financing (Funding Pattern)/Dimensions of Venture Capital

Venture capital is typically available in four forms in India: equity, conditional loan, income note and conventional loan.

i) Equity: All VCFs in India provide equity but generally their contribution does not exceed 49 per cent of the total equity capital. Thus, the effective control and majority ownership of the firm remain with the entrepreneur. They buy shares of an enterprise with an intention to ultimately sell them off to make capital gains.

ii) Conditional loan: It is repayable in the form of a royalty after the venture is able to generate sales. No interest is paid on such loans. In India, VCFs charge royalty ranging between 2 and 15 per cent; actual rate depends on the other factors of the venture, such as gestation period, cost-flow patterns and riskiness.

iii) Income note: It is a hybrid security which combines the features of both conventional loan and conditional loan. The entrepreneur has to pay both interest and royalty on sales, but at substantially low rates.

iv) Conventional loan: Under this form of assistance, the enterprise is assisted by way of loans. On the loans, a lower fixed rate of interest is charged, till the unit becomes commercially operational. When the company starts earning profits, normal or higher rate of interest will be charged on the loan. The loan has to be repaid as per the terms of loan agreement.

v) Other financing methods: A few venture capitalists, particularly in the private sector, have started introducing innovative financial securities like participating debentures introduced by TCFC.

4.14 Stages of Venture Capital Financing

i) Early stage financing: This stage has three levels of financing. These three levels are:

(a) Seed financing: This is the finance provided at the project development stage. A small amount of capital is provided to the entrepreneurs for concept testing or translating an idea into business.

(b) Start up finance/first stage financing: This is the stage of initiating commercial production and marketing. At this stage, the venture capitalist provides capital to manufacture a product.

(c) Second stage financing: This is the stage where product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of business. Venture capital firms provide larger funds at this stage.

ii) Later stage financing: This stage of financing is required for expansion of an enterprise that is already profitable but is in need of further financial support. This stage has the following levels:

(a) Third stage/development financing: This refers to the financing of an enterprise which has overcome the highly risky stage and has recorded profits but cannot go for public issue. Hence it requires financial support. Funds are required for further expansion.

(b) Turnarounds: This refers to finance to enable a company to resolve its financial difficulties. Venture capital is provided to a company at a time of severe financial problem for the purpose of turning the company around.

(c) Fourth stage financing/bridge financing: This stage is the last stage of the venture capital financing process. The main goal of this stage is to achieve an exit vehicle for the investors and for the venture to go public. At this stage the venture achieves a certain amount of market share.

(d) Buy-outs: This refers to the purchase of a company or the controlling interest of a company's share. Buy-out financing involves investments that might assist management or an outside party to acquire control of a company. This results in the creation of a separate business by separating it from their existing owners.

4.15 Legal Aspects of Venture Capital

The legal aspects relating to venture capital in India may be briefly explained as follows:

Regulatory Structure: The SEBI regulates venture capital industry in India. It announced the regulations for the venture capital funds in 1996, with the primary objective of protecting the interest of investors and providing enough flexibility to the fund managers to make suitable investment decisions. Venture capital funds appoint an asset management company to manage the portfolio of the fund. Any company proposing to undertake venture capital investments is required to obtain certificate of registration from SEBI. Venture capital fund can invest up to 40% of the paid up capital of the invested company or up to 20% of the corpus of the fund in one undertaking. At least 80% of funds raised by VCF shall be invested in equity shares or equity related securities issued by company whose shares are not listed on recognised stock exchange. Venture capital investments are required to be restricted to domestic companies engaged in business of software, information technology, biotechnology, agriculture, and allied sectors.

Key Legal Areas in VC

i) Fund Structuring & Regulation:

- ✓ **Entity Choice:** VCs often form as Trusts or Companies (e.g., Private Limited in India), impacting tax and governance.
- ✓ **Registration:** Funds must register with regulatory bodies (e.g., SEBI in India).
- ✓ **Jurisdiction-Specific Rules:** Governed by securities laws (like SEBI Act in India, SEC rules in the US).

ii) Investment Documentation:

- ✓ **Term Sheet:** Non-binding outline of valuation, investment amount, equity, board seats, and control terms.

- ✓ **Shareholders' Agreement (SHA):** Binding contract on shareholder rights, voting, board control, and exit.
- ✓ **Stock Purchase Agreement (SPA):** Details share purchase terms.
- ✓ **Investors' Rights Agreement:** Defines info rights, registration rights, etc.

iii) Investor Protections & Control:

- ✓ **Liquidation Preferences:** Determines payout order in liquidation (VCs usually get paid first).
- ✓ **Anti-Dilution Provisions:** Protects investor ownership percentage in future rounds.
- ✓ **Reserved Matters/Protective Provisions:** Requires investor consent for major decisions (e.g., selling company, large debt).
- ✓ **Board Representation:** VCs seek board seats for oversight.

iv) Compliance & Risk Management:

- ✓ **Due Diligence:** Thorough legal, financial, and operational vetting of the startup.
- ✓ **Intellectual Property (IP):** Ensuring IP ownership and protection.
- ✓ **Regulatory Compliance:** Adhering to investment restrictions and reporting.

v) Exit Strategies:

- ✓ **Mechanisms:** IPOs, mergers, acquisitions, buybacks.
- ✓ **Legal Provisions:** Drag-along rights (forcing minority shareholders to sell) and co-sale rights.

vi) Taxation:

- ✓ **Incentives:** Capital gains exemptions, income tax deductions for investors (varies by country).

- ✓ **Angel Tax:** Compliance (like DPIIT registration in India) to avoid penalties on funds raised.

vii) Dispute Resolution:

- ✓ **Arbitration:** Often favored for confidentiality and speed (e.g., Arbitration and Conciliation Act in India).

4.16 Guidelines for the Venture Capital Companies

The Government of India has issued the following guidelines for various venture capital funds operating in the country.

- ✓ The financial institutions, State Bank of India, scheduled banks, and foreign banks are eligible to establish venture capital companies or funds subject to the approval as may be required from the Reserve Bank of India.
- ✓ The venture capital funds have a minimum size of Rs. 10 crores and a debt equity ratio of 1:1.5. If they desire to raise funds from the public, promoters will be required to contribute minimum of 40% of the capital.
- ✓ The guidelines also provide for NRI investment upto 74% on a non-repatriable basis.
- ✓ The venture capital funds should be independent of the parent organisation.
- ✓ The venture capital funds will be managed by professionals and can be set up as joint ventures even with non-institutional promoters.
- ✓ The venture capital funds will not be allowed to undertake activities such as trading, broking, and money market operations but they will be allowed to invest in leasing to the extent of 15% of the total funds deployed. The investment or revival of sick units will be treated as a part of venture capital activity.

- ✓ A person holding a position of being a full time chairman, chief executive or managing director of a company will not be allowed to hold the same position simultaneously in the venture capital fund/company.
- ✓ The venture capital assistance should be extended to the promoters who are now, and are professionally or technically qualified with inadequate resources.

SEBI (Venture Capital Funds) (Amendment) Regulations, 2000 and SEBI (Foreign Venture Capital Investors) Regulations, 2000

A. Following are the salient features of the SEBI (Venture Capital Funds) (Amendment) Regulations, 2000:

1. Definition of venture capital fund: The venture capital fund is now defined as a fund established in the form of a Trust, a company including a body corporate and registered with SEBI which:

- (a) has a dedicated pool of capital;
- (b) raised in the manner specified under the Regulations; and
- (c) to invest in venture capital undertakings in accordance with the Regulations.

2. Definition of venture capital undertaking: Venture capital undertaking means a domestic company:

- (a) Whose shares are not listed on a recognised stock exchanges in India
- (b) Which is engaged in business including providing services, production or manufacture of articles or things, or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf. The negative list includes real estate, non-banking financial

services, gold financing, activities not permitted under the Industrial Policy of the Government of India.

3. Minimum contribution and fund size: The minimum investment in a Venture Capital Fund from any investor will not be less than Rs. 5 lakhs and the minimum corpus of the fund before the fund can start activities shall be at least Rs. 5 crores.

4. Investment criteria: The earlier investment criteria have been substituted by a new investment criteria which has the following requirements:

- (a) Disclosure of investment strategy;
- (b) Maximum investment in single venture capital undertaking not to exceed 25% of the corpus of the fund;
- (c) Investment in the associated companies not permitted;
- (d) At least 75% of the investible funds to be invested in unlisted equity shares or equity linked instruments.
- (e) Not more than 25% of the investible funds may be invested by way of;
 - ✓ Subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock-in period of one year.
 - ✓ Debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity.

It has also been provided that venture capital fund seeking to avail benefit under the relevant provisions of the Income Tax Act will be required to divest from the investment within a period of one year from the listing of the venture capital undertaking.

5. Disclosure and information to investors: In order to simplify and expedite the process of fund raising, the requirement of filing the placement memorandum with SEBI is dispensed with

and instead the fund will be required to submit a copy of Placement Memorandum/copy of contribution agreement entered with the investors along with the details of the fund raised for information to SEBI. Further, the contents of the Placement Memorandum are strengthened to provide adequate disclosure and information to investors. SEBI will also prescribe suitable reporting requirement from the fund on their investment activity.

6. QIB status for venture capital funds: The venture capital funds will be eligible to participate in the IPO through book building route as Qualified Institutional Buyer subject to compliance with SEBI (Venture Capital Fund) Regulations.

7. Relaxation in takeover code: The acquisition of shares by the company or any of the promoters from the Venture Capital Fund under the terms of agreement shall be treated on the same footing as that of acquisition of shares by promoters/companies from the state level financial institutions and shall be exempt from making an open offer to other shareholders.

8. Investments by mutual funds in venture capital funds: In order to increase the resources for domestic venture capital funds, mutual funds are permitted to invest upto 5% of its corpus in the case of open-ended schemes and upto 10% of its corpus in the case of close-ended schemes. Apart from raising the resources for venture capital funds this would provide an opportunity to small investors to participate in venture capital activities through mutual funds.

9. Government of India guidelines: The government of India (MOF) guidelines for overseas venture capital investment in India dated September 20, 1995 will be repealed by the MOF on notification of SEBI Venture Capital Fund Regulations.

10. The following will be the salient features of SEBI (Foreign Venture Capital Investors) Regulations, 2000.

a. Definition of foreign venture capital investor: outside India and proposes to make investment in undertaking and registered with SEBI.

b. Eligibility criteria: Entity incorporated and established outside India in the form of investment company, trust partnership, pension fund, mutual fund, university fund, endowment fund, asset management company, investment manager, investment management company or other investment vehicle incorporated outside India would be eligible for seeking registration from SEBI. SEBI for the purpose of registration shall consider whether the applicant is regulated by an appropriate foreign regulatory authority; or is an income tax payer; or submits a certificate from its banker of its or its promoters' track record where the applicant is neither a regulated entity nor an income tax payer.

C. Investment criteria:

(i) Disclosure of investment strategy;

(ii) Maximum investment in single venture capital undertaking not to exceed 25% of the funds committed for investment to India. However, it can invest its total fund committed in one venture capital fund.

(iii) At least 75% of the investible funds to be invested in unlisted equity shares or equity linked instruments. (iv) Not more than 25% of the investible funds may be invested by way of;

- ✓ Subscription to initial public offer of a venture capital undertaking whose shares are proposed to be listed subject to lock-in period of one year;
- ✓ Debt or debt instrument of a venture capital undertaking in which the venture capital fund has already made an investment by way of equity.

11. Hassle free entry and exit: The foreign venture capital investors proposing to make venture capital investment under the Regulations would be granted registration by SEBI. SEBI registered

foreign venture capital investors shall be permitted to make investment on an automatic route within the overall sectoral ceiling of foreign investment under Annexure III of Statement of Industrial Policy without any approval from FIPB. Further, SEBI registered FVCIs shall be granted a general permission from the exchange control angle for inflow and outflow of funds and no prior approval of RBI would be required for pricing, however, there would be ex-post reporting requirement for the amount transacted.

12. Trading in unlisted equity: The Board also approved the proposal to permit OTCEI to develop a trading window for unlisted securities where Qualified Institutional Buyers (QIB) would be permitted to participate.

Check Your Progress

Choose the Correct Answer:

1. Venture capital mainly provides finance to:

- A. Large established companies
- B. Government enterprises
- C. New and innovative start-ups
- D. Loss-making public companies

Answer: C. New and innovative start-ups

2. Which of the following is a key feature of venture capital?

- A. Short-term investment
- B. Low risk and guaranteed return
- C. Long-term investment with high risk
- D. Investment only in listed companies

Answer: C. Long-term investment with high risk

3. Venture capitalists usually provide finance in the form of:

- A. Debentures only
- B. Equity or equity-linked instruments
- C. Fixed deposits
- D. Trade credit

Answer: B. Equity or equity-linked instruments

4. Which type of venture capital is provided at the initial stage of a business idea?

- A. Expansion finance
- B. Bridge finance
- C. Seed capital
- D. Turnaround finance

Answer: C. Seed capital

5. Venture capital provided to help a firm expand its operations is called:

- A. Seed finance
- B. Start-up finance
- C. Growth/Expansion finance
- D. Exit finance

Answer: C. Growth/Expansion finance

6. Which factor mainly contributed to the growth of venture capital in India?

- A. Decline in banking sector
- B. Growth of IT and start-up ecosystem
- C. Increase in government ownership
- D. Reduction in foreign investment

Answer: B. Growth of IT and start-up ecosystem

7. Which institution played an important role in promoting venture capital in India?

- A. RBI
- B. SEBI
- C. IRDA
- D. NABARD

Answer: B. SEBI

8. Financing under venture capital generally follows which pattern?

- A. One-time full payment
- B. Stage-wise financing
- C. Only debt financing
- D. Grant-based financing

Answer: B. Stage-wise financing

9. Which of the following is NOT a stage of venture capital financing?

- A. Seed stage
- B. Start-up stage
- C. Maturity stage
- D. Decline stage

Answer: D. Decline stage

10. Legal guidelines for venture capital funds in India are issued by:

- A. Ministry of Finance
- B. Reserve Bank of India

C. Securities and Exchange Board of India (SEBI)

D. Government of India only

Answer: C. Securities and Exchange Board of India (SEBI)

Small Questions – LOCF Mapping Table

S.No	Small Question	CO	Bloom's Level	PO
1	What is venture capital and what are its key features?	CO1	Remember	PO1
2	Name and explain the types of venture capital.	CO1	Understand	PO1
3	Describe the growth of venture capital in India.	CO2	Understand	PO2
4	What is the typical financing pattern under venture capital?	CO2	Remember	PO2
5	Explain the legal aspects and guidelines for venture capital in India.	CO3	Understand	PO3

Big Questions – LOCF Mapping Table

S.No	Big Question	CO	Bloom's Level	PO
1	Explain the concept and key features of venture capital.	CO1	Understand	PO1
2	Discuss the different types of venture capital with examples.	CO1	Analyze	PO1
3	Explain the growth of venture capital in India and its impact on entrepreneurship.	CO2	Analyze	PO2
4	Describe the financing patterns under venture capital and how funds are allocated.	CO2	Understand	PO2
5	Explain the legal aspects and guidelines governing venture capital in India.	CO3	Evaluate	PO3

UNIT – V

Structure:

5.1 Introduction to Mutual Funds

5.2 Meaning of Mutual Funds

5.3 Definitions of Mutual Funds

5.4 Types of Mutual Funds

5.5 Objectives of Mutual Funds

5.6 Functions of Mutual Funds

5.7 Advantages of Mutual Funds

5.8 Mutual Funds in India

5.9 Introduction to Digital Payments

5.10 Types of Digital Payments

5.11 Advantages of Digital Payments

5.12 Growth of Digital Payments in India

5.13 Cryptocurrency

5.1 Introduction to Mutual Funds

A **mutual fund** is a financial institution that collects money from a large number of investors and invests it in a diversified portfolio of securities such as **shares, debentures, bonds, and money market instruments**. The investment is made according to the fund's stated objectives, such as income generation, capital appreciation, or both.

Mutual funds are managed by professional **fund managers**, who use their expertise to make informed investment decisions on behalf of investors. Each investor is allotted **units** of the

fund, which represent their proportionate share in the total investment. The value of these units is expressed through the **Net Asset Value (NAV)**.

One of the major advantages of mutual funds is **diversification**, which helps reduce investment risk. They also offer **liquidity**, **professional management**, and **accessibility** to small investors. In India, mutual funds are regulated by the **Securities and Exchange Board of India (SEBI)** to protect investors' interests and ensure transparency.

Thus, mutual funds provide a convenient and efficient investment option for individuals seeking returns with managed risk.

5.2 Meaning of Mutual Funds

A **mutual fund** is an investment vehicle that pools money from many investors and invests it collectively in a diversified portfolio of securities such as shares, bonds, debentures, and money market instruments. The fund is professionally managed by experts, and each investor owns units that represent their share in the fund's total assets.

5.3 Definitions of Mutual Funds

According to Weston and Brigham "Mutual funds are corporations that accept money from savers and invest it in a diversified portfolio of securities."

According to the Investment Company Institute (ICI) "A mutual fund is an investment company that pools money from many investors and invests the money in stocks, bonds, and other securities."

According to SEBI "A mutual fund is a trust that pools the savings of a number of investors who share a common financial goal and invests the funds in capital market instruments."

According to Gitman “Mutual funds are financial intermediaries that pool the savings of individuals and invest them in a diversified portfolio of securities.”

5.4 Types of Mutual Funds

Mutual funds are one of the most popular forms of investments available in the market today. Mutual funds operate at the behest of asset management companies (or AMCs) that pool together investments from multiple individuals along with institutional investors that each have similar investment objectives. Fund managers are responsible for keeping an eye out for and managing these pooled investments. Mutual funds serve as the perfect tool with which individual investors get exposed to portfolios managed by experts. Read on to understand the varied forms of mutual funds that exist in the country.

Diversify your investment portfolio with various Mutual Funds. There’s a diverse range of options out there, each tailored to specific investment goals, risk levels, asset classes and structures. Whether you're aiming for growth, income or specialised investments, Mutual Funds provide versatile avenues to building wealth.

i) Types of Mutual Funds Based On Asset Class

An asset class refers to a category of financial assets with similar characteristics and behaviours, such as stocks, bonds, real estate or cash equivalents. Discover diverse Mutual Funds categorised by an asset class.

1. Equity Funds

Equity Funds (Stocks): Equity Funds invest in shares of companies. For example, large-cap Equity Funds target well-established, large companies, while small-cap funds focus on smaller, high-growth businesses.

2. Debt Funds

Debt Funds (Bonds): Debt Funds invest in bonds, providing a steady income. They include categories like Government Bond Funds and Corporate Bond Funds.

3. Money Market Funds

Money Market Funds (Short-term securities): Money Market Funds invest in low-risk, short-term securities, such as Treasury bills and commercial paper.

4. Hybrid Funds

Hybrid Funds (Mix of assets): Hybrid Funds blend both stocks and bonds, like balanced funds that aim for growth and stability in a single package.

ii) Types of Mutual Funds Based on Investment Goals

These funds cater to specific financial objectives, offering diverse options to match the investors' unique goals.

1. Growth Funds

Growth Funds focus on capital appreciation by primarily investing in stocks of companies with high growth potential. They are suited for long-term investors seeking substantial returns.

2. Income Funds

Income Funds emphasise regular income generation by investing in bonds, fixed-income securities or dividend-yielding stocks. They suit investors looking for a steady income stream.

3. Liquid Funds

Liquid Funds prioritise liquidity and safety, investing in short-term debt instruments. They are ideal for investors seeking quick access to funds with minimal risk.

4. Tax Saving Funds

Tax-saving funds, also known as ELSS, offer tax benefits under Section 80C. They invest primarily in equities and serve as a tax-efficient investment option.

5. Aggressive Growth Funds

Aggressive Growth Funds target substantial capital appreciation and are willing to accept higher market risks. They suit investors with a long-term horizon and a risk-taking approach.

6. Capital Protection Funds

Capital Protection Funds focus on safeguarding the principal amount while generating modest returns. They are ideal for risk-averse investors looking to protect their investments.

7. Fixed Maturity Funds

Fixed Maturity Funds have a predetermined maturity date, providing investors with a clear investment horizon. They are suited for those looking for fixed returns and minimal interest rate risk.

8. Pension Funds

Pension Funds aim to create a corpus for retirement by investing in a mix of assets. They cater to individuals planning for a secure post-retirement financial future.

iii) Types of Mutual Funds Based on Structure

Mutual Funds are categorised by structure, influencing how investors buy and sell units. These structures include open-ended, closed-ended and interval funds.

1. Open-ended Funds

Open-ended Funds allow investors to buy and sell units continuously, providing liquidity. These funds are suitable for investors looking for flexibility in terms of entry and exit points and they are commonly used for long-term wealth creation.

2. Closed-ended Funds

Closed-ended Funds have a fixed maturity period and a limited number of units. Investors can buy units only during the initial offer period and they can trade these units on stock exchanges. These funds are ideal for those seeking long-term investments with potential tax benefits.

3. Interval Funds

Interval Funds combine features of open and closed-ended funds. They allow periodic redemption requests, typically at predetermined intervals. This structure suits investors looking for a balance between liquidity and long-term investments.

iv) Types of Mutual Funds based on risk

Different Mutual Funds come with their own level of risk, from very low to high, offering choices for diverse investor profiles.

1. Very low Risk Funds

Very low Risk Funds, like Money Market Funds, primarily invest in low-risk securities. These are ideal for conservative investors seeking capital preservation and minimal fluctuations in the investment's value.

2. Low Risk Funds

Low Risk Funds, such as Government Bond Funds, aim for income generation with a slightly higher risk than very low risk options. They are suitable for investors with a slightly higher risk tolerance.

3. Medium Risk Funds

Medium Risk Funds, like balanced funds, offer a balance between risk and reward by combining equity and debt investments. These suit investors seeking moderate growth with a manageable level of risk.

4. High Risk Funds

High Risk Funds, such as sector-specific Equity Funds, focus on capital appreciation with increased risk. These are for investors willing to accept higher volatility in pursuit of potentially higher returns.

5. Specialised Mutual Funds

Explore unique investment options to diversify and meet specific financial objectives with Specialised Mutual Funds

6. Sector Funds

Sector Funds focus on specific industries or sectors, allowing investors to target areas they believe will perform well.

7. Index Funds

Index Funds replicate a market index's performance, providing low-cost exposure to the overall market or specific segments.

8. Funds of Funds

Funds of Funds invest in other Mutual Funds, offering a diversified portfolio through a single investment.

9. Emerging Market Funds

Emerging Market Funds invest in developing economies, offering growth opportunities with a higher risk.

10. International/ Foreign Funds

International or Foreign Funds invest outside the investor's home country, diversifying risk and potentially boosting returns.

11. Global Funds

Global Funds combine domestic and foreign investments, offering a broad geographic diversification.

12. Real Estate Funds

Real Estate Funds invest in properties, providing exposure to the Real Estate market without buying physical assets.

13. Commodity-focused Stock Funds

Commodity-focused Stock Funds invest in companies related to commodities, allowing indirect exposure to the commodity market.

14. Market Neutral Funds

Market Neutral Funds aim to generate returns while reducing market risks by balancing long and short positions.

15. Inverse/Leveraged Funds

Inverse/Leveraged Funds aim to provide returns inversely related to an index's performance or amplify returns.

16. Asset Allocation Funds

Asset Allocation Funds automatically adjust the portfolio's allocation to maintain a specific risk-return profile.

17. Gift Funds

Gift Funds are designed for charitable giving, offering tax advantages to donors while supporting causes.

18. Exchange-Traded Funds

Exchange-Traded Funds (ETFs) combine elements of Mutual Funds and Stocks, providing liquidity and a diversified exposure.

Investing in mutual funds offers numerous advantages across different types of funds available in the market. For one, your money is managed by experienced professionals, so you don't need to be an expert in market trends to benefit from them. Most types of funds do not have a lock-in period, allowing you to withdraw your investment whenever required. The only exception is ELSS mutual funds, which come with a mandatory lock-in. Another attractive feature is the low investment cost, making it easier for a larger number of investors to participate. Additionally, you can start with small amounts through a systematic investment plan (SIP) and invest regularly. If you wish, you also have the flexibility to switch between different types of funds within the same fund house.

Mutual funds, regardless of the types of funds you choose, provide diversification, serve as goal-based investments, and offer high liquidity, enabling you to access your money in times of financial need. With such wide-ranging benefits, mutual funds remain a reliable and versatile investment option.

5.5 Objectives of Mutual Funds

i) Capital Appreciation

- ✓ To increase the value of the invested capital over the long term.
- ✓ Example: Equity growth funds aim for capital gains.

ii) Regular Income

- ✓ To provide steady income through dividends or interest from debt securities.
- ✓ Example: Income funds or debt funds.

iii) Diversification of Risk

- ✓ To reduce risk by investing in a variety of securities across sectors and instruments.
- ✓ Example: Balanced or hybrid funds invest in both equity and debt.

iv) Liquidity

- ✓ To allow investors to redeem units and access their money quickly.
- ✓ Example: Open-ended funds or liquid funds.

v) Professional Management

- ✓ To benefit from expert fund managers who handle investment decisions.
- ✓ Example: All mutual funds are professionally managed by AMCs.

vi) Tax Benefits

- ✓ To provide tax saving opportunities under the Income Tax Act.
- ✓ Example: ELSS (Equity Linked Savings Scheme).

vii) Participation in Capital Markets

- ✓ To enable small investors to participate in the stock and bond markets.
- ✓ Example: Any equity or balanced fund.

5.6 Functions of Mutual Funds

1. Mobilization of Savings:

One of the primary functions of mutual funds is to collect savings from a large number of investors and pool them together. This helps small investors, who may not have enough capital

individually, to participate in the financial markets. By mobilizing scattered household savings, mutual funds channel funds into productive investments, contributing to economic growth.

2. Investment in Securities:

Mutual funds invest the collected money in a diversified portfolio of securities such as shares, debentures, bonds, and money market instruments. This enables investors to gain exposure to a wide range of investment opportunities without having to invest directly in each security themselves. Different schemes are designed to meet various investment objectives like growth, income, or balanced returns.

3. Professional Management:

Mutual funds are managed by professional fund managers who have expertise in financial markets and investment strategies. These experts conduct research, analyze market trends, and make informed decisions about which securities to buy or sell. Professional management ensures that the investors' money is invested efficiently, maximizing returns while managing risk.

4. Risk Diversification:

Mutual funds help in spreading investment risk by investing in multiple securities across different sectors and industries. Diversification reduces the impact of poor performance of any single investment on the overall portfolio. This is particularly beneficial for small investors who may not have the resources to diversify on their own.

5. Providing Liquidity:

Many mutual fund schemes, especially open-ended funds, allow investors to redeem their units at any time at the prevailing Net Asset Value (NAV). This ensures that investors can access their money quickly whenever needed, making mutual funds a flexible investment option.

6. Regular Income:

Certain mutual fund schemes, such as income funds or debt funds, provide regular returns in the form of dividends or interest. This is particularly useful for investors seeking a steady stream of income, such as retirees or conservative investors who prioritize income over capital gains.

7. Enabling Small Investors to Enter Capital Market:

Mutual funds allow even small investors to participate in capital markets, which would otherwise require large amounts of capital. By pooling resources, individuals can access investments in stocks, bonds, and other financial instruments that may have been beyond their reach individually.

8. Tax Benefits:

Some mutual fund schemes, like Equity Linked Savings Schemes (ELSS), provide tax-saving benefits under the Income Tax Act. This encourages savings and long-term investment among investors while offering them incentives in the form of tax deductions.

5.7 Advantages of Mutual Funds

Mutual funds offer several benefits to investors, making them one of the most popular investment options:

1. Professional Management:

Mutual funds are managed by experienced fund managers who analyze markets and select the best investment opportunities. This allows investors to benefit from expert knowledge without having to manage investments themselves.

2. Diversification of Risk:

By investing in a variety of securities across sectors, mutual funds spread the risk. Losses in one investment can be offset by gains in another, reducing the overall risk for investors.

3. Liquidity:

Open-ended mutual fund schemes allow investors to redeem their units at any time at the prevailing NAV. This makes mutual funds a flexible investment option.

4. Small Investment Requirement:

Investors can start with a relatively small amount, such as ₹500 or ₹1,000, making it accessible for people with limited savings.

5. Regular Income:

Certain mutual fund schemes provide periodic income through dividends or interest, making them suitable for investors looking for steady returns.

6. Convenience and Transparency:

Investors receive regular statements about the performance of their investments. Mutual funds also publish their NAVs and portfolio details, ensuring transparency.

7. Tax Benefits:

Some funds, like ELSS, provide tax-saving benefits under Section 80C of the Income Tax Act, encouraging long-term investment.

8. Access to Capital Markets:

Mutual funds allow small investors to participate in the stock and bond markets, which would otherwise require large amounts of capital and expertise.

5.8 Mutual Funds in India

Mutual funds in India have grown rapidly over the past few decades, becoming an important part of the financial market and providing investors with a convenient way to invest in a diversified portfolio.

The **history of mutual funds in India** began in **1963**, when the **Unit Trust of India (UTI)** was established by an Act of Parliament. UTI was the first mutual fund in India and played a pioneering role in mobilizing savings from the public and channelizing them into productive investments. Initially, mutual funds were limited in number and focused mainly on government and corporate securities.

In the **1990s**, with the liberalization of the Indian economy, the mutual fund industry witnessed significant growth. The government allowed **private and foreign players** to enter the market. The **Securities and Exchange Board of India (SEBI)** introduced regulations in 1993 to ensure transparency, protect investors, and regulate mutual fund operations. This led to the establishment of several private mutual fund companies such as HDFC, ICICI Prudential, and SBI Mutual Fund.

Today, India has a **wide range of mutual fund schemes**, including equity funds, debt funds, balanced funds, sector-specific funds, index funds, and tax-saving funds (ELSS). Mutual funds in India are managed by **Asset Management Companies (AMCs)** and are regulated by **SEBI**, which ensures that investors' interests are protected through guidelines on fund disclosure, pricing, and governance.

The growth of mutual funds in India has been driven by factors such as rising awareness among investors, growth of the middle class, technological advancements for online investing, and government incentives like tax benefits on ELSS schemes. Mutual funds have made

investment in capital markets accessible to small investors and have played a key role in mobilizing household savings into productive avenues.

In short, **mutual funds in India provide an efficient, professional, and safe investment option**, contributing both to personal wealth creation and to the development of the Indian capital market.

5.9 Introduction to Digital Payments

Digital payments refer to any form of payment made through **electronic or digital means**, without the use of physical cash. It involves transferring money from one bank account to another or making purchases online using electronic platforms such as mobile apps, internet banking, or payment wallets.

Digital payments have become an essential part of modern financial systems due to the growth of the internet, smartphones, and technology-driven banking solutions. They are fast, convenient, and allow users to make transactions anytime and anywhere. Examples include **UPI (Unified Payments Interface), mobile wallets (Paytm, PhonePe), credit/debit card payments, net banking, and QR code-based payments**.

The main advantages of digital payments are **speed, transparency, security, and reduced dependency on cash**. They also support financial inclusion by bringing more people into the formal banking system. Governments and financial institutions worldwide, including India, have promoted digital payments to **increase efficiency, reduce cash circulation, and curb black money**.

In India, initiatives like **UPI, Bharat QR, BHIM App, and RuPay cards** have revolutionized digital payments, making them an everyday part of commerce for individuals and businesses.

5.10 Types of Digital Payments

1. Mobile Wallets (E-Wallets):

- ✓ These are apps or platforms that store money digitally and allow users to make payments using smartphones.
- ✓ *Examples:* Paytm, PhonePe, Google Pay.

2. Unified Payments Interface (UPI):

- ✓ A real-time payment system that allows instant transfer of funds between two bank accounts through mobile devices.
- ✓ *Examples:* BHIM App, Google Pay, PhonePe.

3. Credit and Debit Cards:

- ✓ Plastic cards issued by banks to make payments at point-of-sale terminals or online.
- ✓ *Examples:* Visa, MasterCard, RuPay cards.

4. Net Banking / Internet Banking:

- ✓ Allows customers to make payments, transfer funds, or pay bills directly from their bank accounts through online portals.

5. QR Code Payments:

- ✓ Payments made by scanning a QR code using a smartphone to transfer money instantly.
- ✓ *Examples:* Bharat QR, Paytm QR.

6. Contactless Payments:

- ✓ Payments using technologies like NFC (Near Field Communication) without physically swiping cards

5.11 Advantages of Digital Payments

1. Convenience and Speed:

- ✓ Transactions can be completed instantly from anywhere without visiting a bank or carrying cash.

2. Security:

- ✓ Reduces risks associated with carrying cash; most digital payments are encrypted and require authentication.

3. Transparency:

- ✓ Every transaction is recorded digitally, helping in tracking payments and preventing fraud.

4. Financial Inclusion:

- ✓ Brings unbanked populations into the formal financial system through smartphones and basic banking apps.

5. Supports Government Initiatives:

- ✓ Reduces cash circulation and helps curb black money and tax evasion.

5.12 Growth of Digital Payments in India

- ✓ India has witnessed rapid growth in digital payments due to the **Digital India initiative**, rising smartphone penetration, and easy internet access.
- ✓ Platforms like **UPI, BHIM, Bharat QR, and mobile wallets** have become popular for daily transactions, from paying utility bills to shopping.
- ✓ Banks, fintech companies, and government-backed systems have created an **ecosystem that encourages cashless transactions**, boosting efficiency and reducing dependency on cash.

5.13 Cryptocurrency

Cryptocurrency is a **digital or virtual form of money** that uses **cryptography** for secure financial transactions, control of new unit creation, and verification of asset transfers. Unlike traditional currencies issued by governments (like the Indian Rupee or US Dollar), cryptocurrencies are **decentralized** and operate on a technology called **blockchain**, which is a distributed ledger that records all transactions securely and transparently.

Key Features of Cryptocurrency:

1. **Digital and Decentralized:** Exists only in digital form and is not controlled by any single authority or government.
2. **Secure and Anonymous:** Uses cryptography to secure transactions and protect user identities.
3. **Global Accessibility:** Can be sent or received anywhere in the world instantly through the internet.
4. **Limited Supply:** Many cryptocurrencies, like Bitcoin, have a fixed maximum supply, reducing inflation risk.

Popular Cryptocurrencies:

- ✓ **Bitcoin (BTC):** The first and most widely used cryptocurrency.
- ✓ **Ethereum (ETH):** Known for smart contracts and decentralized applications.
- ✓ **Ripple (XRP), Litecoin (LTC), Dogecoin (DOGE):** Other popular cryptocurrencies used for payments or investments.

Advantages of Cryptocurrencies:

- ✓ Fast and borderless transactions without intermediaries like banks.
- ✓ Reduced transaction costs.

- ✓ Financial inclusion for people without access to traditional banking.
- ✓ Transparency due to blockchain technology.

Risks and Challenges:

- ✓ High price volatility leading to potential losses.
- ✓ Regulatory uncertainty in many countries, including India.
- ✓ Possibility of misuse for illegal activities due to anonymity.

Cryptocurrency in India:

- ✓ India has not legalized cryptocurrency as legal tender, but trading and investment in crypto is allowed under regulations.
- ✓ The government is exploring the development of a **Central Bank Digital Currency (CBDC)** called the **Digital Rupee**, which will be a regulated digital currency issued by the Reserve Bank of India (RBI).

Cryptocurrency represents a **new era of digital finance** with the potential to revolutionize money and payments. While it offers fast, secure, and global transactions, it also carries risks like volatility and regulatory uncertainty, which investors and governments need to carefully manage.

Check Your Progress

Choose the Correct Answer:

1. What is the primary function of a mutual fund?
 - A. Provide loans to small businesses
 - B. Pool savings from investors and invest in diversified securities
 - C. Print currency for the government
 - D. Issue insurance policies

Answer: B. Pool savings from investors and invest in diversified securities

2. Which of the following is an example of an open-ended mutual fund?

- A. ICICI Pru Growth Fund
- B. HDFC Balanced Fund
- C. UTI Mastershare Fund
- D. All of the above

Answer: D. All of the above

3. Which mutual fund scheme primarily aims at providing tax benefits under Section 80C?

- A. Money Market Fund
- B. ELSS (Equity Linked Savings Scheme)
- C. Balanced Fund
- D. Debt Fund

Answer: B. ELSS (Equity Linked Savings Scheme)

4. What is the main objective of a balanced mutual fund?

- A. Only capital appreciation
- B. Only regular income
- C. Both capital appreciation and regular income by investing in equity and debt
- D. Provide loans to investors

Answer: C. Both capital appreciation and regular income by investing in equity and debt

5. Which of the following is NOT a function of mutual funds?

- A. Professional management of investments
- B. Mobilization of savings

C. Issue legal tender currency

D. Risk diversification

Answer: C. Issue legal tender currency

6. Which of the following is a digital payment method?

A. Credit/debit cards

B. UPI

C. Mobile wallets

D. All of the above

Answer: D. All of the above

7. What is a key advantage of digital payments?

A. Requires physical cash

B. Slower transactions

C. Fast, secure, and convenient transactions

D. Cannot be used for online shopping

Answer: C. Fast, secure, and convenient transactions

8. Cryptocurrency is based on which technology?

A. Blockchain

B. Internet Banking

C. ATM Networks

D. SWIFT

Answer: A. Blockchain

9. Which of the following is a popular cryptocurrency?

A. Bitcoin (BTC)

B. RuPay

C. Paytm

D. UPI

Answer: A. Bitcoin (BTC)

10. What is the main risk associated with cryptocurrencies?

A. Lack of liquidity

B. Price volatility and regulatory uncertainty

C. Low returns

D. Requires physical cash

Answer: B. Price volatility and regulatory uncertainty

Small Questions – LOCF Mapping Table

S.No	Small Question	CO	Bloom's Level	PO
1	What is a mutual fund and what is its meaning?	CO1	Remember	PO1
2	Name and explain the types of mutual funds.	CO1	Understand	PO1
3	What are the main objectives and functions of mutual funds?	CO2	Understand	PO2
4	List the advantages of investing in mutual funds.	CO2	Remember	PO2
5	Give an introduction to digital payments and cryptocurrency.	CO3	Understand	PO3

Big Questions – LOCF Mapping Table

S.No	Big Question	CO	Bloom's Level	PO
1	Explain the meaning and concept of mutual funds and their importance in investment planning.	CO1	Understand	PO1
2	Discuss the different types of mutual funds and their features.	CO1	Analyze	PO1
3	Explain the objectives and functions of mutual funds.	CO2	Understand	PO2
4	Describe the advantages of investing in mutual funds with suitable examples.	CO2	Evaluate	PO2
5	Explain digital payments and cryptocurrency, including their significance in modern financial transactions.	CO3	Understand	PO3