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# FINANCIAL MARKETS AND MARKETING MANAGEMENT

# STUDY MATERIAL

By

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# PREFACE

With the increasing prominence of Development Banks in India, the Indian financial system has been undergoing a tremendous transformation in the recent years The varagies of the stock scam also stamped a sense of scar in the minds of all the enterprising investors and have created an awarenes among the depositors and investors about their investments in financial and non-financial assets With the present Governments policy of privatisation by granting permission to set-up private sector banks, a greater element of competition is likely to be created which might pave the way for a new work ethics in the nationalised banks Changes are inevitable in a developing country There is likely to be a sea change in the field of banking and financial systems in India The commercial banks which were functioning on traditional lines have begun to think of innovative proposals to safeguard their existence

Marketing as a subject of study, is now ttracting attention of all business concerns, companies, institutions and countries An effective marketing system is necessary for a high level of economic activity The success of any firm or industry is largely depending on its ability to market the goods In olden days, the maret were seller amarket and naturally marketing was not given much importance The businessmen devoted much of their time on production rather than on the marketing side But those days have gone The present day marekt is buyers market and the producers have to manufacture goods according to the tastes, desires and preferences of consumers The task of marketing has become more exciting and challenging and calls for expert skill and knowledge It has grown as a large tree with various branches like advertising, marketing management, salesmanship etc

This study material covers the entire SOEL syllabus for B Com , LL B., (Hons) students for Fiancial Markets and Marketing Management All important concepts have been explained in simple terms and wherever necessaary concepts have been explained in simple terms and wherever necessary diagrams and flowcharts have been given

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## COURSE OUTLINE

### UNIT – 1

**Introduction to Financial Services**

Financial service – Meaning – Importance – Types – Financial service and Economic Development – Financial Instruments – Financial Services Sector – Problems – Challenges – Reforms – Financial Markets and Capital Markets in India

### UNIT – II

**Merchant Banking and Venture Capital Finance**

Merchant Banking – Concept – Origin and Growth Scope of Merchant Banking and Services – Issues – Issue Management – Underwriting – Importance – Methods – Venture Capital Finance – Concept and Growth of Venture Capital Fianance in India – Leasing – Type and methods – Leasing and Borrowing – Credit Rating – Importance – Factoring – Arrangements – Purpose and Procedures of Credit Rating – Short term and Long term Instruments – Role of CRISIL, ICRA and other Credit Rating Agencies.

### UNIT – III

**Mutual Funds and Foreign Exchange Market**

Mutual Funds – Concept – Objectives – Importance – Mutual fund Schemes – Mutual Fund and Money Markets – Portfolios – Concepts – Importance – Classification – Portfolio Management – Debt Securitization – SEBI – Introduction – Functions – Role of SEBI – NSDL – CSDL – Foreign Exchange Market – Importance – Currency Swap – Forward Contract and Future Contract – Money Laundering – Importance.

### UNIT – IV

**INTRODUCTION TO MARKETING MANAGEMENT**

Marketing Management – Meaning – Importance – Fundamentals – Approaches – Factors affecting Marketing – functions – Market Mix – Buyers Behavior and Motives – Consumer Goods and Industrial Goods – Market Segmentation – Targeting – Positioning.

### UNIT – V

**The Product and Marketing Channels**

The Product – Meaning – Characteristics and Classifications – New Product Process – Product Life Cycle – Branding – Packaging – Physical Distribution – Importance and Kinds – Marketing Channels – Promotion – Advertisement – Publicity – Direct Selling and Sales Promotion.

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# UNIT – I

# FINANCIAL SERVICES - INTRODUCTION

## 1.INTRODUCTION

A system that aims at establishing and providing a regular, smooth, efficient and cost effective linkage between depositors and investors is known as financial system The functions of financial system are to channelise the funds from the surplus units to the deficit units An efficient financial system not only encourages savings and investments, it also efficiently allocates resources in different investment avenues and thus accelerates the rate of economic development The financial system of a country plays a crucial role of allocating scare resources to productive uses Its efficient functioning is of critical importance to the economy

## 1.1 CONCEPT OF FINANCIAL SYSTEM

Financial system is one of the industries in an economy It is a particularly important industry that frequently has a far reaching impact on society and the economy But if its occult trappings are stripped it is like any industry, a group of firms that combine factors of production (land, labour and capital) under the general direction of a management team and produce a product or cluster of products for sale in financial market The product of the financial industry is not tangible rather it is an intangible service Financial industry as a whole, produces a wide range of services but all these services are related directly or indirectly to assets and liabilities, that is, claims on people, organization, institutions, companies and government These are the forms in which people accumulate much of their wealth In simple terms we are referring to paper assets shares, debentures, deposits, mortgages and other securities Thus, financial system performs certain essential functions for the economy, including maintenance of payment system (through which purchasing power is transferred from one participant to another i e. from buyer to seller), collection and allocation of the savings of society, and creation of a variety of stores of wealth to suit the preferences of savers This brief sketch of functions of financial system gives us its gist Performance of these functions pre-supposes the existence of financial assets, financial institutions (intermediaries) and financial markets. A combination of these three constitute financial system

To interpret the financial system and evaluate its performance, it requires an understanding of its functions in an economy Financial system in fact has the following functions

**a) Capital formation function**

This is the process of diversion of the productive capacity of the economy to the making of capital goods which increase future productive capacity Process of capital formation involve three distinct but interdependent activities savings, finance and investment

**b) Allocative function**

The financial system in process of capital formation has to decide as to how capital is to be used Poor choice in deciding which economic projects ~~are to be embarked upon, leads~~ to wastage of resources The better the quality of judgment exercised in allocation, the more rapid economic progress will be

**c) Service function**

An effective financial system offers the economic segments services in form of providing opportunities to hold wealth in secured and convenient way so that they pay a positive rate of return The availability of these services of the financial system contributes importantly, if in an intangible way, to the satisfaction of consumers

Finance is the flowing blood in the body of financial system It is a link between savings and investments by providing the mechanism through which savings (claims to resources) of savers are pooled and are put into the hands of those able and willing to invest by financial intermediaries Financial intermediaries create assets that have property of liquidity or convertibility into a fixed amount of money on demand Liquidity refers to cash, money and nearness to cash Liquidity is the most significant aspect of financial intermediation while holding essentially illiquid assets themselves, intermediaries are able to create liquid assets to be held by the ultimate savers in the economy Illiquid assets refer to credit creation In Indian economy Central Bank (RBI in India) performs the function of cash creation where as financial institutions create credit Flow of finance in the system takes place between two segments i e. Surplus Unit and Deficit Unit as shown in Chart I Surplus unit, having excess of income over current consumption can be public surplus unit or private surplus unit The former have savings through normal budgetary channels and the retained earnings of public sector enterprises The latter refer to household savings and non-corporate sector savings but corporate sector savings are dominating in volume Corporate sector savings depend mainly on profitability and distribution policy of the enterprise On the other hand size of household savings is a function of capacity, ability and willingness of the people to save which in return depends on numerous factors like psychological, social, economic On the other end of flow of fund, we have deficit unit which seeks funds for investment or consumption purposes Their investment and sometimes consumption pattern is outcome of their strategy about future earnings This in turn is a function of existing stock of capital, state of industry and economy, government policies, potentials of opportunity for new investments Government and business sector are the major borrowers whose investment normally surpass their savings

The role of financial system is thus, to promote savings and their channalisation in the economy through financial assets that are more productive than the physical assets The fund flows in an efficient financial system from less productive to more productive purpose, from unproductive/less productive activities to productive activities and from idle balance to active balances Thus, ultimate objective is to add value through flow of fund in the system This means that the operations of financial system are vital to the pace and structure of the growth of the economy However we must not forget that some of the transfers are to households to acquire consumer goods and services and to government for assorted purposes, including collective consumption This system plays a significant role in accelerating the rate of economic development which leads to improving general standard of living and higher social welfare

There is another way to look at financial system Financial system makes it easier to trade People trade because they differ in what they have and in what they want Trade may be trade in lending (giving uppurchasing power now in exchange for purchasing power in the future), trade in risk (reducing economicburden of risks through insurance and forward transactions) and trade in goods Trade benefits everyone Thus, financial system is concerned with every one and every one is interacting with the system, consciously or unconsciously Financial system makes trade easier through its technology of payments (whether throughcredit or cash), technology of lending (through financial market or direct lending) and technology of risk (taking up insurance policy or contracting in futures market) Technology basically refers to network of institutions, markets and instruments of financial system

Financial system is changing very fast Changes are due to two types of innovations First category of innovation facilitates serving existing needs in new ways An example is leasing, which enables the user to use the asset without buying it Second category of innovation uses existing technology to serve new needs Securitisation of financial assets is an example here Funds extended in form of loans are tied up To make use of such tied up funds these financial assets are securitised and liquid resources are raised to extend more loans

Another dimension of financial system in an economy is the government It is the government which lays down the rules of the game for financial system i e directs how the markets operate, which are permissible instruments and what are operating constraints of financial intermediaries Intervention of government has two facets one is ensuring efficiency in the system and second is providing stability and buildingconfidence A financial system is said to be efficient when the sum of all gains from lending, payment and trade in risk are as large as they can be An immature financial system needs higher degree of intervention and vice-versa Government also intervenes in financial system to provide its stability in absence of which the system breaks down and it can be disastrous There has to be a limit to governmental intervention Excessive intervention mars innovations Innovations in financial system is the result of attempts to get out of the restrictive regulations It is essential to appreciate role of financial system or sector in an economy As the economy grows, the set up and operations of this systems changes The major role as discussed earlier has been resources mobilization An efficient financial system facilitate raising huge amount through even small contributions from large number of investors A firm can raise Rs 100 crore through issue of 10 crore shares being subscribed by investors with minimum contributions of Rs 2000 being issue of minimum 200 shares of Rs 10 each or through a mutual fund or financial institutions Large amount can be mobilized from small investors The instruments issued to raise fund may have maturity patterns which are different for the investor's need. To over come such situation secondary markets emerge as special part of financial system. To minimize the risk associated with investment, financial system offers a wide variety of investment opportuniting enabling investor to diversify their investment hence risk

## 1.2 FINANCIAL CONCEPTS

An understanding of the financial system requires an understanding of the following concepts

(i) Financial assets

(ii) Financial intermediaries

(iii) Financial markets

(iv) Financial rates of return

(v) Financial instruments

### 1.2.1 Financial Assets

In any financial transaction, there should be a creation or transfer of financial assets Hence, the basic product of any financial system is the financial asset A financial assets is one which is used for production or consumption or for further creation of assets For instance, A buys equity shares and these shares are financial assets since they earn income in future

In this context, one must know the distinction between financial assets and physical assets Unlike financial assets, physical assets are not useful for further production of goods or for earning income For example X purchases land and building, or gold or silver These are physical assets since they cannot be used for further production Many physical assets are useful for consumption only

It is interesting to note that the objective of investment decides the nature of the asset For instance if a building is bought for residence purpose, it becomes a physical asset If the same is bought for hiring, it becomes a financial asset

**Classification of Financial Assets**

Financial assets can be classified differently under different circumstances One such classification is

(i) Marketable assets

(ii) Non-marketable assets

**Marketable Assets :** Marketable assets are those which can be easily transferred from one person to another without much hindrance Examples are shares of listed companies, Government securities, bonds of public sector undertakings etc

**Non-Marketable Assets :** On the other hand, if the assets cannot be transferred easily, they come under this category Examples are bank deposits, provident, funds, pension funds, National Savings Certificates, insurance policies etc

Yet another classification is as follows

(i) Money or cash asset

(ii) Debt asset

(iii) Stock asset

**Cash Asset :** In India, all coins and currency notes are issued by the RBI and the Ministry of Finance, Government of India Besides, commercial banks can also create money by means of creating credit When loans are sanctioned, liquid cash is not granted Instead an account is opened in the borrower's name and a deposit is created It is also a kind of money asset

**Debt Asset :** Debt asset is issued by a variety of organizations for the purpose of raising their debt capital Debt capital entails a fixed repayment schedule with regard to interest and principal. There are different ways of raising debt capital Example are issue of debentures, raising of term loans, working capital advance, etc

**Stock Asset :** Stock is issued by business organizations for the purpose of raising their fixed capital There are two types of stock namely equity and preference Equity shareholders are the real owners of the business and they enjoy the fruits of ownership and at the same time they bear the risk as well Preference shareholders, on the other hand get a fixed rate of dividend (as in the case of debt asset) and at the same time they retain some characteristics of equity

### 1.2.2 Financial Intermediaries

The term financial intermediary includes all kinds of organizations which intermediate and facilitate financial transactions of both individual and corporate customers Thus, it refers to all kinds of financial institutions and investing institutions which facilitate financial transactions in financial markets They may be in the organized sector or in the unorganized sector They may also be classified into two

(i) Capital market intermediaries

(ii) Money market intermediaries

**Capital Market Intermediaries :** These intermediaries mainly provide long term funds to individuals and corporate customers They consist of term lending institutions like financial corporations and investing institutions like LIC

**Money Market Intermediaries :** Money market intermediaries supply only short term funds to individuals and corporate customers They consist commercial banks, co-operative banks, etc

### 1.2.3 Financial Markets

Generally speaking, there is no specific place or location to indicate a financial market Wherever a financial transaction takes place, it is deemed to have taken place in the financial market Hence financial markets are pervasive in nature since financial transactions are themselves very pervasive throughout the economic system For instance, issue of equity shares, granting of loan by term lending institutions, deposit of money into a bank, purchase of debentures, sale of shares and so on

However, financial markets can be referred to as those centers and arrangements which facilitate buying and selling of financial assets, claims and services Sometimes, we do find the existence of a specific place or location for a financial market as in the case of stock exchange

**Classification of Financial Markets**

The classification of financial markets in India is shown in Chart II

**(a) Unorganised Markets**

In these markets there are a number of money lenders, indigenous bankers, traders etc , who lend money to the public Indigenous bankers also collect deposits from the public There are also private finance companies, chit funds etc , whose activities are not controlled by the RBI Recently the RBI has taken steps to bring private finance companies and chit funds under its strict control by issuing non-banking financial companies (Reserve Bank) Directions, 1998 The RBI has already taken some steps to bring the unorganized sector under the organized fold. They have not been successful The regulations concerning their financial dealings are still inadequate and their financial instruments have not been standardized

**(b) Organised Markets**

In the organized markets, there are standardized rules and regulations governing their financial dealings There is also a high degree of institutionalization and instrumentalisation These markets are subject to strict supervision and control by the RBI or other regulatory bodies

These organized markets can be further classified into two They are

(i) Capital market

(ii) Money market

**(i)Capital Market :** The capital market is a market for financial assets which have a long or indefinite maturity Generally, it deals with long term securities which have a maturity period of above one year Capital market may be further divided into three namely

(i) Industrial securities market

(ii) Government securities market and

(iii) Long term loans market I

Industrial securities market As the very name implies, it is a market for industrial securities namely

(i) Equity shares or ordinary shares,

(ii) Preference shares, and

(iii) Debentures or bonds

It is a market where industrial concerns raise their capital or debt by issuing appropriate instruments It can be further subdivided into two They are

(i) Primary market or New issue market

(ii) Secondary market or Stock exchange

**Primary Market :** Primary market is a market for new issues or new financial claims Hence it is also called New Issue market The primary market deals with those securities which are issued to the public for the first time In the primary market, borrowers exchange new financial securities for long term funds Thus, primary market facilitates capital formation

There are three ways by which a company may raise capital in a primary market They are

(i) Public issue

(ii) Rights issue

(iii) Private placement

The most common method of raising capital by new companies is through sale of securities to the public It is called public issue When an existing company wants to raise additional capital, securities are first offered to the existing shareholders on a pre-emptive basis It is called rights issue Private placement is a way of selling securities privately to a small group of investors

**Secondary Market :** Secondary market is a market for secondary sale of securities In other words, securities which have already passed through the new issue market are traded in this market Generally, such securities are quoted in the stock exchange and it provides a continuous and regular market for buying and selling of securities This market consists of all stock exchanges recognized by the Government of India The stock exchanges in India are regulated under the Securities Contracts (Regulation) Act, 1956 The Bombay Stock Exchange is the principal stock exchange in India which sets the tone of the other stock markets

### II. Government Securities Market

It is otherwise called Gilt-Edged securities market It is a market where Government securities are traded In India there are many kinds of Government Securities-short term and long term Long term securities are traded in this market while short term securities are traded in the money market Securities issued by the

Central Government, State Governments, Semi-Government authorities like City Corporations, Port Trusts Improvement Trusts, State Electricity Boards, All India and State level financial institutions and public sector enterprises are dealt in this market

Government securities are issued in denominations of Rs 100 Interest is payable half-yearly and they carry tax exemptions also The role of brokers in marketing these securities is practically very limited and the major participant in this market in the "commercial banks" because they hold a very substantial portion of these securities to satisfy their S L R requirements

The secondary market for these securities is very narrow since most of the institutional investors tend to retain these securities until maturity The Government securities are in many forms These are generally

(i) Stock certificates or inscribed stock

(ii) Promissory Notes

(iii) Bearer Bonds which can be discounted

Government securities are sold through the Public Debt Office of the RBI while Treasury Bills (short term securities) are sold through auctions

Government securities offer a good source of raising inexpensive finance for the Government exchequer and the interest on these securities influences the prices and yields in this market Hence this market also plays a vital role in monetary management

**III. Long Term Loans Market**

Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customers Long term loans market may further be classified into

(i) Term loans market

(ii) Mortgages market

(iii) Financial Guarantees market

**(i)Term Loans Market:** In India, many industrial financing institutions have been created by thee Government both at the national and regional levels to supply long term and medium term loans to corporate customers directly as well as indirectly These development banks dominate the industrial finance in India Institutions like IDBI, IFCI, ICICI, and other state financial corporations come under this category These institutions meet the growing and varied long-term financial requirements of industries by supplying long term loans They also help in identifying investment opportunities, encourage new entrepreneurs and support modernization efforts

**(ii)Mortgages Market :** The mortgages market refers to those centers which supply mortgage loan mainly to individual customers A mortgage loan is a loan against the security of immovable property like real estate The transfer of interest in a specific immovable property to secure a loan is called mortgage This mortgage may be equitable mortgage or legal one Again it may be a first charge or second charge Equitable mortgage is created by a mere deposit of title deeds to properties as security whereas in the case of legal mortgage the title in the property is legally transferred to the lender by the borrower Legal mortgage is less risky

Similarly, in the first charge, the mortgager transfers his interest in the specific property to the mortgagee as security When the property in question is already mortgaged once to another creditor, it becomes a second charge when it is subsequently mortgaged to somebody else The mortgagee can also further transfer his interest in the mortgaged property to another In such a case, it is called a sub-mortgage

The mortgage market may have primary market as well secondary market The primary market consists of original extension of credit and secondary market has sales and re-sales of existing mortgages at prevailing prices

In India residential mortgages are the most common ones The Housing and Urban Development Corporation (HUDCO) and the LIC play a dominant role in financing residential projects Besides, the Land Development Banks provide cheap mortgage loans for the development of lands, purchase of equipment etc These development banks raise finance through the sale of debentures which are treated as trustee securities

**(iii)Financial Guarantees Market :** A Guarantee market is a center where finance is provided against the guarantee of a reputed person in the financial circle Guarantee is a contract to discharge the liability of a third party in case of his default Guarantee acts as a security from the creditor's point of view In case the borrower fails to repay the loan, the liability falls on the shoulders of the guarantor Hence the guarantor must be known to both the borrower and the lender and he must have the means to discharge his liability

Though there are many types of guarantees, the common forms are (i) Performance Guarantee, and (ii) Financial Guarantee Performance guarantees cover the payment of earnest money, retention money, advance payments, non-completion of contracts etc On the other hand financial guarantees cover only financial contracts

In India, the market for financial guarantees is well organized The financial guarantees in India relate to

(i) Deferred payments for imports and exports

(ii) Medium and long term loans raised abroad

(iii) Loans advanced by banks and other financial institutions

These guarantees are provided mainly by commercial banks, development banks, Governments both central and states and other specialized guarantee institutions like ECGC (Export Credit Guarantee Corporation) and DICGC (Deposit Insurance and Credit Guarantee Corporation) This guarantee financial service is available to both individual and corporate customers For a smooth functioning of any financial system, this guarantee service is absolutely essential

**Importance of Capital Market:**

Absence of capital market acts as a deferent factor to capital formation and economic growth Resources would remain idle if finance are not funneled through capital market. The importance of capital market can be briefly summarized as follows ·

(i) The capital market serves as +an important source for the productive use of the economy's savings. It mobilizes the savings of the people for further investment and thus avoids their wastage in unproductive uses.

(ii) It provides incentives to saving and facilitates capital formation by offering suitable rates of interest as the price of capital

(iii) It provides an avenue for investors, particularly the household sector to invest in financial assets which are more productive than physical assets.

(iv) It facilitates increase in production and productivity in the economy and thus enhance the economic welfare of the society Thus, it facilitates "the movement of stream of command over capital to the point of highest yield" towards those who can apply them productively and profitably to enhance the national income in the aggregate

(v) The operations of different institutions in the capital market induce economic growth They give quantitative and qualitative directions to the flow of funds and bring about rational allocation of scarce resources.

(vi) A healthy capital market consisting of expert intermediaries promotes stability in values of securities representing capital funds

(vii) Moreover, it serves as an important source for technological up gradation in the industrial sector by utilizing the funds invested by the public

Thus, a capital market serves as an important link between those who save and those who aspire to invest these savings

**(ii)Money Market**

Money market is a market for dealing with financial assets and securities which have a maturity period of upto one year In other words, it is a market for purely short term funds The money market may be subdivided into four. They are·

(i) Call money market

(ii) Commercial bills market

(iii) Treasury bills market

(iv) Short term loan market

**Call Money Market :** The call money market is a market for extremely short period loans say one day to fourteen days So, it is highly liquid The loans are repayable on demand at the option of either the lender or the borrower In India, call money markets are associated with the presence of stock exchanges and hence, they are located in major industrial towns like Bombay, Calcutta, Madras, Delhi, Ahmedabad etc The special feature of this market is that the interest rate varies from day to day and even from hour to hour and centre to centre It is very sensitive to changes in demand and supply of call loans

**Commercial Bills Market :** It is a market for bills of exchange arising out of genuine trade transactions In the case of credit sale, the seller may draw a bill of exchange on the buyer The buyer accepts such a bill promising to pay at a later date specified in the bill The seller need not wait until the due date of the bill Instead, he can get immediate payment by discounting the bill

In India the bill market is under-developed The RBI has taken many steps to develop a sound bill market The RBI has enlarged the list of participants in the bill market The Discount and Finance House of India was set up in 1988 to promote secondary market in bills In spite of all these, the growth of the bill market is slow in India There are no specialized agencies for discounting bills The commercial banks play a significant role in this market

**Treasury Bills Market :** It is a market for treasury bills which have 'short-term' maturity A treasury bill is a promissory note or a finance bill issued by the Government It is highly liquid because its repayment is guaranteed by the Government It is an important instrument for short term borrowing of the Government There are two types of treasury bills namely (i) ordinary or regular and (ii) adhoc treasury bills popularly known as 'adhocs'

Ordinary treasury bills are issued to the public, banks and other financial institutions with a view to raising resources for the Central Government to meet its short term financial needs. Adhoc treasury bills are issued in favour of the RBI only They are not sold through tender or auction They can be purchased by the RBI only Adhocs are not marketable in India but holders of these bills can sell them back to 364 days only Financial intermediaries can park their temporary surpluses in these instruments and earn income

**Short-Term Loan Market :** It is a market where short-term loans are given to corporate customers for meeting their working capital requirements Commercial banks play a significant role in this market Commercial banks provide short term loans in the form of cash credit and overdraft Overdraft facility is mainly given to business people whereas cash credit is given to industrialists Overdraft is purely a temporary accommodation and it is given in the current account itself But cash credit is for a period of one year and it is sanctioned in a separate account

**Foreign Exchange Market**

The term foreign exchange refers to the process of converting home currencies into foreign currencies and vice versa According to Dr Paul Einzing "Foreign exchange is the system or process of converting one national currency into another, and of transferring money from one country to another"

The market where foreign exchange transactions take place is called a foreign exchange market It does not refer to a market place in the physical sense of the term. In fact, it consists of a number of dealers, banks and brokers engaged in the business of buying and selling foreign exchange It also includes the central bank of each country and the treasury authorities who enter into this market as controlling authorities.

**Functions :** The most important functions of this market are :

(i) To make necessary arrangements to transfer purchasing power from one country to another.

(ii) To provide adequate credit facilities for the promotion of foreign trade.

(iii) To cover foreign exchange risks by providing hedging facilities.

In India, the foreign exchange business has a three-tiered structure consisting of:

(i) Trading between banks and their commercial customers.

(ii) Trading between banks through authorized brokers.

(iii) Trading with banks abroad Brokers play a significant role in the foreign exchange market in India

Apart from authorised dealers, the RBI has permitted licensed hotels and individuals (known as Authorised Money Changers) to deal in foreign exchange business. The FEMA helps to smoothen the flow of foreign currency and to prevent any misuse of foreign exchange which is a scarce commodity

### 1.2.4 FINANCIAL RATES OF RETURN

Most households in India still prefer to invest on physical assets like land, buildings, gold, silver etc But, studies have shown that investment in financial assets like equities in capital market fetches more return than investments on gold. It is imperative that one should have some basic knowledge about the rate of return on financial assets also. The return on Government securities and bonds are comparatively less than on corporate securities due to lower risk involved therein. The Government and the RBI determine the interest rates on Government securities. Thus, the interest rates are administered and controlled. The peculiar feature of the interest rate structure is that the interest rates do not reflect the free market forces They do not reflect the scarcity value of capital in the country also. Most of these rates are fixed on an ad hoc basis depending upon the credit and monetary policy of the Government. Generally the interest rate policy of the Government is designed to achieve the following:

(i) To enable the Government to borrow comparatively cheaply.

(ii) To ensure stability in the macro-economic system

(iii) To support certain sectors through preferential lending rates

(iv) To mobilize substantial savings in the economy

### 1.2.5 FINANCIAL INSTRUMENTS

Financial instruments refer to those documents which represent financial claims on assets As discussed earlier, financial asset refers to a claim to the repayment of a certain sum of money at the end of a specified period together with interest or dividend. Examples are Bill of exchange, Promissory Note, Treasury Bill, Government Bond, Deposit Receipt, Share, Debenture, etc. Financial instruments can also be called financial securities Financial securities can be classified into

(i) Primary or direct securities

(ii) Secondary or indirect securities.

**Primary Securities :** These are securities directly issued by the ultimate investors to the ultimate savers, e g shares and debentures issued directly to the public

**Secondary Securities :** These are securities issued by some intermediaries called financial intermediaries to the ultimate savers, e.g. Unit Trust of India and mutual funds issue securities in the form of units to the public and the money pooled is invested in companies

Again these securities may be classified on the basis of duration as follows :

(i) Short-term securities

(ii) Medium-term securities

(iii) Long-term securities

Short-term securities are those which mature within a period of one year. For example, Bill of Exchange, Treasury Bill, etc Medium-term securities are those which have a maturity period ranging between one and five years like Debentures maturing within a period of 5 years. Long-term securities are those which have a maturity period of more than five years For example, Government Bonds maturing after 10 years

**Characteristic Features Of Financial Instruments:**

Generally speaking, financial instruments possess the following characteristic features·

(i) Most of the instruments can be easily transferred from one hand to another without many cumbersome formalities

(ii) They have a ready market i e , they can be bought and sold frequently and thus trading in these securities is made possible

(iii) They possess liquidity, i e , some instruments can be converted into cash readily For instance, a bill of exchange can be converted into cash readily by means of discounting and rediscounting

(iv) Most of the securities possess security value, i e , they can be given as security for the purpose of raising loans

(v) Some securities enjoy tax status, i e , investment in these securities are exempted from Income Tax, Wealth Tax, etc , subject to certain limits

(vi) They carry risk in the sense that there is uncertainty with regard to payment of principal or interest or dividend as the case may be

(vii) These instruments facilitate future trading so as to cover risks due to price fluctuations, interest rate fluctuations etc

(viii) These instruments involve less handling costs since expenses involved in buying and selling these securities are generally much less

(ix) The return on these instruments is directly in proportion to the risk undertaken

(x) These instruments may be short-term or medium term or long-term depending upon the maturity period of these instruments

## 1.3 DEVELOPMENT OF FINANCIAL SYSTEM IN INDIA

Some serious attention was paid to the development of a sound financial system in India only after the launching of the planning era in the country At the time of Independence in 1947, there was no strong financial institutional mechanism in the country There was absence of issuing institutions and nonparticipation of intermediary financial institutions The industrial sector also had no access to the savings of the community The capital market was very primitive and shy The private as well as the unorganized sector played a key role in the provision of 'liquidity' On the whole, chaotic conditions prevailed in the system With the adoption of the theory of mixed economy, the development of the financial system took a different turn so as to fulfill the socio-economic and political objectives The Government started creating new financial institutions to supply finance both for agricultural and industrial development and it also progressively started nationalizing some important financial institutions so that the flow of the finance might be in the right direction

### Nationalisation of Financial Institution

As we know that the RBI is the leader of the financial system But, it was established as a private institution in 1935 It was nationalized in 1948 It was followed by the nationalization of the Imperial Bank of India in 1956 by renaming it as State Bank of India In the same year, 245 Life Insurance Companies were brought under Government control by merging all of them into a single corporation called Life Insurance Corporation of India. Another significant development in our financial system was the nationalization of 14 major commercial banks in 1969 Again, 6 banks were nationalized in 1980 This process was then extended to General Insurance Companies which were reorganized under the name of General Insurance Corporation of India. thus, the important financial institutions were brought under public control

**Starting of Unit Trust of India**

Another landmark in the history of development of our financial system is the establishment of new financial institutions to strengthen our system and to supply institutional credit to industries

The Unit Trust of India was established in 1964 as a public sector institution to collect the savings of the people and make them available for productive ventures. It is the oldest and largest mutual fund in India It is governed by its own statues and regulations However, since 1994, the schemes of UTI have to be approved by the SEBI It has introduced a number of open-ended and close-ended schemes. It also provides re-purchase facility of units of the various income schemes of UTI are linked with stock exchanges. Its investment is confined to both corporate and non-corporate sectors It has established the following subsidiaries·

(i) The UTI Bank Ltd., in April 1994

(ii) The UTI Investor Service Ltd , to act as UTI's own Registrar and Transfer agency

(iii) The UTI Security Exchange Ltd

**Establishment of Development Banks**

Many development banks were started not only to extend credit facilities to financial institutions but also to render advisory services These banks are multipurpose institutions which provide medium and long term credit to industrial undertakings, discover investment projects, undertake the preparation of project reports, provide technical advice and managerial services and assist in the management of industrial units These institutions are intended to develop backward regions as well as small and new entrepreneurs.

The Industrial Finance Corporation of India (IFCI) was set up in 1948 with the object of "making medium and long term credits more readily available to industrial concerns in India, particularly under circumstances where normal banking accommodation is inappropriate or recourse to capital issue method is impracticable" At the regional level, State Financial Corporations were established under the State Financial Corporation Act, 1951 with a view to providing medium and long term finance to medium and small industries It was followed by the establishment of the Industrial Credit and Investment Corporation of India (ICICI) in 1955 to develop large and medium industries in private sector, on the initiative of the World Bank It adopted a more dynamic and modern approach in industrial financing Subsequently, the Government of India set up the Refinance Corporation of India (RCI) in 1958 with a view to providing refinance facilities to banks against term loans granted by them to medium and small units Later on it was merged with the Industrial Development Bank of India. The Industrial Development Bank of India (IDBI) was established on July 1, 1964 as a wholly owned subsidiary of the RBI The ownership of IDBI was then transferred to the Central Government with effect from February 16, 1976 The IDBI is the apex institution in the area of development banking and as such it has to co-ordinate the activities of all the other financial institutions At the State level, the State Industrial Development Corporations (SIDCO)/ State Industrial Investment Corporations were created to meet the financial requirements of the States and to promote regional development

In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India (IRCI) with the main objective of reconstruction and rehabilitation of sick industrial undertakings The IRCI was converted into a statutory corporation in March 1985 and renamed as the Industrial Reconstruction Bank of India (IRBI) In 1997, the IRBI has to be completely restructured since it itself has become sick due to financing of sick industries Now, it is converted into a limited company with a new name of Industrial Investment Bank of India (IIBI) Its objective is to finance only for expansion, diversification, modernization etc , of industries and thus it has become a development bank

The Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI It commenced operations on April 2, 1990 The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund

**Institution for Financing Agriculture**

In 1963, the RBI set up the Agricultural Refinance and Development Corporation (ARDC) to provide refinance support to banks to finance major development projects such as minor irrigation, farm mechanization,, land development, horticulture, daily development, etc However, in July 1982, the National Bank for Agriculture and Rural Development (NABARD) was established and the ARDC was merged with it The whole sphere of agricultural finance has been handed over to NABARD The functions of the Agricultural Credit Department and Rural Planning and Credit Cell of the RBI have been taken over by NABARD

**Institution for Foreign Trade**

The Export and Import Bank of India (EXIM Bank) was set up on January 1, 1982 to take over the operations of International Finance wing of the IDBI Its main objective is to provide financial assistance to exporters and importers It functions as the principal financial institution for coordinating the working of other institutions engaged in financing of foreign trade It also provides refinance facilities to other financial institutions against their export-import financing activities

**Institution for Housing Finance**

The National Housing Bank (NHB) has been set up on July 9, 1988 as an apex institution to mobilize resources for the housing sector and to promote housing finance institutions both at regional and local levels It also provides refinance facilities to housing finance institutions and scheduled banks It also provides guarantee and underwriting facilities to housing finance institutions Again, it co-ordinates the working of all agencies connected with housing Stock Holding Corporation of India Ltd (SHCIL) Recently in 1987 another institution viz , Stock Holding Corporation of India Ltd was set up to tone up the stock and capital markets in India Its main objective is to provide quick share transfer facilities, clearing services, Depository services, support services, management information services and development services to investors both individuals and corporates The SHCIL was set up by seven All India financial institutions viz , IDBI, IFCI, ICICI, LIC, GIC, UTI and IRBI

## Mutual Funds Industry

Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public and investing them in a diversified portfolio They provide investment avenues for small investors who cannot participate in the equities of big companies Mutual funds have been floated by some public sector banks, LIC, GIC and recently by private sector also

## Venture Capital Institutions

Venture capital is another method of financing in the form of equity participation A venture capitalist finances a project based on the potentialities of a new innovative project Much thrust is given to new ideas or technological innovations Indeed it is a long term risk capital to finance high technology projects The IDBI venture capital fund was set up in 1986 The IFCI has started a subsidiary to finance venture capital viz , The Risk Capital and Technology Finance Corporation (RCTC) Likewise the ICICI and the UTI have jointly set up the Technology Development and Information Company of India Limited (TDICI) in 1988 to provide venture capital Similarly many State Financial Corporations and commercial banks have started subsidiaries to provide venture capital The Indus Venture Capital Fund and the Credit Capital Venture Fund Limited come under the private sector

## Credit Rating Agencies

Of late, many credit rating agencies have been established to help investors to make a decision of their investment in various instruments and to protect them from risky ventures At the same time it has the effect of improving the competitiveness of the companies so that one can excel the other. Credit rating is now mandatory for all debt instruments Similarly, for accepting deposits, non-banking companies have to compulsorily go for credit rating Some of the credit rating agencies established.

(i) Credit Rating and Information Services of India Ltd (CRISIL)

(ii) Investment Information and Credit Rating Agency of India Ltd (ICRA)

(iii) Credit Analysis and Research Ltd (CARE)

(iv) Duff Phelps Credit Rating Pvt Ltd (DCR India)

The rating is confined to fixed deposits, debentures, preference shares and short term instruments like commercial paper The establishment of various credit rating agencies will go a long way in stabilizing the financial system in India by supplying vital credit information about corporate customers

## Multiplicity of Financial Instruments

The expansion in size and number of financial institutions has consequently led to a considerable increase in the financial instruments also New instruments have been introduced in the form of innovative schemes of LIC, UTI, Banks, Post Office Savings Bank Accounts, Shares and debentures of different varieties, Public Sector

Bonds, National Savings Scheme, National Savings Certificates, Provident Funds, Relief Bonds, Indira Vikas Patra, etc Thus different types of instruments are available in the financial system so as to meet the diversified requirements of varied investors and thereby making the system more healthy and vibrant.

**Legislative Support**

The Indian financial system has been well supported by suitable legislative measures taken by the Government then and there for its proper growth and smooth functioning Though there are many enactments, some of them are very important. The Indian Companies Act was passed in 1956 with a view to regulating the function of companies from birth to death It mainly aims at giving more protection to investors since there is a diversity of ownership and management in companies It was a follow up to the Capital Issues Control Act passed in 1947 Again, in 1956, the Securities Contracts (Regulations) Act was passed to prevent undesirable transactions in securities It mainly regulates the business of trading in the stock exchanges. This Act permitted only recognized stock exchanges to function

To ensure the proper functioning of the economic system and to prevent concentration of economic power in the hands of a few, the Monopolies and Restrictive Trade Practices Act was passed in 1970 In 1973, the Foreign Exchange Regulations Act was enacted to regulate the foreign exchange dealings and to control Indian investments abroad and vice versa

The Capital Issue Control Act was replaced by setting up of the Securities Exchange Board of India Its main objective is to protect the interest of investors by suitably regulating the dealings in the stock market and money market so as to achieve efficient and fair trading in these markets When the Government adopted the New Economic Policy, many of these Acts were amended so as to remove many unwanted controls Bank and financial institutions have been permitted to become members of the stock market in India They have been permitted to float mutual funds, undertake leasing business, carry out factoring services etc

Besides the above, the Indian Contract Act, The Negotiable Instruments Act, The Law of Limitation Act, The Banking Regulations Act, The Stamp Act etc , deserve a special mention When the financial system grows, the necessity of regulating it also grows side by side by means of bringing suitable legislations These legislative measures have re-organised the Indian financing system to a greater extent and have restored confidence in the minds of the investing public as well

## 1.4 WEAKNESSES OF INDIAN FINANCIAL SYSTEM

After the introduction of planning, rapid industrialization has taken place It has in turn led to the growth of the corporate sector and the Government sector In order to meet the growing requirements of the Government and the industries, many innovative financial instruments have been introduced. Besides, there has been a mushroom growth of financial intermediaries to meet the ever growing financial requirements of different types of customers Hence, the Indian financial system is more developed and integrated today than what it was 50 years ago Yet, it suffers from some weaknesses as listed below

**(i) Lack of Co-ordination between different Financial Institutions**

There are a large number of financial intermediaries  Most of the vital financial institutions are owned by the Government  At the same time, the Government is also the controlling authority of these institutions  In these circumstances, the problem of co-ordination arises  As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions

**(ii) Monopolistic Market Structures**

In India some financial institutions are so large that they have created a monopolistic market structures in the financial system  For instance the entire life insurance business is in the hands of LIC  The UTI has more or less monopolized the mutual fund industry  The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement or lack of effort in mobilizing savings of the public and so on  Ultimately it would retard the development of the financial system of the country itself

**(iii) Dominance of Development Banks in Industrial Financing**

The development banks constitute the backbone of the Indian financial system occupying an important place in the capital market  The industrial financing today in India is largely through the financial institutions created by the Government both at the national and regional levels  These development banks act as distributive agencies only, since, they derive most of their funds, from their sponsors  As such, they fail to mobilize the savings of the public  This would be a serious bottleneck which stands in the way of the growth of an efficient financial system in the country  For industries abroad, institutional finance has been a result of institutionalization of personal savings through media like banks, LIC, pension and provident funds, unit trusts and so on  But they play a less significant role in Indian financial system, as far as industrial financing is concerned  However, in recent times attempts are being made to raise funds from the public through the issue of bonds, units, debentures and so on  It will go a long way in forging a link between the normal channels of savings and the distributing mechanism

**(iv) Inactive and Erratic Capital Market**

The important function of any capital market is to promote economic development through mobilization of savings and their distribution to productive ventures  As far as industrial finance in India is concerned, corporate customers are able to raise their financial resources through development banks  So, they need not go to the capital market  Moreover, they don't resort to capital market since it is very erratic and inactive  Investors too prefer investments in physical assets to investments in financial assets  The weakness of the capital market is a serious problem in our financial system

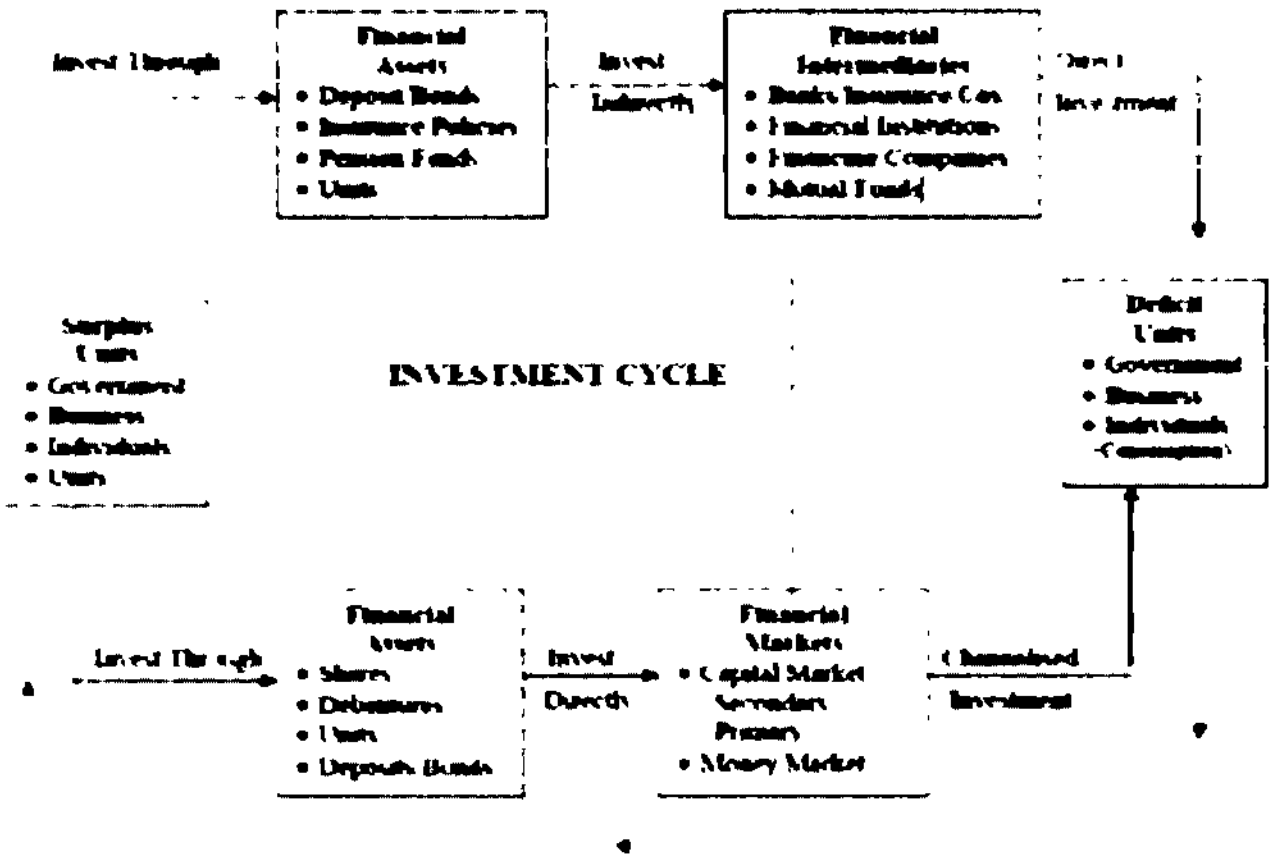
**(v) Imprudent Financial Practice**

The dominance of development banks has developed imprudent financial practice among corporate customers  The development banks provide most of the funds in the form of term loans  So there is a preponderance of debt in the financial structure of corporate enterprises  This predominance of debt capital has made the capital structure of the borrowing concerns uneven and lopsided To make maters worse, when corporate enterprises face any financial crises, these financial institutions permit a greater use of debt than a warranted It is against the traditional concept of a sound capital structure

However, in recent times all efforts have been taken to activate the capital market Integration is also taking place between different financial institutions For instance, the Unit Linked Insurance Schemes of the UTI are being offered to the public in collaboration with the LIC Similarly the refinance and rediscounting facilities provided by the IDBI aim at integration Thus, the Indian financial system has become a developed one

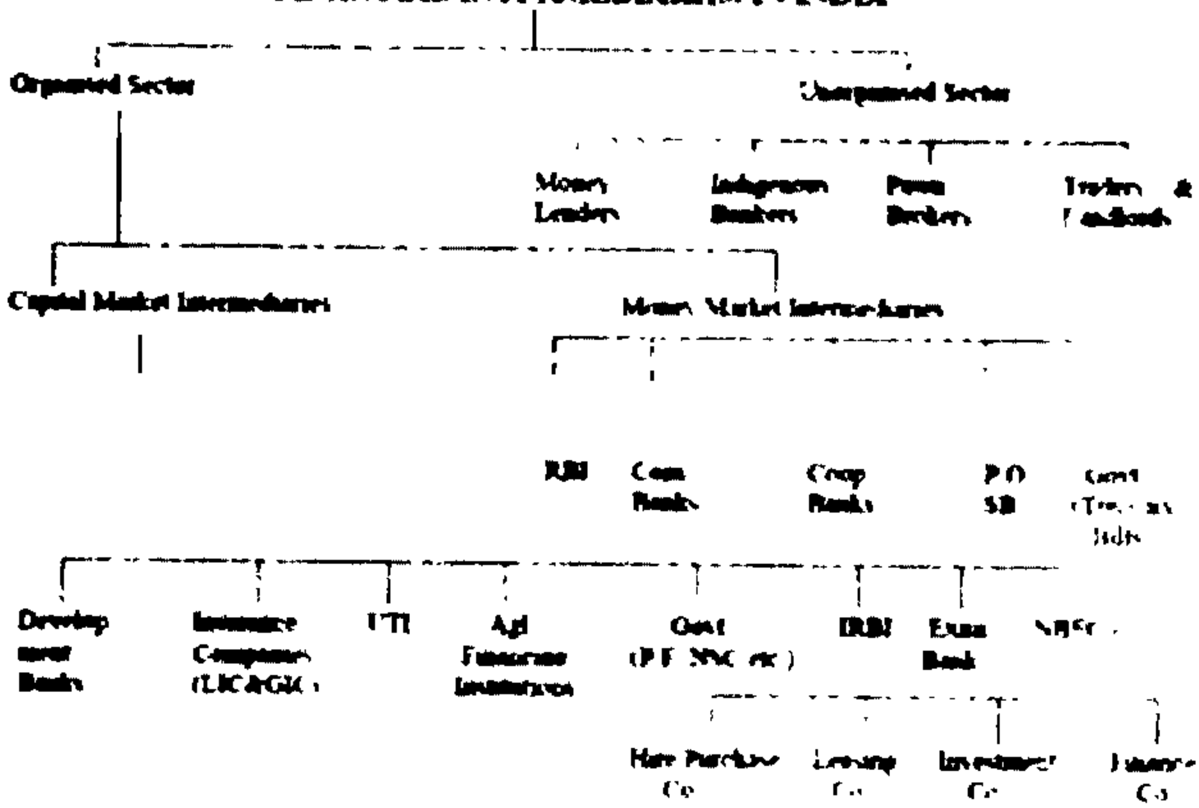
**CHART – I**

**WORKING OF FINANCIAL SYSTEM**



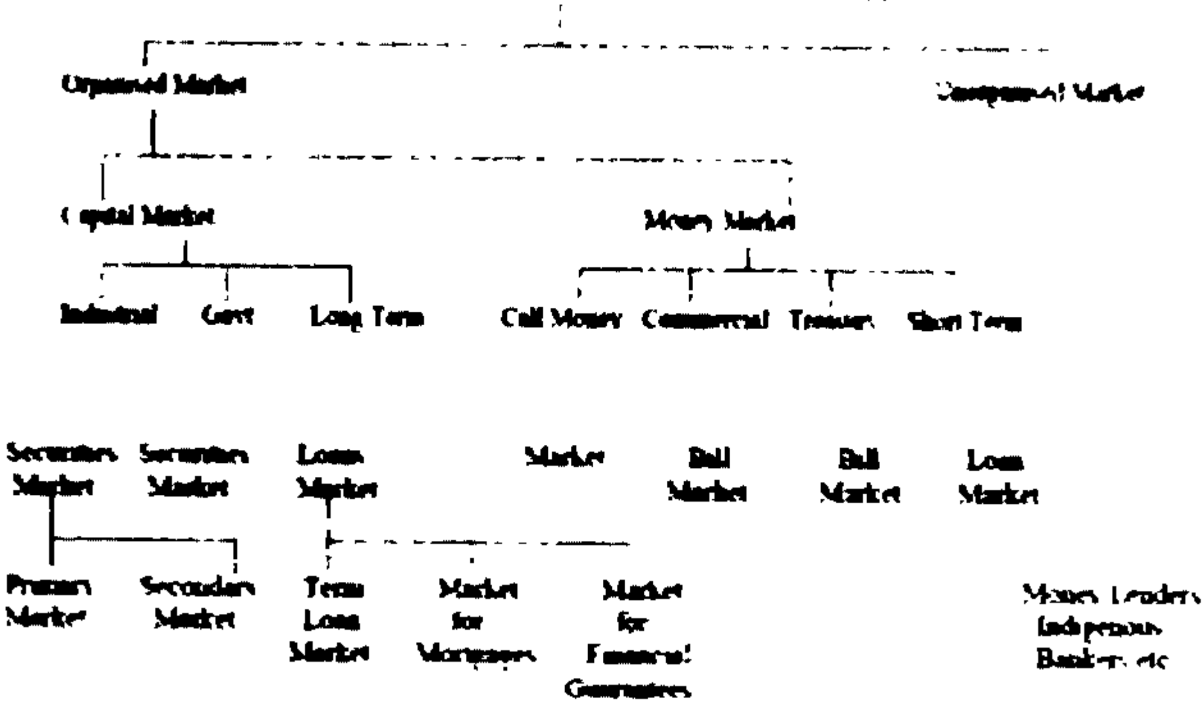
## CHART II

## FINANCIAL INTERMEDIARIES IN INDIA




## CHART III

## CLASSIFICATION OF FINANCIAL MARKETS



## 1.5 MEANING OF FINANCIAL SERVICES

The Indian Financial services industry has undergone a metamorphosis since 1990 During the late seventies and eighties, the Indian financial service industry was dominated by commercial banks and other financial institutions which cater to the requirements of the Indian industry Infact the capital market played a secondary role only The economic liberalization has brought in a complete transformation in the Indian financial services industry

Prior to the economic liberalization, the Indian financial service sector was characterized by so many factors which retarded the growth of this sector Some of the significant factors were

(i) Excessive controls in the form of regulations of interest rates, money rates etc

(ii) Too many control over the prices of securities under the erstwhile Controller of Capital Issues

(iii) Non-availability of financial instruments on a large scale as well as on different varieties

(iv) Absence of independent credit rating and credit research agencies

(v) Strict regulation of the foreign exchange market with too many restrictions on foreign investment and foreign equity holding in Indian companies

(vi) Lack of information about international developments in the financial sector

(vii) Absence of a developed Government securities market and the existence of stagnant capital market without any reformation

(viii)Non-availability of debt instruments on a large scale

However, after the economic liberalisation, the entire financial sector has undergone a sea-saw change and now we are witnessing the emergence of new financial products and services almost everyday Thus, the present scenario is characterized by financial innovation and financial creativity and before going deep into it, it is imperative that one should understand the meaning and scope of financial services

In general, all types of activities which are of a financial nature could be brought under the term 'financial services' The term "Financial Services" in a broad sense means "mobilizing and allocating savings" Thus, it includes all activities involved in the transformation of saving into investment

The 'financial service' can also be called 'financial intermediation' Financial intermediation is a process by which funds are moblised from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers Thus, financial services sector is a key are and it is very vital for industrial developments A well developed financial services industry is absolutely necessary to mobilize the savings and to allocate them to various investable channels and thereby to promote industrial development in a country

## 1.6 CLASSIFICATION OF FINANCIAL SERVICES INDUSTRY

The financial intermediaries in India can be traditionally classified into two

(i) Capital market intermediaries and (ii) Money market intermediaries

The capital market intermediaries consist of term lending institutions and investing institutions which mainly provide long term funds. On the other hand, money market consists of commercial banks, cooperative banks and other agencies which supply only short term funds Hence, the term 'financial services industry' includes all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers

## 1.7 SCOPE OF FINANCIAL SERVICES

Financial services cover a wide range of activities They can be broadly classified into two namely

(i) Traditional activities

(ii) Modern activities

**Traditional activities**

Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities

They can be grouped under two heads viz,

(i) Fund based activities and

(ii) Non-fund based activities

**Fund based activities :** The traditional services which come under fund based activities are the following

(i) Underwriting of or investment in shares, debentures, bonds etc of new issues (primary market activities)

(ii) Dealing in secondary market activities

(iii) Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc

(iv) Involving in equipment leasing, hire purchase, venture capital, seed capital etc

(v) Dealing in foreign exchange market activities

**Non-fund based activities :** Financial intermediaries provide services on the basis of non-fund activities also. This can also be called "fee based" activity Today, customers whether individual or corporate are not satisfied with mere provision of finance They expect more from financial service companies Hence, a wide variety of services, are being provided under this head They include the following

(i) Managing the capital issues i e , management of pre-issue and post-issue activities relating to the capital issue in accordance with the SEBI guidelines and thus enabling the promoters to market their issues

(ii) Making arrangements for the placement of capital and debt instruments with investment institutions

(iii) Arrangement of funds from financial institutions for the clients' project cost or his working capital requirements

(iv) Assisting in the process of getting all Government and other clearances

**Modern activities**

Besides the above traditional services, the financial intermediaries render innumerable services in recent times Most of them are in the nature of non-fund based activity In view of the importance, these activities have been discussed in brief under the head 'New financial products and services' However, some of the modern services provided by them are given in brief hereunder

(i) Rendering project advisory services right from the preparation of the project report till the raising of funds for starting the project with necessary Government approval

(ii) Planning for mergers and acquisitions and assisting for their smooth carry out

(iii) Guiding corporate customers in capital restructuring

(iv) Acting as Trustees to the debenture-holders

(v) Recommending suitable changes in the management structure and management style with a view to achieving better results

(vi) Structuring the financial collaboration/joint ventures by identifying suitable joint venture partner and preparing joint venture agreement

(vii) Rehabilitating and reconstructing sick companies through appropriate scheme of reconstruction and facilitating the implementation of the scheme

(viii)Hedging of risk due to exchange rate risk, interest rate risk, economic risk and political risk by using swaps and other derivative products

(ix) Managing the portfolio of large Public Sector Corporations

(x) Undertaking risk management services like insurance services, buy-back options etc

(xi) Advising the clients on the question of selecting the best source of funds taking into consideration the quantum of funds required, their cost, lending period etc

(xii) Guiding the clients in the minimization of the cost of debt and in the determination of the optimum debt-equity mix.

(xiii)Undertaking services relating to the capital market such as

(a) Clearing services,

(b) Registration and transfers,

(c) Safe-custody of securities,

(d) Collection of income on securities

(xiv)Promoting credit rating agencies for the purpose of rating companies which want to go public by the issue of debt instruments

## 1.8 CAUSES FOR FINANCIAL INNOVATION

Financial intermediaries have to perform the task of financial innovation to meet the dynamically changing needs of the economy and to help the investors cope with an increasingly volatile and uncertain market place There is a dire necessity for the financial intermediaries to go for innovation due to the following reasons

**(i) Low profitability :** The profitability of the major financial intermediary, namely the banks has been very much affected in recent times There is a decline in the profitability of traditional banking products So, they have been compelled to seek out new products which may fetch high returns

**(ii) Keen competition :** The entry of many financial intermediaries in the financial sector market has led to severe competition amount themselves This keen competition has paved the way for the entry of varied nature of innovative financial products so as to meet the varied requirements of the investors

**(iii) Economic Liberalisation :** Reform of the financial sector constitutes the most important component of India's programme towards economic liberalization The recent economic liberalization measures have opened the door to foreign competitors to enter into our domestic market Deregulation in the form of elimination of exchange controls and interest rate ceilings have made the market more competitive Innovation has become a must for survival

**(iv) Improved communication technology :** The communication technology has become so advanced that even the world's issuers can be linked with the investors in the global financial market without any difficulty by means of offering so many options and opportunities Hence, innovative products are brought into the domestic market in no time

**(v) Customer Service :** Now-a-days, the customer's expectations are very great They want newer products at lower cost or at lower credit risk to replace the existing ones To meet this increased customer sophistication, the financial intermediaries are constantly undertaking research in order to invent a new product which may suit to the requirement of the investing public Innovations thus help them in soliciting new business

**(vi) Global impact :** Many of the providers and users of capital have changed their roles all over the world Financial intermediaries have come out of their traditional approach and they are ready to assume more credit risks As a consequence, many innovations have taken place in the global financial sector which have its own impact on the domestic sector also.

**(vii) Investor awareness :** With a growing awareness amongst the investing public, there has been a distinct shift from investing the savings in physical assets like gold, silver, land etc to financial assets like shares, debentures, mutual funds etc Again, within the financial assets, they go from 'risk free' bank deposits to risky investments in shares To meet the growing awareness of the public, innovation has become the need of the hour.

**Financial Engineering**

Thus, the growing need for innovation has assumed immense importance in recent times This process is being referred to as financial engineering. Financial engineering is the lifeblood of any financial ability "Financial engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance"

## 1.9 NEW FINANCIAL PRODUCTS AND SERVICES

Today, the importance of financial services is gaining momentum all over the world In these days of complex finance, people expect a Financial Service Company to play a very dynamic role not only as a provider of finance but also as a departmental store of finance With the injection of the economic liberation policy into our economy and the opening of the economy to multinationals, the free market concept has assumed much significance As a result, the clients both corporates and individuals are exposed to the phenomena of volatility and uncertainty and hence they expect the financial service company to innovate new products and service so as to meet their varied requirements

As a result of innovations, new instruments and new products are emerging in the capital market The capital market and the money market are getting widened and deepened Moreover, there has been a structural change in the international capital market with the emergence of new products and innovative techniques of operation in the capital market. Many financial intermediaries including banks have already started expanding their activities in the financial services sector by offering a variety of new products As a result, sophistication and innovations have appeared in the arena of financial intermediations Some of them are discussed below

**(i) Merchant Banking :** A merchant banker is a financial intermediary who helps to transfer capital from those who posses it to those who need it Merchant banking includes a wide range of activities such as management of customers securities, portfolio management, project counseling and appraisal, underwriting of shares and debentures, loan syndication, acting as banker for the refund orders, handling interest and dividend warrants etc Thus, a merchant banker renders a host of services to corporates and thus promotes industrial development in the country

**(ii) Loan Syndication :** This is more or less similar to 'consortium financing' But, this work is taken up by the merchant banker as a lead-manager It refers to a loan arranged by a bank called lead manager for a borrower who is usually a large corporate customer or a Government Department The other banks who are willing to lend can participate in the loan by contributing an amount suitable to their own lending policies Since a single bank cannot provide such a huge sum as loan, a number of banks join together and form a syndicate It also enables the members of the syndicate to share the credit risk associated with a particular loan among themselves

**(iii) Leasing :** A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called "rental charges" The lessee cannot acquire any ownership to the asset, but he can use it and have full control over it he is expected to pay for all maintenance charges and repairing and operating costs In countries like the U S A , the U K and Japan equipment leasing is very popular and nearly 25% of plant and equipment is being financed by leasing companies In India also, many financial companies have started equipment leasing business Commercial banks have also been permitted to carry on this business by forming subsidiary companies

**(iv) Mutual Funds :** A mutual fund refers to a find raised by a financial service company by pooling the savings of the public It is invested in a diversified portfolio with a view to spreading and minimizing risk The fund provides investment avenue for small investors who cannot participate in the equities of big companies It ensures low risk, steady returns, high liquidity and better capital appreciation in the long run

**(v) Factoring :** Factoring refers to the process of managing the sales ledger of a client by a financial service company In other words, it is an arrangement under which a financial intermediary assumes the credit risk in the collection of book debts for its clients The entire responsibility of collecting the book debts passes on to the factor His services can be compared to a del credre agent who undertakes to collect debts But, a factor provides credit information, collects debts, monitors the sales ledger and provides finance against debts Thus, he provides a number of services apart from financing

**(vi) Forfeiting :** Forfeiting is a technique by which a forfeitor (financing agency) discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills The forfeitor does so without any recourse to the exporter and the exporter is protected against the risk of non-payment of debts by the importers

**(vii) Venture Capital :** A venture capital is another method of financing in the form of equity participation A venture capitalist finances a project based on the potentialities of a new innovative project It is in contrast to the conventional "security based financing" Much thrust is given to new ideas or technological innovations Finance is being provided not only for 'start-up capital' but also for 'development capital' by the financial intermediary

**(viii) Custodial Services :** It is another line of activity which has gained importance, of late Under this, a financial intermediary mainly provides services to clients, particularly to foreign investors, for a prescribed fee Custodial services provide agency services like safe keeping of shares and debentures, collection of interest and dividend and reporting of matters on corporate developments and corporate securities to foreign investors

**(ix) Corporate Advisory Service :** Financial intermediaries particularly banks have set up corporate advisory service branches to render services exclusively to their corporate customers For instance, some banks have extended computer terminals to their corporate customers to that they can transact some of their important banking transactions by sitting in their own office As new avenues of finance like Euro loans, GDRs etc are available to corporate customers, this service is of immense help to the customers.

**(x) Securitisation :** Securitisation is a technique whereby a financial company converts its ill-liquid, non-negotiable and high value financial assets into securities of small value which are made tradable and transferable A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc which are long term in nature and which are non-negotiable In such cases, securitisation would help the financial institution to raise cash against such assets by means of issuing securities of small values to the public. Like any other security, they can be traded in the market it is best suited to housing finance companies whose loans are always long term in nature and their money is locked up for a considerable long period in real estates. Securitisation is the only answer to convert these ill-liquid assets into liquid assets.

**(xi) Derivative Security :** A derivative security is a security whose value depends upon the values of other basic variables backing the security In most cases, these variables are nothing but the prices of traded securities. A derivative security is basically used as a risk management tool and it is resorted to cover the risk due to price fluctuations by the investments manager. Just like a forward contract which is a derivative of a spot contract, a derivative security is derived from other trading securities backing it Naturally the value of a derivative security depends upon the values of the backing securities. Derivative helps to break the risks into various components such as credit risk, interest rates risk, exchange rates risk and so on. It enables the various risk components to be identified precisely and priced them and even traded them if necessary Financial intermediaries can go for derivatives since they will have greater importance in the near future In India some forms of derivatives are in operation

**(xii) New Products in Forex Market :** New products have also emerged in the forex markets of developed countries Some of these products are yet to make full entry in Indian markets Among them, the following are the important ones

**(a) Forward Contracts :** A forward transaction is one where the delivery of a foreign currency takes place at a specified future date for a specified price. It may have a fixed maturity for e g 31st May or a flexible maturity for e.g 1st to 31st May There is an obligation to honour this contract at any cost, failing which, there will be some penalty Forward contracts are permitted only for genuine business transactions It can be extended to other transactions like interest payments

**(b) Options :** As the very name implies, it is a contract wherein the buyer of the option has a right to buy or sell a fixed amount of currency against another currency at a fixed rate on a future date according to his option There is no obligation to buy or sell, but it is completely left to his option Options may be of two types namely call options and put options Under call options, the customer has an option to buy and it is the option to sell under put options Options trading would lead to speculation and hence there are much restrictions in India

**(c) Futures :** It is a contract wherein there is an agreement to buy or sell a stated quantity of foreign currency at a future date at a price agreed to between the parties on the stated exchange Unlike options, there is an obligation to buy or sell foreign exchange on a future date at a specified rate it can be dealt only in a stock exchange

**(d) Swaps :** A swap refers to a transaction wherein a financial intermediary buys and sells a specified foreign currency simultaneously for different maturity dates-say, for instance, purchase of spot and sale of forward or vice versa with different maturities Thus swaps would result in simultaneous buying and selling of the same foreign currency of the same value for different maturities to eliminate exposure risk It can also be used as a tool to enter arbitrage operations, if any, between two countries It can also be used in the interest rate market also

**(xiii) Lines of Credit (LOC) :** It is an innovative funding mechanism for the import of goods and services on deferred payment terms LOC is an arrangement of financing institution/bank of one country with another institution/ bank/agent to support the export of goods and services to as to enable the importers to import no deferred payment terms This may be backed by a guarantee furnished by the institution/bank in the importing country The LOC helps the exporters to get payment immediately as soon as the goods are shipped, since, the funds would be paid out of the pool account with the financing agency and it would be debited to the account of the borrower agency/importer whose contract for availing the facility is already approved by the financing agency on the recommendation of the overseas institution It acts as conduct of financing which is for a certain period and on certain terms for the required goods to be imported The greatest advantage is that it saves a lot of time and money on mutual verification of bonafides, source of finance etc It serves as a source of forex

## 1.10 INNOVATIVE FINANCIAL INSTRUMENTS

In recent years, innovation has been the key word behind the phenomenal success of many of the financial service companies and it forms an integral part of all planning and policy decisions This has helped them to keep in tune with the changing times and changing customer needs Accordingly, many innovative financial instruments have come into the financial market in recent times Some of them have been discussed hereunder

**(i) Commercial Paper :** A paper is a short-term negotiable money market instrument It has the character of an unsecured promissory note with a fixed maturity of 3 to 6 months Banking and non-banking companies can issue this for raising their short term debt It also carries an attractive rate of interest Commercial papers are sold at a discount from their face value and redeemed at their face value Since its denomination is very high, it is suitable only to institutional investors and companies

**(ii) Treasury Bill :** A treasury bill is also a money market instrument issued by the Central Government. It is also issued at a discount and redeemed at par Recently, the Government has come out with short term treasury bills of 182-days bills and 364-days bills

**(iii) Certificate of Deposit :** The scheduled commercial banks have been permitted to issue certificate of deposit without any regulation on interest rates This is also a money market instrument and unlike a fixed deposit receipt, it is a negotiable instrument and hence it offers maximum liquidity. As such, it has a secondary market too Since the denomination is very high, it is suitable to mainly institutional investors and companies

**(iv) Inter-bank Participations (IBPs) :** The scheme of inter-bank participation is confined to scheduled banks only for a period ranging between 91 days and 180 days This may be 'with risk' participation or 'without risk' participation However, only a few banks have so far issued IBPs carrying an interest rate ranging between 14 and 17 per cent per annum This is also a money market instrument

**(v) Zero Interest Convertible Debenture/Bonds :** As the very name suggests, these instruments carry no interest till the time of conversion These instruments are converted into equity shares after a period of time

**(vi) Deep Discount Bonds :** There will be no interest payments in the case of deep discount bonds also Hence, they are sold at a large discount to their nominal value For example, the Industrial Development Bank of India issued in February 1996 deep discount bonds Each bond having a face value of Rs.2,00,000 was issued at a deep discounted price of Rs 5300 with a maturity period of 25 years Of course, provisions are there for early withdrawal or redemption in which case the deemed face value of the bond would be reduced proportionately This bond could be gifted to any person

**(vii) Index-Linked Guilt Bonds :** These are instruments having a fixed maturity Their maturity value is linked to the index prevailing as on the date of maturity Hence, they are inflation-free instruments

**(viii) Option Bonds :** These bonds may be cumulative or non-cumulative as per the option of the holder of the bonds In the case of cumulative bonds, interest is accumulated and is payable only on maturity But, in the case of non-cumulative bond, the interest is paid periodically This option has to be exercised by the prospective investor at the time of investment

**(ix) Secured Premium Notes :** These are instruments which carry no interest of three years In other words, their interest will be paid only after 3 years, and hence, companies with high capital intensive investments can resort to this type of financing

**(x) Medium Term Debentures :** Generally, debentures are repayable only after a long period But, these debentures have a medium term maturity Since they are secured and negotiable, they are highly liquid These types of debt instruments are very popular in Germany

**(xi) Variable Rate Debentures :** Variable rate debentures are debt instruments They carry a compound rate of interest, but this rate of interest is not a fixed one It varies from time to time in accordance with some pre-determined formula as we adopt in the case of Dearness Allowance calculations

**(xii) Non-Convertible Debentures with Equity Warrants :** Generally debentures are redeemed on the date of maturity but, these debentures are redeemed in full at a premium in instalments as in the case of anticipated insurance policies The instalments may be paid at the end of 5th, 6th, 7th and 8th year from the date of allotment

**(xiii) Equity with 100% Safety Net :** Some companies make "100% safety net" offer to the public It means that they give a guarantee to the issue price Suppose, the issue price is Rs 40/- per share (nominal value of Rs 10/- per share), the company is ready to get it back at Rs 40/- at any time, irrespective of the market price

That is, even if the market price comes down to Rs 30/- there is 100% safety net and hence the company will get it back at Rs 40/-

**(xiv) Cumulative convertible Preference Shares :** These instruments along with capital and accumulated dividend must be compulsorily converted into equity shares in a period of 3 to 5 years from the date of their issue, according to the discretion of the issuing company The main object of introducing it is to offer the investor an assured minimum return together with the prospect of equity appreciation This instrument is not popular in India

**(xv) Convertible Bonds :** A convertible bond is one which can be converted into equity shares at a perdetermined timing neither fully or partially There are compulsory convertible bonds which provide for conversion within 18 months of their issue There are optionally convertible bonds which provide for conversion within 36 months There are also bonds which provide for conversion after 36 months and they carry 'call' and 'put' features

**(xvi) Debentures with 'Call' and 'Put' Feature :** Sometimes debentures may be issued with 'Call' and 'Put' feature In the case of debentures with 'Call feature', the issuing company has the option to redeem the debentures at a certain price before the maturity date In the case of debentures with 'Put features', the company gives the holder the right to seek redemption at specified times at predetermined prices

**(xvii) Easy Exit Bond :** As the name indicates, this bond enables the small investors to encash the bond at any time after 18 months of its issue and thereby paving a way for an easy exit It has a maturity period of 10 years with a call option any time after 5 years Recently the IDBI has issued this type of bond with a face value of Rs 5000 per bond (xviii) Retirement Bond This type of bond enables an investor to get an assured monthly income for a fixed period after the expiry of the 'wait period' chosen by him No payment will be made during the 'wait period' The longer the wait period, the higher will be the monthly income, Besides these, the investor will also get a lump sum amount on maturity For example, the IDBI has issued Retirement Bond '96 assuring a fixed monthly income for 10 years after the expiry of the wait period This bond can be gifted to any person

**(xix) Regular Income Bond :** This bond offers an attractive rate of interest payable half yearly with the facility of early redemption The investor is assured of regular and fixed income For example, the IDBI has issued Regular Income Bond '96 carrying 16% interest p a It is redeemable at the end of every year from the expiry of 3 years from the date of allotment

**(xx) Infrastructure Bond :** It is a kind of debt instrument issued with a view to giving tax shelter to investors The resources raised through this bond will be used for promoting investment in the field of certain infrastructure industries Tax concessions are available under Sec 88, Sec 54 EA and Sec 54EB of the Income Tax Act HUDCO has issued for the first time such bonds Its face value is Rs 1000 each carrying an interest rate of 15% per annum payable semi annually This bond will also be listed in important stock exchanges

**(xxi) Carrot and Stick bonds :** Carrot bonds have a low conversion premium to encourage early conversion, and sticks allow the issuer to call the bond at a specified premium if the common stock is trading at a specified percentage above the strike price

**(xxii) Convertible Bonds with a Premium put :** These are bonds issued at face value with a put, which means that the bond holder can redeem the bonds for more than their face value

**(xxiii) Debt with Equity Warrant :** Sometimes bonds are issued with warrants for the purchase of shares These warrants are separately tradable.

**(xxiv) Dual Currency Bonds :** Bonds that are denominated and pay interest in one currency and are redeemable in another currency come under this category They facilitate interest rate arbitrage between two markets

**(xxv) ECU Bonds (European Currency Unit Bonds) :** These bonds are denominated in a basket of currencies of the 10 countries that constitute the European community They pay principal and interest in ECUs or in any of the 10 currencies at the option of the holder

**(xxvi) Yankee Bonds :** If bonds are raised in U S A , they are called Yankee bonds and if they are raised in Japan, they are called Samurai Bonds

**(xxvii) Flip-Flop Notes :** It is a kind of debt instrument which permits investors to switch between two types of securities e g to switch over from a long term bond to a short term fixed-rate note

**(xxviii) Floating Rate Notes (FRNs) :** These are debt instruments which facilitate periodic interest rate adjustments

**(xxix) Loyalty Coupons :** These are entitlements to the holder of debt for two to three years to exchange into equity shares at discount prices To get this facility, the original subscriber must hold the debt instruments for the said period

**(xxx) Global Depository Receipt (GDR) :** A global depository receipt is a dollar denominated instrument traded on a stock exchange in Europe or the U S A / or both It represents a certain number of underlying equity shares Though the GDR is quoted and traded in dollar terms, the underlying equity shares are denominated in rupees The shares are issued by the company to an intermediary called depository in whose name the shares are registered It is the depository which subsequently issues the GDRs

## 1.11. CHALLENGES FACING THE FINANCIAL SERVICES SECTOR

However, the financial service sector has to face many challenges in its attempt to fulfill the ever growing financial demands of the economy Some of the important challenges are reported hereunder

**(i) Lack of qualified personnel :** The financial services sector is fully geared to the task of 'financial creativity' However, this sector has to face many challenges In fact, the dearth of qualified and trained personnel is an important impediment in its growth Hence, it is very vital that a proper and comprehensive training must be given to the various financial intermediaries

**(ii) Lack of investor awareness :** The introduction of new financial products and instruments will be of no use unless the investor is aware of the advantages and uses of the new and innovative products and instruments

Hence, the financial intermediaries should educate the prospective investors/users of the advantages of the innovative instruments through literature, seminars, workshops, advertisements and even through audio-visual aids

**(iii) Lack of transparency :** The whole financial system is undergoing a phenomenal change in accordance with the requirements of the national and global environments It is high time that this sector gave up their orthodox attitude of keeping accounts in a highly secret manner Hence, this sector should opt for better levels of transparency In other words, the disclosure requirements and the accounting practices have to be in line with the international standards

**(iv) Lack of specialization :** In the Indian scene, each financial intermediary seems to deal in different financial service lines without specializing in one or two areas In other words, each intermediary is acting as a financial super market delivering so many financial products and dealing in different varieties of instruments In other countries, financial intermediaries like Newtons, Solomon Brothers etc specialize in one or two areas only This helps them to achieve high levels of efficiency and excellence Hence, in India also, financial intermediaries can go for specialization

**(v) Lack of recent data :** Most of the intermediaries do not spend more on research It is very vital that one should build up a proper data base on the basis of which one could embark upon 'financial creativity' Moreover, a proper data base would keep oneself abreast of the recent developments in other parts of the whole world and above all, it would enable the fund managers to take sound financial decisions

**(vi) Lack of efficient risk management system :** With the opening of the economy to multinationals and the exposure of Indian companies to international competition, much importance is given to foreign portfolio flows It involves the utilization of multi currency transactions which exposes the client to exchange rate risk, interest rate risk and economic and political risk Unless a proper risk management system is developed by the financial intermediaries as in the West, they would not be in a position to fulfil the growing requirements of their customers Hence, it is absolutely essential that they should introduce Futures, Options, Swaps and other derivative products which are necessary for an efficient risk management system

The above challenges are likely to increase in number with the growing requirements of the customers. The financial services sector should rise up to the occasion to meet these challenges by adopting new instruments and innovative means of financing so that it could play a very dynamic role in the economy

## 1.12 PRESENT SCENARIO

The present scenario of financial service sector is

**(i) Conservatism to dynamism**

At present, the financial system in India is in a process of rapid transformation, particularly after the introduction of reforms in the financial sector The main objective of the financial sector reforms is to promote an efficient, competitive and diversified financial system in the country This is very essential to raise the allocative efficiency of available savings, increase the return on investment and thus to promote the accelerated growth of the economy as a whole As a result, we have recently witnessed phenomenal changes in the money market, securities market, capital market, debt market and the foreign exchange market In this changed context, the role of financial services has assumed greater significance in our county At present, numerous new financial intermediaries have started functioning with a view to extending multifarious services to the investing public in the area of financial services The emergence of various financial institutions and regulatory bodies have transformed the financial services sector from being a conservative industry to a very dynamic one

**(ii) Emergence of Primary Equity Market**

Now, we are also witnessing the emergence of many private sector financial services The capital markets which were very sluggish, have become a popular source of raising finance The number of stock exchanges in the country has gone up from 9 in 1980 to 24 in 2004 The aggregate funds raised by the industries in the primary markets have gone from up The number of companies listed on the stock exchange have also gone up from 2265 in 1980 to over 10000 in 2004 Thus, the primary equity market has emerged as an important vehicle to channelise the savings of the individuals and corporates for productive purposes and thus to promote the industrial and economic growth of our nation

**(iii) Concept of Credit Rating**

There is every possibility of introducing equity grading Hitherto, the investment decisions of the investors have been based on factors like name recognition of the company, operations of the group, market sentiments, reputation of the promoters etc Now, grading from an independent agency would help the investor in his portfolio management and thus, equity grading is going to play a significant role in investment decisionmaking From the company point of view, equity grading would help to broaden the market for their public offer, to replace the name recognition by objective opinion and to have a wider investor base Thus, grading would give further fillip to the primary market Moreover, the concept of credit rating would play a significant role in identifying the risk level of the corporate entity in which the investor wants to take part

Now it is mandatory for the non-banking financial companies to get credit rating for their debt instruments The three major credit rating agencies functioning in India are

(i) Credit Rating Information Services of India Ltd (CRISIL)

(ii) Credit Analysis and Research ltd (CARE) and

(iii) Investment Information and Credit Rating Agency (ICRA)

(iv) Duff Phelps Credit Rating Pvt Ltd (DCR India) Their activities have been mainly confined to debt instruments only

**(iv) Process of Globalisation**

Again, the process of globalisation has paved the way for the entry of innovative and sophisticated financial products into our country Since the Government is very keen in removing all obstacles that stand in the way of inflow of foreign capital, the potentiabilities for the introduction of innovative international financial products in India are very great Moreover, India is likely to enter the full convertibility era soon Hence, there is every possibility of introduction of more and more innovative and sophisticated financial services in our country

**(v) Process of Liberalisation**

Realizing all these factors, the Government of India has initiated many steps to reform the financial services industry The Government has already switched over to free pricing of issues from pricing issues The interest rates have been deregulated The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized The Securities Exchange Board of India has liberalized many stringent conditions so as to boost the capital and money markets In this changed context, the financial service industry in India has to play a very position and dynamic role in the years to come by offering many innovative products to suit to the varied requirements of the millions of prospective investors spread throughout the country

# UNIT – II

# MERCHANT BANKING AND VENTURE CAPITAL FINANCE

## 2 CONCEPT AND NATURE OF MERCHANT BANKING

Despite the fact that merchant banking is emerging as one of the prominent segment of financial service sector, it is difficult to define what merchant banking is The reason is very obvious as its limits have never been adequately and strictly defined and it caters to wide variety of financial activities Dictionary of Banking and Finance explains merchant bank as an organisation that underwrites securities for corporations, advises such clients on mergers and is involved in the ownership of commercial ventures Securities and Exchange Board of India (Merchant Bankers) Rules 1992 defines merchant bankers as "any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory services in relation to such issue management The Guidelines for Merchant Bankers (issued by Ministry of Finance, Deptt. of Economic Affairs, Stock Exchange Division on 9-4-1990) instead of defining merchant banking stated that these guidelines shall apply to those presently engaged in merchant banking activity including as managers to issue and undertakes authorised activities These activities interalia include underwriting, portfolio management etc Thus to defines merchant bankers a definite better approach is to include those agencies as merchant bankers which do what a merchant banker does

To understand nature of merchant banking well, a contrast may be involved, between commercial banking and merchant banking Although the terms 'Merchant' and 'Commercial' have similar connotations yet commercial banking and merchant banking are different Commercial bankers are basically a financing agency where as merchant banks provide basically financial (not financing) services Commercial bankers are comparatively retail banking activity where as merchant banking is a whole sale banking (even if it provides financing services also) A merchant banking firm does not undertake commercial banking where as its, reverse is possible Commercial banking involves collections of savings and putting it, to optimum use as per plans and guidelines where as merchant banking refers to just an agency facilitating transfer capital from those who own to those who can use it without handling the amount of its own Merchant bankers is more of an intermediary In the same context a merchant bank can be distinguished from a development bank since the latter is more involved in fund raising and lending Like commercial banks, development banks may also have separate merchant banking division

### 2.1 FUNCTIONS OF MERCHANT BANKER

Setting up of new industrial units, expansion, diversification and modernisation of existing units have been the central plank of the rapid industrialisation in any economy This process besides adequate financial resources requires sound technical and managerial inputs Though, a number of financial agencies are instituted to cater to the needs of rapid industrialisation, the task of financing has become more complicated, thus requiring a fresh look. In view of increasing specialisation in every sphere the process of industrialisation from the primary planning stages of setting up a new unit to that of research and development including expansion, diversification or modernisation requires the services of specialists or professionals Thus, the need for having expert advice, guidance of specialists or professionals in the field has become an absolute necessity with rapid economic growth and spectacular industrial development in India It has also been necessitated by the plethora of regulations for industry, capital, issues, foreign investment and collaboration, amalgamations, Companies Act, SEBI, Government policy regarding backward area development, export promotion and import substitution etc A few agencies are able to provide expert advice in the diversified areas mentioned above But it is inconvenient to entrepreneurs industrialists to knock at the doors of several agencies in getting the guidance of specialists and professionals Hence, it is highly essential to provide expert advice in diversified areas under a single roof to provide a comfortable cushion to entrepreneurs to accelerate industrial development This is where merchant bankers come to picture. Although is it is very difficult to spellout all the areas where merchant bankers can interact, yet, some important areas where merchant bankers have decisive role are discussed here These role can broadly be divided into two parts One is service based another is fund based

A Service based Functions

**i) Project counselling**

The first step to launch a business unit is selection of a viable project. Merchant bankers undertake this assignment on a very large scale since they have experts with them in diverse fields Project counselling covers a variety of sub assignments Illustrative list of services which can be rendered under this category is

- Guidance in relation to project viability i e project identification and counselling. It may be for setting up new units, expansion or improvement of existing facilities
- Selection of consultants for preparation of project reports/market surveys etc Sometimes merchant bankers also engage in preparation of project reports or market surveys
- Advice on various procedural steps including obtaining of governmental approvals clearance etc e g for foreign collaboration
- Proposing a suitable capital structure laying broad as well as specific features
- Teachno- economic soundness of the project and marketing aspects Financial engineering i e selection of right mix of financing pattern specifically for short term requirements
- Organisation and management set up for a strong base and efficient working of the project

**ii) Credit syndication**

Normally every project has to raise debt funds for different sources as per need. Substantial debt raising may be required for a new and capital intensive project For such project merchant bankers may undertake credit syndication Credit syndication is credit procurement service As per the requirements, such syndication can be from national as well as international sources Some of the important credit syndication services offered are

- Preparing applications for financial assistance to be submitted to financial institutions and banks
- Monitoring the sanction of funds while acting as a specialised liaison agency
- Negotiating the term of assistance on behalf of client
- Post sanction formalities with these institutions and banks
- Assistance in drawl of term loans and or bridging loans
- Assessing working capital requirements and arranging it

Need of syndication arises due to the fact that specially in big projects one institution may hesitate to meet the whole debt requirement of the project They want to spread the risk Further shortage of funds availability with one lender also requires credit syndication The merchant banker by rendering credit syndication services saves the time of the borrower

The modus operandi of a syndication is really quite simple The borrower approaches several banks which might be willing to syndicate a loan, specifying the amount and the tenor for which loan is to be syndicated On receiving a query, the syndicator scouts for banks who may be willing to participate in the syndicate Based on an informal survey, it communicates its desire to syndicate the loan at an indicative price to the corporate borrower, all in a matter of days After reviewing the bids from various banks, the borrower awards the mandate to the bank that offers him the best terms

The syndicator, on his part, can underscore his willingness to syndicate the loan on a firm commitment basis or on a best-efforts basis The former is akin to underwriting and will attract capital adequacy requirements That may reduce the bank's flexibility. "In India, given the fact that banks may not be willing to maintain capital in the interim period, most syndicates the likely to be done on a best-efforts basis "

Best-efforts, as the name suggests, limits the obligation of the syndicator, as he is not compelled to provide the loan on his own, in case he fails to arrange the loan

However, more often than not, the syndicator would try to fulfill his commitments for the inability to do so would tarnish his reputation Once the syndicator has been awarded a mandate, the borrower has to sign a 'clear market clause' which stops him from seeking a syndicated loan from any other bank, till such time as the documentation for the syndication is drawn up by the syndicate manager This may take about threefour weeks

In the interim period, the syndicate manager gets the banks to agree to syndicating the loan It can do this on a 'broadcast' basis, by sending taxes to the concerned banks inviting participation If the company is well known, the loan uncomplicated and the market liquid, such a method would work well However, if the corporate tends to keep a low profile and the loan structure is complicated, the syndicate manager would have to woo the participant banks with offer documents or an information memorandum on the company The document is similar to a prospects but less detailed Nevertheless drawing up such a document does call for a lot of homework The syndicate manager has to be very careful because he can be held responsible for any inaccuracy or omission of material facts

The participants, after reviewing the prospects, decide whether or not to join the syndicate However, given the fact that most of the participants may be smaller Indian banks, they may take weeks to give the final nod Once the bank decides to become a member of the syndicate, it indicates the amount and the price that it is likely to charge on the loan Based on information received from all participants, the syndicate manager prepares a common document to be signed by all the members of the syndicate and the borrowing company The document usually lists out details of the agreement with regard to tenor, interest prepayment clause, security, covenants, warranties and agency clause

**iii) Issue management**

Traditionally this is one of the main functions of merchant banker When ever an issue is made whether it is public issue or private placement and further whether it is for equity shares, preference shares or debentures, the merchant banker has a crucial role to play Raising of funds from public has many dimensions and formalities which are not possible for the concerned. companies to comply with, where merchant banker comes to their rescue Marketing effort to convince the prospective investor needs special attention Here again merchant bankers are specialists The specific important activities related to issue management performed by merchant banks are mentioned here

- Advise the company about the quantum and terms of raising funds
- Advise as to what type of security may be acceptable in the market as well as to the concerned lending institutions at the time of issue
- Advise as to whether a fresh issue to be made or right issue to be made or if both, then in what proportion, obtaining the desired consents, if any, from government or other authorities ? Advice on the appointment of bankers, brokers to the issue
- Advice on the selection of issue house or Registrar to the issue, printer advertising agency etc
- Fixing the terms of the agencies engaged to facilitate making a public issue
- Preparation of a complete action plan and budget for total expenses of the issue
- Drafting of documents like prospectus, letter of offer and getting approval from concerned agencies
- Assisting in advertisement campaigns, holding the press, brokers' and investors' conferences etc for grooming the issue
- Advise the company for the issue period and days of opening and closing the issue
- Monitoring the collection of funds in public issue
- Coordination with underwriters, brokers and bankers to the issue and stock exchange etc
- Strict compliance of post issue activities

### iv) Corporate counselling

Although the functions discussed up till now are also covered under corporate counselling but here other dimensions will be deliberated Corporate counselling is to rejuvenate the corporate units which are otherwise having signals to low productivity, low efficiency and low profitability The merchant bankers can play a substantial role in reviving the sick units They make mergers and acquisition exercise smooth, They can advise on improvement in the systems operating in managing the show of a corporate unit Some of the specific assignments for the merchant banker are

- Rejuvenating old line and ailing/sick unit or appraising their technology and process, ssessing their requirements and restructuring their capital base
- Evolving rehabilitation programmes/packáges which can be acceptable to the financial institutions and banks
- Assisting in obtaining approvals from Board for Industrial and Financial Reconstruction (BIFR) and other authorities under the Sick Industrial Companies (special provisions) Act1985 (SICA)
- Monitoring implementation of schemes of rehabilitation.
- Advice on financial restructuring involving redeployment of corporate assets to refocus companies line of business
- Advice on rearranging the portfolio of business assets through acquisition etc
- Assisting in valuing the assets and liabilities
- Identifying potential buyers for disposal of assets if required Identify the candidates for take over
- Advice on tactics in approaching potential acquisition
- Assisting in deciding the mode of acquisition whether friendly or unfriendly or hostile
- Designing the transaction to reap the maximum tax advantages Acting as an agent for leveraged buyout (LBO) involving heavy use of borrowed funds to purchase a company or division of a company
- Facilitating Management Buy outs (MBO) i e selling a part of business to their own managers by a company
- Clearly spelling out organisation goals
- Evolving corporate strategies to achieve the laid down goals
- Designing or restructuring the organisational pattern and size
- Evolving Management Information System

Corporate advisory services should offer real value addition to the client Highly specialised in nature, these services should be clearly distinguished from the gamut of other financial services offered by NBFCs such as underwriting or fund-based activities of leasing and hire purchase In India corporate advisory has a good potential The Indian industry is going through an unprecedented churning, bracing itself for global com-petition The Indian corporate sector has been on a restructuring spree Groups have been shedding companies Companies in turn, have been dropping divisions as they struggle to become fit to survive in the new milieu. Free pricing of issues and the opportunity to tap the international market through the Euro-issue route has greatly enhanced the need for expert advisory services In areas of restructuring, strategic alliances and corporate planning is now advising foreign companies in their plans for development of infrastructure in India Merchant bankers have a great role to play

Strategic product consolidation is another recent phenomenon Units in which the company does not plan to become a market leader are spun off to others A good corporate advisor is always on the alert to seize such opportunities The process of acquisition cannot be done overnight It requires a patient search for the right company which can be acquired, the proper evaluation of the financial impact of the acquisition, a sound strategy in blending the business acquired within the fold of the group, followed by negotiation and execution of the agreement Occasionally, advisory services are required in cases of splits within the family group In such cases, there is a need to split the company into different units amongst the disputing family members At the same time, the shareholders interest is to be kept in mind by the corporate advisor

**v) Portfolio management**

Merchant bankers as a body of professionally qualified persons also undertake assignments of managing an individual investor's portfolio Portfolio management is being practised as an investment management counselling in which the investor is advised to seek financial assets like government securities, commercial papers, debentures, shares, warrants etc that would grow in value and/or provide income The investors whether local or foreigner with substantial amount for investment in securities seek portfolio management services of authorised merchant bankers The functioning of portfolio manager can be regulated or unregulated Portfolio manager may use totally his discretion or may act only after getting signal from investor for each transaction of sale or purchase A diverse range of services which may be rendered by merchant banker include

- Advising what and when to sell and buy
- Arranging sale or purchase of securities
- Communicating changes in investment market to the client investor
- Compliance of regulations of different regulating bodies for sale of purchase of portfolio
- Collection of returns and reinvest as per directions of clients
- Evaluating the portfolio at regular intervals or at direction of investors
- Advising on tax matters pertaining to income from and investment in portfolio
- Safe custody of securities

4

**vi) Stock broking and dealership**

The merchant bankers who have requisite professional knowledge and experience may also act as share broker on a stock exchange and even as dealer for Over The Counter trading. To venture into this area it is normally desired that the merchant banker has reasonable network. Their actions and activities are regulated by rules and regulations of the concerned stock exchange. They are at liberty to appoint sub brokers and sub dealers to ensure wider net work of their operations. They can be broker for inland as well as foreign stock exchanges In India the merchant bankers who desire to act as brokers are regulated by SEBI (Stock Broker and Sub-brokers) Rules 1992.

**vii) Joint venture abroad**

Depending on economic and political considerations many countries may permit joint ventures by local businessmen abroad Here again merchant bankers can play a decisive role. They facilitate meeting of foreign partner, get sanctions under various provisions, make techno economic surveys, legal documentations under local as well as foreign legal provisions etc

**viii) Debenture trusteeship**

The merchant bankers can get themselves registered to act as trustee These trustees are to protect the interests of debenture holders as per the terms laid down in trust deed. They are, as trustees, to undertake redressal of grievances of debenture holders. They are to ensure that refund monies are paid and debenture certificates are dispatched in accordance with the Companies Act. Debenture trustees are expected to observe high standards of integrity and fairness in discharging their functions They can call for periodical reports from the body corporate They charge fee for such services.

**B. Fund based Functions**

**(i) Bill discunting**

Bill discounting is a service against which merchant banker has to arrange funds against the bills which have been discounted This service is undertaken by merchant bankers generally if bill market is big as well as mature. Otherwise bill discounting is undertaken by banks only Depending on their credibility they may also undertake the assignment of bill acceptance. These bills accepted and or discounted can be foreign and merchant bankers can specify what types of bills they entertain They charge commission for these services

**(ii) Venture capital**

Venture capital is the organized financing of relatively new enterprises to achieve substantial capital gains Such new companies are chosen because of their potential for considerable growth due to advance technology, new products or services or other valuable innovations A high risk is implied in the term and is implicit in this type of investment Since certain ingredients necessary for success of such projects are missing in the begging but are added later on Merchant bankers undertake to arrange and if necessary, to provide such venture capital since traditional sources of finance like banks, financial institutions or public issue etc may not be available Since expected returns on projects involving venture capital is high, these are normally provided on soft terms Such scheme is also popular as seed capital or risk capital scheme Merchant bankers deeply study such proposals before releasing the money At opportune time such investment can be disinvested to keep the cycle of venture capital more on

**(iii) Bought out deals**

When a promoter envisages that if public issue made to raise capital will not clinch, he may approach merchant bankers (bought out dealer or sponsor) and places the shares of company initially with him which are offered to public at a later stage, this route is known as bought out deal Many a time a syndicate of merchant bankers jointly sponsor a bought out deal to spread the risk involved In contract to venture capital, there is no role to be played by non traditional technology. Such bought shares by sponsor can be disposed off at an opportune time on 'over the counter' or other stock exchanges

**(iv) Lease financing and hire purchase**

Depending on the funds available, merchant bankers can also enter the field of lease or hire purchase financing Lease is an agreement where by the lessor (merchant banker in our case) conveys to the lessee (the user), in return for rent, the right to use an asset for an agreed period of time On the other hand in hire purchase the user at the end of the agreed period has an option to purchase the asset which he has used till date The merchant bankers can advise the client to go in for leasing or hire purchase system of financing an asset A comparative study may be communicated to the prospective client showing benefits of these alternatives The client can also depend on merchant banker for acquiring the needed asset and complying with all formalities

**(v) Factoring**

Factoring is a novel financing innovation It is a mixed service having financial as well as non financial aspects On one hand it involves management and collection of books debts which arise in process of credit sale The merchant bankers can take up this assignment and are required to perform activities like sales ledger administration, credit collection, credit protection, evolving credit policy, arranging letter of credit etc On the other hand there is involvement of finance Against factored debts the merchant banker may provide advance with a certain margin The released funds can be used by client to manage its liquidity and working capital Merchant bankers are entitled to service charges for factoring services

The merchant banker's role is thus to

- ❑ Maintain the books of accounts pertaining to credit sales
- ❑ Make a systematic analysis of relevant information for credit monitoring and control
- ❑ Provide full or partial protection against bad debts and accepting the risk of non realization

- Provide financial assistance to the client
- Provide information about prospective buyers.
- Provide financial counseling and assisting managing the liquidity.

**vi) Underwriting**

It refers to a contract by means of which merchant banker gives an assurance to the issuing company that the former would subscribe to the securities offered in the event of non-subscription by the persons to whom it was offered The liability of merchant banker arises if the issue is not fully subscribed and this liability is restricted to the commitment extended by him. The merchant bankers undertaking underwriting make efforts on their own to induce the prospective investors to subscribe to the concerned issue

Such assignment is accepted after evaluating viz :

- Company's standing and its past record.
- Competence of the management
- Purpose of the issue.
- Potentials of the project being financed.
- Offer price and terms of the issue.
- Business environment

The financial involvement of merchant banker in underwriting arises in case of development. To get their blocked funds released, the merchant bankers have stock exchange as exit route They get underwriting commission

These are some of the prominent activities being undertaken by merchant bankers world over The practices may differ from country to country depending on maturity of financial sector of their economy The multifarious activities of the corporate sector and spectacular growth of industry gives new dimensions to merchant banking activities. In the phase of globalisation of economies merchant bankers are facing new challenges The changing international financing environment has rather pushed merchant bankers to operate at international level creating more opportunities to serve the world business community in diverse ways

**Lead Manager**

It is required under regulations that every issue should be managed by at least one merchant banker acting as 'lead manager' Such lead manager is not required if

- the issue is right issue
- the size of issue is not exceeding rupees 50 lakh

The merchant banker acting as lead manager must enter into an agreement with the concerned company This agreement must state their mutual rights, liabilities and obligations relating to such issue Agreement terms pertaining to particulars to disclosures, allotment and refund should be clearly defined, allocated and determined

In bigger issues more than one lead managers can be appointed but their number is subject to norms laid down by SEBI Size of issue Maximum number of led manager

a) Less than rupees fifty crore Two

b) Rupees 50 crore but less than Rs 100 crore Three

c) Rs 100 crore but less than Rs 200 crore Four

d) Rs 200 crore but less than Rs 400 crore Five

e) Rs 400 crore and above Five or more as agreed by SEBI

## 2.2 DUTIES OF MERCHANT BANKER/LEAD MANAGER

a) In case more than one merchant bankers are engaged as lead manager, they have to clearly demark their duties and responsibilities. A statement of such division of job and responsibilities is to be furnished to SEBI at least one month before opening of the issue Where the circumstances warrant joint and several responsibility of lead manager for a particular activity, a coordinator designated from among the lead managers shall furnish to SEBI with report, comments etc on the matters relating to the joint responsibility The activities where division is normally sought is on 'preissue activities' and 'post issue activities', SEBI requires that 'post issue activities' should be the responsibility of one lead manager It involves essential follow up steps like finalisation of basis of allotment/weeding out multiple applications, listing of instrument, dispatch of certificates and refunds etc

b) A merchant banker can not be a lead manager to an issue made by any body corporate which is an associate of the lead merchant banker

c) A lead manager is not to associate with an issue if any merchant banker associated with the issue is not holder of certificate of registration

d) A lead manager who is category I merchant banker has to accept a minimum underwriting obligation of 5 per cent of the total underwriting commitment or Rs 25 lakh which ever is less This is to ensure his financial involvement in the issue.

e) It is his duty to submit SEBI a due diligence certificate in 'Form C' This is to ensure that the contents of the prospectus or letter of an offer are verified and are reasonable This certificate is to reach at least two weeks prior to opening of an issue

f) SEBI requires lead manager to submit specified documents like particulars to the issue, draft letter of offer or prospectus

g) Lead manager to incorporate changes in prospectus etc if desired by SEBI

h) Lead manager has to continue as lead manager with the issue till the subscribers have received the certificates or refunds of excess money

i) Merchant bankers are prohibited from entering into any transaction, directly or indirectly in securities on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment It is referring to insider trading

j) SEBI is to be informed, by merchant banker about the acquisition of securities of the boy corporate whose issue is being managed by the merchant banker, within 15 days from the date of entering into such transaction

k) A merchant banker has to disclose to SEBI the following information

i) his responsibilities with regard to the management of the issue

ii) any change in the information or particulars previously furnished which have a bearing on the certificate granted to it

iii) the name of body corporate whose issues he has managed or has been associated with

iv) any default in capital adequacy requirements

v) his activities as a manager, underwriter, consultant or adviser to an issue as the case may be

l) Every merchant banker shall keep and maintain the required books of accounts, records and documents like balance sheet, income statement, auditor's report, a statement of financial statement Such records are to be maintained for 5 years They are to submit half yearly unaudited financial results when required by SEBI with a view to monitor the capital adequacy of the merchant banker

m) When SEBI initiates inspection of the said records, the merchant banker has to cooperate SEBI shall give notice before inspection

## 2.3 ISSUES MANAGEMENT

The new issue market / activity was regulated by the Controller of Capital Issues (CCI) under the provisions of the Capital Issues (Control) Act, 1947 and the exemption orders and rules made under it With the repeal of the Act and the consequent abolition of the office of the CCI in 1992, the protection of the interest of the investors in securities market and promotion of the development and regulation of the market/ activity became the responsibility of the SEBI To tone up the operations of the new issues in the country, it has put in place rigorous measures These cover both the major intermediaries as well as the activities

So, we will discuss here, various intermediaries, their regulation and SEBI guidelines related to them

**Merchant Bankers**

In modern times, importance of merchant banker is very much, because it the key intermediary between the company and issue of capital Main activities of the merchant bankers are – determining the composition of the capital structure, drafting of prospectus and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfer, listing of securities, arrangement of underwriting / sub-underwriting, placing of issues, selection of brokers, bankers to the issue, publicity and advertising agents, printers and so on.

Due to overwhelming importance of merchant banker, it is now mandatory that merchant banker(s) functioning as lead manager(s) should manage all public issues. In case of rights issue not exceeding Rs 50 lakh, such appointments may not be necessary The salient features of the SEBI framework, related to merchant bankers are discussed as under

**Registration :** Merchant bankers require compulsory registration with the SEBI to carry out their activities Previously there were four categories of merchant bankers, depending upon the activities Now, since Dec 1997, there is only one category of registered merchant banker and they perform all activities

**Grant of Certificate :** The SEBI grants a certificate of registration to applicant if it fulfills all the conditions like (i) it is a body corporate and is not a NBFC (ii) it has got necessary infrastructure to support the business activity (iii) it has appointed at least two qualified and experienced (in merchant banking) persons (iv) its registration is in the general interest of investors

**Capital Adequacy Requirement :** A merchant banker must have adequate capital to support its business Hence SEBI grants recognition to only those merchant bankers who have paid up capital and free reserves of minimum Rs 1 crore.

**Fee:** A merchant banker has to pay a registration fee of Rs 5 lakh and renewal fees of Rs 2 5 lakh every three years from the fourth year from the date of registration

**Code of Conduct :** Every merchant banker has to abide by the code of conduct, so as to maintain highest standards of integrity and fairness, quality of services, due diligence and professional judgment in all his dealings with the clients and other people A merchant banker has always to endeavor to (a) render the best possible advice to the clients regarding clients needs and requirements, and his own professional skill and (b) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner

**Restriction on Business :** No merchant banker, other than a bank/public financial institution is permitted to carry on business other than that in the securities market w e f Dec 1997 However a merchant banker who is registered with RBI as a primary dealer/satellite dealer may carry on such business as may be permitted by RBI w.e.f Nov 1999

**Maximum number of lead managers :** The maximum number of lead managers is related to the size of the issue For an issue of size less than Rs 50 crores, two lead managers are appointed For size groups of 50 to 100 crores and 100 to 200 crores, the maximum permissible lead managers are three and four respectively A company can appoint five and five or more (as approved by SEBI) lead managers in case of issue sizes between Rs.200 to 400 crores and above Rs 400 crores respectively

**Responsibilities of Lead Managers :** Every lead manager has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosure, allotment and refund A statement specifying these is to be furnished to the SEBI at least one month before the opening of the issue for subscription It is necessary for a lead manager to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs 25 lakh whichever is less

**Due diligence certificate :** The lead manager is responsible for the verification of the contents of a prospectus / letter of offer in respect of an issue and the reasonableness of the views expressed in them He has to submit to the SEBI at least two weeks before the opening of the issue for subscription a due diligence certificate

**Submission of documents :** The lead managers to an issue have to submit at least two weeks before the date of filing with the ROC/regional SE or both, particulars of the issue, draft prospectus/ letter of offer, other literature to be circulated to the investors / shareholders, and so on to the SEBI They have to ensure that the modifications/ suggestions made by it witH respect to the information to be given to the investors are duly incorporated

**Acquisition of Shares :** A merchant banker is prohibited from acquiring securities of any company on the basis of unpublished price sensitive information obtained during the course of any professional assignment either from the client or otherwise

**Disclosure to SEBI :** As and when required, a merchant banker has to disclose to SEBI (i) his responsibilities with regard to the management of the issue, (ii) any change in the information/ particulars previously furnished which have a bearing on the certificate of registration granted to it, (iii) names of the companies whose issues he has managed or has been associated with (iv) the particulars relating to the breach of capital adequacy requirements and (v) information relating to his activities as manager, underwriter, consultant or advisor to an issue

**Action in case of Default :** A merchant banker who fails to comply with any conditions subject to which the certificate of registration has been granted by SEBI and / or contravenes any of the provisions of the SEBI Act, rules or regulations, is liable to any of the two penalties (a) Suspension of registration or (b) Cancellation of registration

**Underwriters**

Another important intermediary in the new issue/ primary market is the underwriters to issue of capital who agree to take up securities which are not fully subscribed They make a commitment to get the issue subscribed either by others or by themselves Though underwriting is not mandatory after April 1995, its organization is an important element of primary market Underwriters are appointed by the issuing companies in consultation with the lead managers / merchant bankers to the issues

**Registration :** To act as underwriter, a certificate of registration must be obtained from SEBI On application registration is granted to eligible body corporate with adequate infrastructure to support the business and with net worth not less than Rs 20 lakhs

**Fee :** Underwriters had to pay Rs 5 lakh as registration fee and Rs 2 lakh as renewal fee every three years from the fourth year from the date of initial registration Failure to pay renewal fee leads to cancellation of certificate of registration

General Obligations and responsibilities

**Code of conduct :** Every underwriter has at all times to abide by the code of conduct, he has to maintain a high standard of integrity, dignity and fairness in all his dealings He must not make any written or oral statement to misrepresent (a) the services that he is capable of performing for the issuer or has rendered to other issues or (b) his underwriting commitment

**Agreement with clients :** Every underwriter has to enter into an agreement with the issuing company The agreement, among others, provides for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to subscribe to the issue after being intimated by/on behalf of the issuer, the amount of commission/brokerage, and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations

**General responsibilities :** An underwriter cannot derive any direct or indirect benefit from underwriting the issue other than by the underwriting commission. The maximum obligation under all underwriting agreements of an underwriter cannot exceed twenty times his net worth Underwriters have to subscribe for securities under the agreement within 45 days of the receipt of intimation from the issuers.

**Bankers to an Issue**

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investor in respect of capital and refund of application money

**Registration :** To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI The applicant should be a scheduled bank Every banker to an issue had to pay to the SEBI an annual free for Rs 5-lakh and renewal fee or Rs 2 5 lakh every three years from the fourth year from the date of initial registration Non-payment of the prescribed fee may lead to the suspension of the registration certificate

**General Obligations and Responsibilities Furnish Information :** When required, a banker to an issue has to furnish to the SEBI the following information (a) the number of issues for which he was engaged as banker to an issue (b) the number of applications / details of the applications money received (c) the dates on which applications from investors were forwarded to the issuing company / registrar to an issue (d) the dates / amount of refund to the investors.

**Books of account/record / documents :** A banker to an issue is required maintain books of accounts/ records/ documents for a minimum period of three years in respect of, inter alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company / registrar to the issue and dates and ~~amounts of refund~~ money to investors

**Agreement with issuing companies :** Every banker to an issue enters into an agreement with the issuing company The agreement provides for the number of collection centers at which application/ application money received is forwarded to the registrar for issuance and submission of daily statement by the designated controlling branch of the baker stating the number of applications and the amount of money received from the investor

**Code of Conduct :** Every banker to an issue has to abide by a code of conduct He should observe high standards of integrity and fairness in all his dealings with clients/ investors/ other members of the profession He should exercise due diligence A banker to an issue should always endeavor to render the best possible advice to his clients and ensure that all professional dealings are effected in a prompt, efficient and cost-effective manner

**Brokers to the Issue**

Brokers are persons mainly concerned with the procurement of subscription to the issue from the prospective investors The appointment of brokers is not compulsory and the companies are free to appoint any number of brokers The managers to the issue and the official brokers organize the preliminary distribution of securities and procure direct subscription from as large or as wide a circle of investors as possible A copy of the consent letter from all the brokers to the issue, should be filed with the prospectus to the ROC

The brokerage applicable to all types of public issue of industrial securities is fixed at 1 5%, whether the issue is underwritten or not. The listed companies are allowed to pay a brokerage on private placement of capital at a maximum rate of 0 5% Brokerage is not allowed in respect of promoters' quota including the amounts taken up by the directors, their friends and employees, and in respect of the rights issues taken by or renounced by the existing shareholders Brokerage is not payable when the applications are made by the institutions/ bankers against their underwriting commitments or on the amounts devolving on them as underwriters consequent to the under subscription of the issues

**Registrars to an Issue and Share Transfer Agents**

The registrars to an issue, as an intermediary in the primary market, carry on activities such as collecting applications from the investors, keeping a proper record of applications and money received from the investors or paid to the sellers of securities and assisting companies in determining the basis of allotment of securities in consultation with the stock exchanges, finalizing the allotment of securities and processing / dispatching allotment letters, refund orders, certificates and other related documents in respect of the issue of capital

To carry on their business, the registrars must be registered with the SEBI They are divided into two categories (a) Category I, to carry on the activities as registrar to an issue and share transfer agent, (b) Category II, to carry on the activity either as registrar or as a share transfer agent Category I registrars mush have minimum net worth of Rs 6 lakhs and Category II, Rs 3 Category I is required to pay a initial registration fee of Rs 50,000 and renewal fee of Rs 40,000 every three years, where as Category II is required to pay Rs 30,000 and Rs 25,000 respectively

**Code of Conduct :** The registrars to an issue and the share transfer agents have to maintain high standards of integrity and fairness in all dealings with their clients and other registrars to the issue and share transfer agents in the conduct of the business They should endeavor to ensure that (a) enquiries from investors are adequately dealt with, and (b) adequate steps are taken for proper allotment of securities and refund of application money without delay and as per law Also, they should not generally and particularly in respect of any dealings in securities to be a party to (a) creation of false market, (b) price rigging or manipulation (c) passing of unpublished price sensitive information to brokers, members of stock exchanges and other intermediaries in the securities market or take any other action which is not in the interest of the investors and (d) no registrar to an issue, share transfer agent or any of its directors, partners or managers managing all the affairs of the business is either on their respective accounts, or though their respective accounts, or through their associates or family members, relatives or friends indulges in any insider trading

**Debenture Trustees**

A debenture trustee is a trustee for a trust deed needed for securing any issue of debentures by a company To act as a debenture trustee a certificate from the SEBI is necessary Only scheduled commercial banks, PFIs, Insurance companies and companies are entitled to act as a debenture trustees The certificate of registration is granted to suitable applicants with adequate infrastructure, qualified manpower and requisite funds Registration fee is Rs 5 lakh and renewal fee is Rs 2 5 lakh every three years

**Responsibilities and obligations :** Before the issue of debentures for subscription, the consent in writing to the issuing company to act as a debenture trustee is obligatory He has to accept the trust deed which contains matters pertaining to the different aspects of the debenture issue

**Duties :** The main duties of a debenture trustee include the following

i Call for periodical report from the company

ii Inspection of books of accounts, records, registration of the company and the trust property to the extent necessary for discharging claims

iii Take possession of trust property, in accordance with the provisions of the trust deed

iv. Enforce security in the interest of the debenture holders

v Carry out all the necessary acts for the protection of the debenture holders and to the needful to resolve their grievances

vi Ensure refund of money in accordance with the Companies Act and the stock exchange listing agreement vii Exercise due diligence to ascertain the availability of the assets of the company by way of security as well as their adequacy / sufficiency to discharge claims when they become due

viii Take appropriate measure to protect the interest of the debenture holders as soon as any breach of trust deed/ law comes to notice

ix Ascertain the conversion / redemption of debentures in accordance with the provisions / conditions under which they were offered to the holders

x Inform the SEBI immediately of any breach of trust deed / provisions of law

In addition, it is also the duty of trustees to call or ask the company to call a meeting of the debenture holders on a requisition in writing signed by debenture holders, holding at least one-tenth of the outstanding amount, or on the happening of an event which amounts to a default or which, in his opinion, affects their interest

**Portfolio Managers**

Portfolio manager are defined as persons who in pursuance of a contract with clients, advise, direct, undertake on their behalf the management/ administration of portfolio of securities/ funds of clients The term portfolio means the total holdings of securities belonging to any person The portfolio management can be (i) Discretionary or (ii) Non-discretionary The first type of portfolio management permits the exercise of discretion in regard to investment / management of the portfolio of the securities / funds In order to carry on portfolio services, a certificate of registration from SEBI is mandatory

The certificate of registration for portfolio management services is granted to eligible applicants on payment of Rs 5 lakh as registration fee Renewal may be granted by SEBI on payment of Rs 2 5 lakh as renewal fee (every three years)

**Contract with clients :** Every portfolio manager is required, before taking up an assignment of management of portfolio on behalf of the a client, is enter into an agreement with such clients clearly defining the inter se relationship, and setting out their mutual rights, liabilities and obligations relating to the management of the portfolio of the client The contract should, inter alia, contains

i The investment objectives and the services to be provided

ii Areas of investment and restrictions, if any, imposed by the client with regards to investment in a particular company or industry

iii Attendant risks involved in the management of portfolio

iv Period of the contract and provisions of early termination, if any

v Amount to be invested

vi. Procedure of setting the clients' account including the form of repayment on maturity or early termination of contract

vii Fee payable to the portfolio managers viii Custody of securities

The funds of all clients must be placed by the portfolio manager in a separate account to be maintained by him in a scheduled commercial bank He can charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and such fee should be independent of the returns to the client and should not be on a return sharing basis

**Investment of Clients money :** The portfolio manager should not accept money or securities from his clients for less than one year Any renewal of portfolio fund on the maturity of the initial period is deemed as a fresh placement for a minimum period of one year The portfolio funds and be withdrawn or taken back by the portfolio clients at his risk before the maturity date of the contract under the following circumstances

a. Voluntary or compulsory termination of portfolio management services by the portfolio manager

b Suspension or termination of registration of portfolio manager by the SEBI

c Bankruptcy or liquidation in case the portfolio manager is a body corporate.

d. Permanent disability, lunacy or insolvency in case the portfolio manager is an individual

The portfolio manager can invest funds of his clients in money market instruments or as specified in the contract, but not in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies While dealing with client's money he should not indulge in speculative transactions

**Reports to be furnished to the Clients :** The portfolio manager should furnish periodically a report to the client, agreed in the contract, but not exceeding a period of six months containing the following details

a The composition and the value of the portfolio, description of security, number of securities, value of each security held in portfolio, cash balances aggregate value of the portfolio as on the date of report

b Transactions undertaken during the period of report including the date of transaction and details of purchases and sales

c Beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures,

d Expenses incurred in managing the portfolio of the client and details of risk relating to the securities recommended by the portfolio manager for investment or disinvestments

So, we discussed so far the intermediaries in security market Next task of yours would be to submit in writing the latest regulations of SEBI in the regards to various intermediaries

## 2.4 CONCEPT OF VENTURE CAPITAL

Venture capital is a growing business of recent origin in the area of industrial financing in India The various financial institutions set up in India to promote industries have done commendable work However, these institutions do not come upto the benefit of risky ventures when they are undertaken by new or relatively unknown entrepreneurs They contend to give debt finance, mostly in the form of term loans to the promoters and their functioning has been more akin to that of commercial banks The financial institutions have devised schemes such as seed capital scheme, risk capital fund etc , to help new entrepreneurs However, to evaluate the projects and extend financial assistance they follow the criteria such as safety, security, liquidity and profitability and not potentiality The capital market with its conventional financial instruments/schemes does not come much to the benefit or risky venture New institutions such as mutual funds, leasing and hire purchase company's have been established as another source of finance to industries These institutions also do not mitigate the problems of new entrepreneurs who undertake risky and innovative ventures

India is poised for a technological revolution with the emergence of new breed of entrepreneurs with required professional temperament and technical know how To make the innovative technology of the entrepreneurs a successful business venture, support in all respects and more particularly in the form of financial assistance is all the more essential This has necessitated the setting up of venture capital financing Division/ companies during the latter part of eighties

The term 'Venture Capital' is understood in many ways In a narrow sense, if refers to, investment in new and tried enterprises that are lacking a stable record of growth

In a broader sense, venture capital refers to the commitment of capital as shareholding, for the formulation and setting up of small firms specializing in new ideas or new technologies It is not merely an injection of funds into a new firm, it is a simultaneous input of skill needed to set up the firm, design its marketing strategy and organise and manage it It is an association with successive stages of firm's development with distinctive types of financing appropriate to each stage of development

Venture capital is long term risk capital to finance high technology projects which involve risk but at the same time has strong potential for growth Venture capitalist pool their resources including managerial abilities to assist new entrepreneurs in the early years of the project Once the project reaches the stage of profitability, they sell their equity holdings at high premium

A venture capital company is defined as "a financing institution which joins an entrepreneur as a copromote in a project and shares the risks and rewards of the enterprise "

### 2.4.1 Features Of Venture Capital Financing

1 Venture capital is usually in the form of an equity participation It may also take the form of convertible debt or long term loan

2 Investment is made only in high risk but high growth potential projects

3. Venture capital is available only for commercialisation of new ideas or new technologies and not for enterprises which are engaged in trading, booking, financial services, agency, liaison work or research and development

4. Venture capitalist joins the entrepreneur as a co-promoter in projects and share the risks and rewards of the enterprise

5. There is continuous involvement in business after making an investment by the investor

6. Once the venture has reached the full potential the venture capitalist disinvests his holdings either to the promoters or in the market. The basic objective of investment is not profit but capital appreciation at the time of disinvestments

7 Venture capital is not just injection of money but also an input needed to setup the firm, design its marketing strategy and organise and manage it

8 Investment is usually made in small and medium scale enterprises

### 2.4.2. Scope Of Venture Capital:

Venture capital may take various forms at different stages of the project There are four successive stages of development of a project viz development of a project idea, implementation of the idea, commercial production and marketing and finally large scale investment to exploit the economics of scale and achieve stability Financial institutions and banks usually start financing the project only at the second or third stage but rarely from the first stage But venture capitalists provide finance even from the first stage of idea formulation

The various stages in the financing of venture capital are described below

**(1) Development of an Idea -** Seed Finance In the initial stage venture capitalists provide see capital for translating an idea into business proposition At this stage investigation is made in-depth which normally takes a year or more

**(2) Implementation Stage -** Start up Finance When the firm is set up to manufacture a product or provide a service, start up finance is provided by the venture capitalists The first and second stage capital is used for full scale manufacturing and further business growth

**(3) Fledging Stage :-** Additional Finance In the third stage, the firm has made some headway and entered the stage of manufacturing a product but faces teething problem It may not be able to generate adequate funds and so additional round of financing is provided to develop the marketing infrastructure

**(4) Establishment Stage -** Establishment Finance At this stage the firm is established in the market and expected to expand at a rapid pace It needs further financing for expansion and diversification so that is can reap economics of scale and attain stability At the end of the establishment stage, the firm is listed on the stock exchange and at this point the venture capitalist disinvests their shareholdings through available exist routes

Before investing in small, new or young hi-tech enterprises, the venture capitalists look for percentage of key success factors of a venture capital project They prefer projects that address these problems.

After assessing the viability of projects, the investors decide for what stage they should provide venture capital so that it leads to greater capital appreciation All the above stages of finance involve varying degrees of risks and venture capital industry, only after analysing such risks, invest in one or more Hence they specialize in one or more but rarely all

### 2.4.3. Importance Of Venture Capital:

Venture Capital is of great practical value to every corporate enterprise in modern times

#### I. Advantage to Investing Public

1 The investing public will be able to reduce risk significantly against unscrupulous management, if the public invest in venture fund who in turn will invest in equity of new business With their expertise in the field and continuous involvement in the business they would be able to stop malpractices by management

2 Investor have no means to vouch for the reasonableness of the claims made by the promoters about profitability of the business The venture funds equipped with necessary skills will be able to analyses the prospects of the business

3 The investors do not have any means to ensure that the affairs of the business are conducted prudently The venture fund having representatives on the Board of Directors of the company would overcome it

#### II. Advantages to Promoters

1 The entrepreneur for the success of public issue is required to convince tens of underwriters, brokers and thousands of investors but to obtain venture capital assistance, he will be required to sell his idea to justify the officials of the venture fund

2 Public issue of equity shares has to be proceeded by a lot of efforts viz necessary statutory sanctions, underwriting and brokers arrangement, publicity of issue etc The new entrepreneurs find it very difficult to make underwriting arrangements which involves a great deal of effort Venture fund assistance would eliminate those efforts by leaving entrepreneur to concentrate upon bread and butter activities of business

3 Costs of public issues of equity share often range between 10 per cent to 15 per cent of nominal value of issue of moderate size, which are often even higher for small issues The company is required, in addition to above, to incur recurring costs for maintenance of share registry cell, stock exchange listing fee, expenditure on printing and

posting of annual reports etc These items of expenditure can be ill afforded by the business when it is new Assistance from venture fund does not require such expenditure

**III. General**

1 A developed venture capital institutional set up reduces the time lag between a technological innovation and its commercial exploitation.

2. It helps in developing new processes/products in conducive atmosphere, free from the dead weight of corporate bureaucracy, which helps in exploiting full potential

3 Venture capital acts as a cushion to support business borrowings, as bankers and investors will not lend money with, inadequate margin of equity capital

4. Once venture capital funds start earning profits, it will be very easy for them to raise resources from primary capital market in the form of equity and debts Therefore, the investors would be able to invest in new business through venture funds and, at the same time, they can directly invest in existing business when venture fund disposes its own holding This mechanism will help to channelise investment in new high-tech business or the existing sick business These business will take-off with the help of finance from venture funds and this would help in increasing productivity, better capacity utilisation etc

5 The economy with well developed venture capital network induces the entry of large number of technocrats in industry, helps in stabilizing industries and in creating a new set of trained technocrats to build and manage medium and large industries, resulting in faster industrial development

6 A venture capital firm serves as an intermediary between investors looking for high returns for their money and entrepreneurs in search of needed capital for their start ups

7 It also paves the way for private sector to share the responsibility with public sector

**2.4.4 Growth Of Venture Capital In India:**

Indian tradition of venture capital for industry goes back more than 150 years when many of the managing agency houses acted as venture capitalists providing both finance and management skill to risky projects It was the managing agency system through which Tata Iron and Steels and Empress Mills were able to raise equity capital from the investing public The Tatas also initiated a managing agency hours, named Investment Corporation of India in 1937 which by acting as venture capitalist, successfully promoted hitech enterprises such as CEAT tyres, Associated Bearings, National Rayon etc The early form of venture capital enabled the entrepreneurs to raise large amount of funds and yet retain management control After the abolition of managing agency system, the public sector term lending institutions met a part of venture capital requirements through seed capital and risk capital for hi tech industries which were not able to meet promoters contribution However, all these institutions supported only proven and sound technology while technology development remained largely confined to government labs and academic institutions Many hi-tech industries, thus, found it impossible to obtain financial

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assistance from banks and other financial institutions due to unproven technology, conservative attitude, risk awareness and rigid security parameters

Venture capital's growth in India passed through various stages. In 1973, R S Bhatt Committee recommended formation of Rs 100 crore venture capital fund. The Seventh Five Year Plan emphasised the need for developing a system of funding venture capital The Research and Development Cess Act was enacted in May 1986 which introduced a cess of 5% on all payments made for purchase of technology from abroad The levy provides the source for the venture capital fund.

United Nations Development Programme in 1987 on behalf of government examined the possibility of developing venture capital in private sector. Technology Policy Implementation Committee in the same year also recommended the same provision. Formalised venture capital took roots when venture capital guidelines were issued by Comptroller of Capital Issues in November 1988.

### 2.4.5. Methods Of Venture Financing:

Venture capital is available in three forms in India

1 Equity

2 Conditional Loan

3 Income Note

**1. Equity:** All VCF's in India provide but generally their contribution does not exceed 49% of the total equity capital VCF's buy equity shares of an enterprise with an intention to ultimately sell of to make capital gain

**2. Conditional Loan :** A conditional loan is repayable in the form of royalty after the project generates sales No interest is paid on such loans VCF's charge royalty ranging between 2 and 15 per cent Some VCF's give a choice to the entrepreneur to pay a high interest rate instead of royalty on sales once the project becomes commercially sound.

**3. Income note :** An income note combines the features of both conventional loan and conditional loan The entrepreneur has to pay both interest and royalty on sales. Funds are made available in the form unsecured loans at 9 per cent per year during development phase In addition to interest, royalty on sales could also be charged

## 2.5 LEASING – CONCEPT AND ESSENTIALS OF LEASING

Leasing, as a financing concept, is an arrangement between two parties, the leasing company or lessor and the user or lessee, whereby the former arranges to buy capital equipment for the use of the latter for an agreed period of time in return for the payment of rent The rentals are predetermined and payable at fixed intervals of time, according to the mutual convenience of both the parties However, the lessor remains the owner of the equipment over the primary period

By resorting to leasing, the lessee company is able to exploit the economic value of the equipment by using it as if he owned it without having to pay for its capital cost  Lease rentals can be conveniently paid over the lease period out of profits earned from the use of the equipment and the rent is cent percent tax deductible

Conceptually, a lease may be defined as a contractual arrangement /transaction in which a party owning an asset/equipment (lessor) provides the asset for use to another/transfers the right to use the equipment to the user (lessee)  Over a certain/for an agreed period of time for consideration in the form of/in return for periodic payment (rentals) with or without a further payment (premium)  At the end of the period of contract (lease period), the asset/ equipment reverts back to the lessor unless there is a provision for the renewal of the contract. Leasing essentially involves the divorce of ownership from the economic use of an asset/equipment  It is a device of financing the cost of an asset  It is a contract in which a specific equipment required by the lessee is purchased by the lessor (Financier) from a manufacturer/vendor selected by the lessee  The lessee has possession and use of the asset on payment of the specified rentals over a predetermined period of time  Lease financing is thus a device of financing/money lending  The real function or a lessor is not renting of asset but lending of funds/finance/ credit and lease financing is in effect a contract of lending money  The lessor (financier) is the nominal owner of the asset as the possession and economic use to the equipment vests in the lessee  The lessee is free to choose the asset according to his requirements and the lessor dose not take recourse to the equipment as long as the rentals are regularly paid to him

The essential elements of leasing are the following

**1. Parties to the Contract :** There are essentially two parties to a contract of lease financing, viz, the owner and the user, respectively called the lessor and the lessee Lessors as well as lessees may be individuals, partnerships, joint stock companies, corporations or financial Institution  Sometimes  there may be joint lessors or joint lessess, particularly where the properties or the amount of finance involved is enormous  Besides, there may be a lease-broker who acts as an intermediary in arranging lease deals. Merchant banking divisions of certain foreign banks in India, subsidiaries of some Indian banks and even some private merchant bankers are acting as lease brokers They charge certain percentage of fees for their services, ranging between 0 50 to I per cent  Besides, a lease contract may involve a 'lease financier', who refinances the lessor, either by providing term loans or by subscribing to equity or under a specific refinance scheme

**2. Asset :** The asset, property or equipment to be leased is the subject matter of a contract of lease financing The asset may be an automobile, plant and machinery, equipment, land and building, factory, a running business, aircraft, etc  The asset must, however, be of the lessee's choice suitable for his business needs

**3. Ownership Separated from user :** The essence of a lease financing contract is that during the lease tenure, ownership of the asset vests with the lessor and its use is allowed to the lessee  On the expiry of the lease tenure, the asset reverts to the lessor

**4. Term of Lease :** The term of lease is the period for which the agreement of lease remains in operation Every lease should have a definite period, otherwise it will be legally inoperative The lease period may sometimes stretch over the entire economic life of the asset (i.e , financial lease) or a period shorter than the useful life of the asset (i e, operating lease) ~~The lease may be perpetual, i.e.,~~ with an option at the end of the lease period to renew the lease for a further specific period

**5. Lease Rentals :** The consideration which the lessee pays to the lessor for the lease transaction is the lease rental The lease rentals are so structured as to compensate the lessor for the investment made in the asset (in the form of depreciation), the interest on the investment, repairs, etc. if any borne by the lessor and servicing charges over the lease period

**6. Modes of Terminating Lease :** At the end ot the lease period, the lease is terminated and various courses are possible, viz ,

(a) The lease is renewed on a perpetual basis or for a definite period,

(b) The asset reverts to the lessor,

(c) The asset reverts to the lessor and the lessor sells it to a third party,

(d) The lessor sells the asset to the lessee.

The parties may mutually agree to and choose any of the aforesaid alternatives at the beginning of the lease nature

### 2.5.1 Classification Of Leasing:

An equipment lease transaction can differ on the basis of (1) the extent to which the risks and rewards of ownership are transferred, (ii) number of parties to the transaction, (iii) domiciles of the equipment manufacturer, the lessor and the lessee, etc Risk with reference to leasing refers to the possibility of loss arising on account of under-utilization or technological obsolescence of the equipment while reward means the incremental net cash flows that are generated from the usage of the equipment over its economic life and the realization of the anticipated residual value on expiry of the economic life. On the basis of these variations, leasing can be classified into the following types

(a) Finance lease and operating lease

(b) Sales and lease back, and direct lease

(c) Single investor lease and leveraged lease

(d) Domestic lease and International lease

**(a) Finance Lease and Operating Lease Finance Lease :** According to the International Accounting Standards ( IAS-17 ), in a finance lease the lessor transfers to the lessee, substantially all the risks and rewards incidental to the ownership of the asset whether or not the title is eventually transferred. It involves payment of rentals over an obligatory noncancelable lease period, sufficient in total to amortize the capital outlay of the lessor and leave some profit In such leases, the lessor is only a financier and is usually not interested in the assets It is for this reason that such leases are also usually not interested in the assests, It is for this reason that such leases are also called full payout leases as they enable a lessor to recover his investment in the lease and device a profit types of assets Included under such lease are ships, aircraft, railway wagons, lands, building heavy machinery, diesel generating sets and so on

The IAS-17 stipulates that a substantial part of the ownership related risks and rewards in leasing are transferred when

(i) The ownership of the equipment is transferred to the lease by the end of the lease term or

(ii) The lease has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair market value at the date the option becomes exercisable and at the stipulation of the lease it is reasonable certain that the option will be exercise

(iii) The lease term is for a major part of the useful life of the asset. The title may not eventually be transferred The useful life of an asset refers to the minimum of its .

1)Physical life in terms of the period for which it can perform its function,

2)Technological life in the sense of the period in which it does not become obsolete.

3)Product market life deemed as the period during which its product enjoys satisfactory market. The criterion/ cut-off point is that if the lease term exceeds 75 per cent of the useful life of the equipment, it is a finance lease

(iv) The present value of the minimum lease payment is greater than, or substantially equal to, the fair market value of the asset at the inception of the lease (cost or equipment) The title may or may not be eventually transferred The cut-off point is that the present value exceeds 90 per cent of the fair market value of the equipment The present value should be computed using a discount rate equal to the rate implicit in the lease in the case of lessor and, in the case of the lessee, upon the incremental borrowing rate

In India, however, a lease is a finance lease, if one of the last two conditions, is satisfied A lease agreement with any of the first two conditions is treated as hire-purchase agreement

A finance lease is structured to include the following features

(i) The lessee (the intending buyer) selects the equipment according to his requirement from its manufacturer or distributor

(ii) The lessee negotiates and settles with the manufacturer or distributor, the price, the delivery schedule, installation, terms of warranties, maintenance and payment, etc

(iii) The lessor purchases the equipment either directly from the manufacturer or distributor (under straight-forward leasing) or from the lessee after the equipment is delivered (under sale and lease back)

(iv) The lessor then leases out the equipment to the lessee. The lessor retains the ownership while lessee is allowed to use the equipment

(v) A finance lease may provide a right or option, to the lessee, to purchase the equipment at a future date However, this practice is rarely found in India

(vi) The lease period spreads over the expected economic life of the asset The lease is originally for a non-cancelable period called the primary lease period during which the lessor seeks to recover his investment along with some profit During this period cancellation of lease is possible only at a very heavy cost Thereafter, the lease is subject to renewal for the secondary lease period, during which the rentals are substantially low

(vii) The lessee is entitled to exclusive and peaceful use of the equipment during the entire lease period provided he pays the rentals and complies with the terms of the lease

(viii)As the equipment is chosen by the lessee, the responsibility of its suitability, the risk of obsolescence and the liability for repair, maintenance and insurance or the equipment rest with the lessee

**Operating Lease:** According to the IAS-17, an operating lease is one which is not a finance lease. In an operating lease, the lessor does not transfer all the risks and rewards incidental to the ownership of the asset and the cost of the asset is not fully amortized during the primary lease period The lessor provides services (other than the financing of the purchase price) attached to the leased asset, such as maintenance, repair and technical advice For this reason, operating lease include a cost for the services provided, and the lessor does not depend on a single lessee for recovery of his cost Operating lease is generally used for computers, office equipments, automobiles, trucks, telephones, etc

An operating lease is structured with the following features

(i) An operating lease is generally for a period significantly shorter than the economic life of the leased asset In some cases it may be even on hourly, daily, weekly or monthly basis The lease is cancelable by either party during the lease period

(ii) Since the lease periods are shorter than the expected life of the asset, the lease rentals are not sufficient to totally amortize the cost of the assets

(iii) The lessor does not rely on the single lessee for recovery of his investment He has the ultimate interest in the residual value of the asset The lessor bears the risk of obsolescence, since the lessee is free to cancel the lease at any time

(iv) Operating lease normally include maintenance clause requiring the lessor to maintain the leased asset and provide services such as insurance, support stair, fuel, etc

Examples of Operating leases are

(a) Providing mobile cranes with operators,

(b) Chartering of aircraft and ships, including the provision of crew, fuel and support services

(c) Hiring of computers with operators,

(d) Hiring of taxi for a particular travel, which includes service of driver, provision for maintenance, fuel immediate repairs, etc

**(b) Sale and Lease Back and Direct Lease Sale and Lease back :** In a way, it is an indirect from of leasing The owner of an equipment/asset sells it to a leasing company (Lessor) which leases it back to the owner (lessee) A classic example of this type of leasing is the sale and lease back of safe deposits values by banks under which banks sell them in their custody to a leasing company at a market price substantially higher than the book value The leasing company in turn offers these lockers on a long-term basis to the bank. The bank subleases the lockers to its customers. The lease back arrangement in sale and lease back type of leasing can be in the form of finance lease or operating lease

**Direct Lease :** In direct lease, the lessee, and the owner of the equipment are two different entities a direct lease can be of two types : Bipartite and Tripartite Lease.

**Bipartite Lease :** There are two parties in the lease transaction, namely,

(i) equipment supplier-cum-lessor

(ii) lessee Such a type of lease is typically structured as an operating lease with inbuilt facilities, like up gradation of the equipment (Upgrade Lease), addition to the original equipment configuration and so on The lessor maintains the asset and, if necessary, replaces it with a similar equipment in working conditions (Swap Lease).

Tripartite Lease Such type of lease involves three different parties in the lease agreement equipment supplier, lessor and lessee An innovative variant of tripartite lease is the sales-aid lease under which the equipment supplier arranges for lease finance in various company,

- Providing reference about the customer to the leasing company,
- Negotiating the terms of the lease with the customer and completing all the formalities on behalf of the leasing company,
- Writing the lease on his own account and discounting the lease receivables with the designated leasing company The effect is that the leasing company owns the equipment and obtains an assignment of lease rental

The sales-aid lease is usually with recourse to the supplier in the event of default by the lessee either in the form of offer from the supplier to buy back the equipment from the lessor or a guarantee on behalf of the lessee

**(c) Single Investor Lease and Leveraged Lease**

**Single Investor Lease :** There are only two parties to the lease transaction – the lessor and the lessee The leasing company (lessor) funds the entire investment by an appropriate mix of debt and equity funds The debts raised by the leasing company to finance the asset are without recourse to the lessee, i e in the case of default in servicing the debt by the leasing company, the lender is not entitled to payment from the lessee

**Leveraged Lease :** There are three parties to the transaction (i) lessor (equity investor), (ii) lender and (iii) lessee In such type of lease, the leasing company (equity investor) buys the asset through substantial borrowing The lender (loan participant) obtains an assignment of the lease and a first mortgaged asset on the leased asset The transaction is routed through a trustee who looks after the interest of the lender and lessor On receipt of the rentals from the lessee, the trustee remits the debt service component of the rental to the loan participant and the balance to the lessor

Like other lease transactions, leveraged lease entitles the lessor to claim tax shields on depreciation and other capital allowances on the entire investment cost including the non-recourse debt The return on equity (profit after tax divided by net worth) is, therefore, high From the lessee's point of view, the effective rate of interest implicit in the lease arrangement is less than on a straight loan as the lessor passes on the portion of the tax benefits to the lessee in the form of lower rental payments Leveraged lease packages are generally structured for leasing investment-intensive assets like aircrafts, ships, etc,

**(d) Domestic Lease and International Lease Domestic Lease:** A lease transaction is classified as domestic if all parties to the agreement, namely, equipment supplier, lessor and the lessee, are domiciled in the same country International Lease If the parties to the lease transaction are domiciled in different countries, it is known as international lease, This type of lease is further sub-classified into

(1) Import Lease and

(2) crossborder lease

Import Lease In an import lease, the lessor and the lessee are domiciled in the same country, but the equipment supplier is located in a different country The lessor imports the asset and leases it to the lessee

Cross-border Lease When the lessor and the lessee are domiciled in different countries, the lease is classified as cross-border lease, The domicile of the supplier is immaterial

Operationally, domestic and international leases are differentiated on the basis of risk The latter type of lease transaction is effected by two additional risk factors, i,e, country risk and currency risk The country risk arises from the need to structure the lease transaction in the light of an understanding of the political and economic climate and a knowledge or the tax and regulatory environment governing them in the foreign countries concerned. As the payment to the supplier and the lease rentals are denominated in different currencies, any variation in the exchange rate will involve currency risk

### 2.5.2 Advantages Of Leasing:

To the Lessee  Lease financing has the following advantages to the lessee

- Financing of Capital goods  - Lease financing enables the lessee to have finance for huge investments in land, building, plant, machinery, heavy equipments, etc , up to 100 per cent, without requiring any immediate down payment  Thus, the lessee is able to commence his business virtually without making any initial investment (of course, he may have to invest the minimal sum of working capital needs)

- Additional Source of Finance  - Leasing facilitates the acquisition of equipment, plant and machinery, without the necessary capital outlay, and, thus, has a competitive advantage of mobilizing the scarce financial resources of the business enterprise  It enhances the working capital position and makes available the internal accruals for business operations

- Less Costly  - Leasing as a method of financing is less costly than other alternatives available

- Off-Balance Sheet Financing  - Neither the leased asset is depicted on the balance sheet, nor the lease liability is shown, except that the fact of lease arrangement is mentioned by way of a footnote  Lease financing, therefore, does not affect the debt raising capacity of the enterprise, the lessor's security being also confirmed to the leased asset However, the advantage is by, and large, more apparent than real Development banks and other lending agencies do not base their decision to lend solely on the apparent strength of the balance sheet of the borrower  They certainly call for information regarding the off-balance sheet liabilities to assess the real borrowing capacity

But the off-balance sheet financing can be misleading to lenders who rely on the financial statements  In brief, the non-disclosure of outstanding lease obligations and the value of the leased assets in the balance sheet would result in

(i) understatement of debt -equity ratio and

(ii) Over statement of asset turnover ratio as well as return on investment  They under-estimate the real risk and over-estimate the value of the firm as they are affected by these variables  In recognition of the distortions implicit in the non-disclosures of finance lease in the financial statements of the lessee, the IAS-17 has recommended capitalization of finance leases in the books of the lessee

- **Ownership Preserved: -** Leasing provides finance without diluting the ownership or control of the promoters  Against it, other modes of long-term finance, viz, equity or debentures, normally dilute the ownership of the promoters

- **Avoid Conditionalities:-** Lease finance is considered preferable to institutional finance, as in the former case, there are no conditionalities  Lease financing is beneficial since it is free from restrictive covenants and conditionalities, such as, representations on the board, conversion of debt into equity, payment of dividend, etc, which usually accompany institutional finance and term loans from banks

- **Flexibility in Structuring of Rentals:-** The lease rentals can be structured to accommodate the cash flow situation of the lessee, making the payment of rentals convenient to him The lease rentals are so tailor-made that the lessee is able to pay the rentals from the funds generated from operations The lease period is also chosen so as ~~to suit the lessee's capacity~~ to pay rentals and considering the operating lifespan of the asset

- **Simplicity:-** A lease finance arrangement is simple to negotiate and free from cumbersome procedures with faster and simple documentation As against it, institutional finance and term loans require compliance of covenants and formalities and bulk of documentation, causing procedural delays

- **Tax Benefits:-** By suitable structuring of lease rentals, a lot of tax advantages can be derived If the lessee is in a tax paying position, the rental may be increased to lower his taxable income. The cost of asset is thus amortized more rapidly than in a case where the asset is owned by the lessee, since depreciation is allowable at the prescribed rates If the lessor is in tax paying position, the rentals may be lowered to pass on a part of the tax benefit to the lessee Thus, the rentals can be adjusted suitably for postponement of taxes

- **Obsolescence Risk is Averted :-** In a lease arrangement the lessor being the owner bears the risk of obsolescence and the lessee is always free to replace the asset with the latest technology

- **Full Security :-** The lessor's interest is fully secured since he is always the owner of the leased asset and can take repossession of the asset if the lessee defaults As against it, realising an asset secured against a loan is more difficult and cumbersome

- **Tax Benefit :-** The greatest advantage for the lessor is the tax relief by way of depreciation If the lessor is in high tax bracket, he can lease out assets with high depreciation rates, and thus, reduce his tax liability substantially Besides, the rentals can be suitably structured to pass on some tax benefit to the lessees

- **High Profitability :-** The leasing business is highly profitable since the rate of return is more than what the lessor pays on his borrowings Also, the rate of return is more than in case of lending finance directly

- **Trading on Equity :-** Lessors usually carry out their operations with greater financial leverage, That is, they have a very low equity capital and use a substantial amount of borrowed funds and deposits Thus, the ultimate return on equity is very high

- **High Growth Potential :-** The leasing industry has a high growth potential Leasing financing enables the lessees to acquire equipment and machinery even during a period of depression, since they do not have to invest any capital Leasing, thus, maintains the economic growth even during recessionary period

**2.5.3 Limitations Of Leasing:**

Lease financing suffers from certain limitations too

**Restrictions on Use of Equipment:-** A lease arrangement may impose certain restrictions on use or the equipment, or require compulsory insurance, etc Besides, the lessee is not free to make additions or alterations to the leased asset to suit his requirements

**Limitations of Financial Lease:-** A financial lease may entail higher payout obligations, if the equipment is found not useful and the lessee opts for premature termination of the lease agreement Besides, the lessee is not entitled to the protection of express or implied warranties since he is not the owner of the asset

**Loss of Residual Value:-** The lessee never becomes the owner of the leased asset Thus, he is deprived of the residual value of the asset and is not even entitled to any improvements done by the lessor or caused by inflation or otherwise, such as appreciation in value of leasehold land

**Consequences of Default:-** If the lessee defaults in complying with any terms and conditions of the lease contract, the lessor may terminate the lease and take over the possession of the leased asset In case of finance lease, the lessee may be required to pay for damages and accelerated rental payments

**Understatement of Lessee's Asset :-** Since the leased assets do not form part of lessee's assets, there is an effective understatement of his assets, which may sometimes lead to gross under-estimation of the lessee However, there is now an accounting practice to disclose the leased assets by way or footnote to the balance sheet

**Double Sales Tax:-** With the amendment of sale-tax law in various states, a lease financing transaction may be charged to sales tax twice-once when the lessor purchases the equipment and again when it is leased to the lessee

**2.5.4 Contents Of A Lease Agreement:**

The lease agreement specifies the legal rights and obligations of the lessor and the lessee It typically contains terms relating to the following

1 Description of the lessor, the lessee, and the equipment

2 Amount, time, and place of rental payments

3. Time and place of equipment delivery

4 Lessee's responsibility for taking delivery and possession of the leased equipment.

5 Lessee's responsibility for maintenance, repairs, registration, etc and the lessor's right in case of default by the lessee

6 Lessee's right to enjoy the benefits of the warranties provided by the equipment manufacturer/ supplier

7 Insurance to be taken by the lessee on behalf of the lessor

8 Variation in lease rentals if there is a change in certain external factors like bank interest rates, depreciation rates, and fiscal incentives

9 Option of lease renewal for the lessee

10 Return of equipment on expiry of the lease period

11 Arbitration procedure in the event of dispute

**2.5.5 Leasing And Borrowing:**

- Lease vs buying/ borrowing is a blend of investing and financing decision
- Tax shield on depreciation is allowed only for lessor
- Lease rental is an expense for the lessee but and income for the lessor First Approach

i Investing decision is evaluated separately based on NPV

ii Identify all relevant operating Cash Flows including taxes and capital allowances iii Discount rates always based on WACC or COC iv If NPV is positive, proceed to the financing decision other wise Reject the proposal

Second Approach i Evaluate financing Decision Only Cash Flows, which are relevant to the sourceof finance, are considered. ( Operating Cash Flows are ignored , because they aresame throughout the period)

**1.LEASE** Following Cash Flows are considered only

1 Lease Rental

2 Tax Shield on lease rental

**2.BUYING/ BORROWING**

1 Cost of purchase

2. Tax Shield on Capital Allowance

3 Interest expense and its tax shield are considered only if annual interest paymentsare made

4 Do not considered interest expense and its shield if lump sum amount of loan is paid at the end of the period

## 2.6. CREDIT RATING – CONCEPT

The changing financial scenario in our country after liberalization movement has led to emergence of many new institutions which were concomitant for changed financial set up In this scene there have been innovations in the financial instruments, a result of financial engineering Irrespective of type of financial instrument the basic parameter to evaluate an investment proposal have been the return and safety Debt instruments have been playing an important role for raising funds and in times to come still it is most potential avenue. The basic feature of debt i e. assured return is very attractive for investors to plan their portfolio but it is associated with a risk especially if it is unsecured How the investors is to gauge such risks? Credit Rating is the answer

Credit Rating is a symbolic indicator of the current objective assessment by a rating agency of the relative capability and willingness of an issuer of a debt programmes to service the debt obligations as per the terms of the contract It may be referred as current opinion of a borrower's credit quality in terms of business and financial risk On the basis of such evaluation the investors get some idea about the degree of certainty of timely repayment of the principal amount of the debt instrument besides regular payment of returns on it i e interest So credit rating is neither a general purpose evaluation of a corporate entity nor an overall assessment of the credit risk associated with the instruments issued or to be issued by the concerned business house It only indicates a representatives characters of the particular security which does not amount to any recommendation to purchase sell or hold that security

To understand the concept of credit rating it is worth to have an idea of different credit rating agencies what they consider credit rating as.

**Investment Information and Credit Rating Agency of India Ltd. (ICRA)**

Rating is a symbolic indicator of the current opinion of the relative capability of timely servicing of debt and obligations by the corporate entity with reference to the instrument rated

**Credit Rating Information Services of India Ltd. (CRISIL)**

Rating is current opinion as to the relative safety of timely payment of interest and principal on a debenture, structured obligation, preference shares, fixed deposits programme or shot term instruments

**Credit Analysis and Research Ltd. (CARE)**

Credit rating is an opinion on the relative ability and willingness of an issuer to make timely payment on specific debt or related obligations over the life of the instrument

**Australian Ratings**

Rating provides lender with a simple system of gradation by which the relative capacities of companies to make timely repayment of interest and principal on a particular type of debt can be noted

**Standard & Poors**

Rating is current assessment of the credit worthiness of an obligor with respect to specific obligation

From the above definitions it is understood that

(i) Credit rating is an assessment of the capacity of an issuer of debt security, by an independent agency, to pay interest and repay the principal as per the terms of issue of debt. A rating agency collects the qualitative as well as quantitative data from a company which has to be rated and assesses the relative strength and capacity of company to honour its obligations contained in the debt instrument through out the duration of the instrument. The rating given is based on an objective judgement of a team of experts from the rating agency

(ii) The ratings are expressed in code number which can be easily comprehended even by the lay investors The ratings are the quickest way of understanding a company' financial standing without going into the complicated financial reports Credit rating is only a guidance to the investors and not a recommendation to a particular debt instrument. The important element for investment decision making in debt security are (i) yield to maturity (ii) risk tolerance to investor and

(iii) credit risk of the security Clearly the focus of credit rating is on any one of these three elements viz , credit risk of the security and hence it can not by itself be a basis for investment decision making It is only a current opinion on the relative capacity of firms to repay debt in time

(iv) Credit rating, as it exists in India, is done for a specific debt security and not for a company as a whole No rating agency tells that it is an indicator of the financial status of the company All that a rating agency claims is that the rating symbols indicate the capacity of the company to honour the terms of contract of a debt instrument

(v) A debt rating is not a one time evaluation of credit risk, which can be regarded as valid for the entire life of the security It is an on going appraisal Changes in dynamic world of business may imply a change in the risk characteristics of the security Hence debt rating agencies monitor the business and financial conditions of the issuer to determine whether modification in rating is warranted

(v) A credit rating does not create a fiduciary relationship between the rating agency and the users of rating since there is no legal basis for such relationships

### 2.6.1 Functions Of Credit Ratings:

The credit rating firms are supposed to do the following functions

**1. Superior Information**

Rating by an independent and professional firm offers a superior and more reliable source of information on credit risk for three inter related risks

(a) It provides unbiased opinion

(b) Due to professional resources, a rating firm has greater ability to assess risks

(c) It has access to lot of information which may not be publicly available

**2. Low Cost Information**

A rating firm which gathers, analyses, interprets and summarizes complex information in a simple and readily understood format for wide public consumption represents a cost effective arrangement.

**3. Basis for a Proper Risk-Return Trade Off**

If debt securities are rated professionally and if such ratings enjoy widespread investor acceptance and confidence, a more rational risk return trade off would be established in the capital market

**4. Healthy Discipline on Corporate Borrowers**

Public exposure has healthy influence over the management of issuer because of its desire to have a clear image

**5. Formulation of Public**

Policy Guidelines on Institutional Investment The public policy on the kinds of securities that are eligible for inclusion in different kinds of institutional portfolios can be developed with great confidence if securities are rated professionally by independent agencies.

**2.6.2 Benefits Of Credit Rating:**

The following are the benefits of credit rating

1 Low Cost Information Credit rating is a source of low cost information to investors. The collection, processing and analysis of relevant information is done by a specialised agency which a group of investors can trust

2 Quick Investment Decision In the present day complex world ratings enable investors to take quickest possible decisions based on associated ratings

3 Sources of Additional Certification Credit rating agency provides additional certification to the issue of debt/ financial instrument A highly rated firm can enter the market with great confidence Indian experience shows that individual companies that use credit rating, benefit a great deal by getting larger amount of money from a wider audience at a lower cost

4 Increase the Investors Population A sound credit rating system gives an alternative method to name recognition as a determining factor in making investment and helps increase the population of those investing in debt obligations of the company

5 Forewarns Risks Credit rating acts as a guide to companies which get a lower rating. It forewarns the management of the perception of risk in the market and prompts to take steps on their operating and marketing risks and thereby changes the perception in the market

6 Encourages Financial Discipline Rating also encourage discipline among corporate borrowers to improve their financial structure and performance to obtain better rating for their debt obligations

7. Merchant Bankers Job Made Easy Merchant bankers and brokers will be relieved of the responsibility of guiding investors as to the risk of a particular investment Merchant bankers and brokers, in the absence of objective information, go on the basis of name recognition in guiding their clients With the advent of credit rating, what they would be required to do is to bring to the attention of their clients the ratings of debt obligations

8 Investors Protection Hiring of credit agency implies that the management of the company is ready to show its operations for independent scrutiny So, the investors who are not provided with confidential information can have overall assessment based on ratings A credible and objective rating agency can provide increased disclosure, better accounting standard and improved investor protection

9 Foreign Collaborations made Easy The foreign collaborators always ask for credit rating while negotiating with an Indian company Credit rating enables to identify instantly the relative credit standing of the company The importance of credit rating is being increasingly recognized in the Euro-markets

10 Benefits the Industry as a Whole Relatively small and unknown companies use ratings to instill confidence in investors Higher rate companies get larger amount of money at a lower cost Thus the industry as a whole can benefit from ratings by direct mobilization of savings from individuals rather than from intermediary lending institutions

**2.6.3 Types Of Rating:**

The rating methodology and process discussed earlier is primarily for debt instruments like debentures, fixed deposits, bonds etc This type of rating constitutes the major business of a rating company But with the passage of time these agencies have started providing other types of rating such as

**a) Equity rating**

Rating of equity shares issued in capital market is termed as equity rating In such exercises the opinion on the earnings prospects and risk associated with such earnings can be arrived at through comprehensive information on acquisition, interaction with the management of the corporate, critical analysis and collective judgmental process This exercise is also known as 'equity grading' which is initiated on the initiative of the issuer of equity before making a public issue Grading examines very closely the level, quality, growth and substantiality of earnings in the medium term on the expanded equity base resulting from the present offer and other known future equity expansion Like credit rating, equity grading can also be communicated both as a symbolic grade and a detailed rational Surveillance such grading will make it relevant for secondary market of the issued share The key parameter in the whole exercise is the prospective return on net worth Rating agencies may also make equity assessment at the request of institutional investors with the consent of the corporate house whose equity is sought to be assessed

### b) Mutual fund rating

Mutual Funds which are popular world over are evaluated by rating agencies and it is known as mutual fund rating It facilitate selection of right fund from the available funds Given the nature of mutual funds, the analysis of performance has to rely to a large extent, on past performance Therefore, evaluation is primarily based on the two indicators 'risk and return' Expense ratio, turnover ratio, composition of portfolio, accounting practices, fund management qualities, NAV in past are some of the main parameters to evaluate mutual funds.

### c) Individual credit rating

Consumer finance is gaining popularity in developing countries The success of consumer finance depends on the credit worthiness of the consumer Rating agencies may take up rating of such individuals Individual credit rating is own objective assessment of the risk attached to a financial transaction with respect to an individual at a given point of time based on qualification of parameters influencing credit risk Every aspect of credit seeker's history, age, qualification, occupation, stability at work, residence, martial status, assets, repaying capacity, savings and earnings potentials are used to assess creditworthiness of an individual Agencies broadly rate individuals on social status, economic status and financial status

### d) Rating of banks and financial companies

Banks and financing companies are also issuers of debts like banks issue certificates of deposits (CD) The issuer's internal affair is scanned by evaluation of their background and history Their relation with government and central bank are studied The issuer's innovations and competitive ability to attract cheaper funds is analysed Maturity pattern between the source and deployment of fund is studied Its competitive position and market share is also studied The rating exercise could include a case by case review of major non-performing assets to determine the prospect of reliability The quality of assets is judged Profitability is also gazed The quality of management is judged by the profile of operating executives, human resources policies and organizational structure In case of financial companies, support of group companies could be important in determining their success Accounting figures are considered after adjusting for non standard accounting policies

### e) Sovereign rating

It is primarily rating of a country as to its credit worthiness and probability to risk etc In this process economic parameters and economic policies of the country are under constant observation Such rating influences the availability of foreign aids from agencies like World Bank. All rating agencies may not take up such assignment because of lack of infrastructure and specialists

### f) Rating structured obligation

Structured obligation is a negotiable instrument or security which is backed by some asset The main role of a credit rating agency in analyzing an asset backed security or a structured obligation is to assess the risk of default in meeting the contractual obligations to the investors As in the rating of conventional debt instruments,

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the rating assesses the default risk rating to other debt instruments available to the investor The main thrust in the evaluation of an asset backed transaction is to ensure that the cash flows from the assets and the envisaged structure are capable of meeting the committed payments to the investors even in a "worstcase" scenario A key point to kept in mind is that in the rating of a structured obligation it is not rating the issuer but is assessing the risk associated with the ~~transaction More specially~~, ~~a AAA rating on a~~ particular structured obligation of a particular originator does not necessarily mean that all other issues by the entity would also get a AAA

### 2.6.4 Credit Rating Agencies In India:

Currently there are four credit rating agencies in India

1 Credit Rating Information Service Ltd (CRISIL)

2 Information and Credit Rating Agency of India (ICRA)

3 Credit Analysis and Research (CARE) 4 Duff Phelps Credit Rating Pvt Ltd (DCR India)

**1. Credit Rating Information Service Ltd. (CRISIL)**

On January 1, 1988 the Industrial Credit and Investment Corporation of India (ICICI) and Unit Trust of India (UTI) joined hands to float CRISIL, first rating agency in India with an equity base of Rs 4 00 crores. Each of them holds 18 per cent of the stock The other promoters are . The Asian Development Bank (15 percent), the LIC, the GIC and its subsidiaries and the State Bank of India (each 5 per cent), the Housing Development Finance Corporation (6 2 per cent); 9 nationalized Banks owning 19 5 per cent, the remaining equity is distributed among 10 foreign banks i e Standard Chartered Bank, Banque Indo Suez, Mitsui Bank, Bank of Tokyo, Hongkong and Shanghai Banking Corporation, Citi Bank, Grindlays Bank, Deutsche Bank, Societe General, Banque Nationals de Peris CRISIL became a public limited company in November 1993 and is presently a quoted company on the Bombay Stock Exchange.

Objective The main objective of CRISIL has been to rate debt obligation of Indian companies Its rating provides a guide to the investors as to the risk of timely payment of interest and principal on a particular debt instrument Its ratings create awareness of the concept of credit rating amongst corporations, merchant bankers brokers, regulatory authorities and helps in creating environment that facilitates the debt rating

At the time when CRISIL commenced its operations it was contemplated that it would undertake credit rating for a company at its specific request and subsequently it might cover all companies on its own initiative with the basic idea to provide information about creditworthiness of all companies whether they approach CRISIL or not so that investors know about the company offering securities to the public It had also envisaged to cover under credit rating all securities viz equity shares as well as preference shares, debentures, secured, unsecured convertible and non-convertible and fixed deposits To achieve the objectives and contribute towards stable and healthy growth of the Indian Capital market, the thrust of the CRISIL operations was planned towards

i) Shifting the primary responsibility of established corporate credit quality from the merchant bankers/ brokers/ underwriters/financial advisor to CRISIL and making available widely acceptable standard and uniform rating for the investors,

ii) Providing for increased disclosure, better accounting standards improved financial information to the users i.e. individual investors, financial institutions, stock exchange and corporate research bodies,

iii) Reducing the cost of issue by helping direct mobilization of finance without depending on intermediary agencies, and

iv) Protecting the interest of investors by constant monitoring of the results of rated companies and altering the grading to reflect the true and fair state of affairs of the financial position of companies

Credit Rating Symbols CRISIL uses the conventional rating symbols used in the USA and widely accepted in many other countries The following table shows the investment wise rating symbols assigned by CRISIL and the meaning of each rating from the angle of safety to the investors CRISIL Debenture Rating Symbols

| | |
|---|---|
| **High Investment Grades** | |
| **AAA (Triple A)** | **Highest Safety** |
| **AA (Double A)** | **High Safety** |
| **Investment Grades** | |
| **A** | **Adequate Safety** |
| **BBB (Triple B)** | **Moderate Safety** |
| **Speculative Grades** | |
| **BB (Double B)** | **Inadequate Safety** |
| **B** | **High Risk** |
| **C** | **Substantial Risk** |
| **D** | **Default** |

CRISIL Fixed Deposit Rating Symbols

| | | |
|---|---|---|
| Investment Grades | | |
| FAAA (F-Triple A) | : | Highest Safety |
| FAA (F-Double A) | : | High Safety |
| FA | : | Adequate Safety |
| Speculative Grades | | |
| FB | | Inadequate Safety |
| FB | : | High Risk |
| FC | | Substantial Risk |
| FD | : | Default |

**Credit Rating for Short Term Instruments**

| Rating Symbol | Indication (Each rating indicates that the degree of safety regarding timely payment on the instrument is shown against the symbol) |
|---|---|
| P-1 | Very Strong |
| P-2 | Strong |
| P-3 | Adequate |
| P-4 | Minimal |
| P-5 | Expected to be in default on maturity or in default |

CRISIL monitors the ratings it assigns constantly. The ratings may be upgraded, downgraded or withdrawn depending upon new information or developments concerning the company whose debt obligation is rated It has the right to widely disseminate the ratings through the media, through its own publications or through any other methods

## 2. ICRA Ltd

The ICRA Ltd. has been promoted by the IFCI Ltd. as the main promoter to meet the requirements of the companies based in the northern parts of the country. Apart from the main promoter, which holds 26 per cent of the share capital, the other shareholders are the Unit Trust of India, banks, LIC, GIC, Exim Bank, HDFC Ltd. and ILFS Ltd It started operations in 1991. In order to bring international experience and practices to the Indian capital markets, the ICRA has entered into a MOU with Moody's Investors Service to provide, through its company Financial Programmes Inc (FPI), credit education, risk management software, credit research and consulting services to banks, financial/investment institutions, financial services companies and mutual funds in India As in the case of the CRISIL, the main objectives of the ICRA are

- To assist investors, both individual and institutional, in making well informed decisions,
- To assist issuers in raising funds, from a wider investor base, in large amounts and at a lower cost for highly rated entities,
- To enable banks, investment bankers, brokers in placing debt with investors by providing them with a marketing tool and
- To provide regulators with market driven systems to encourage the healthy growth of the capital markets in a disciplined manner, without additional burden on the Government

Over the years, the ICRA has diversified the range of its services It currently provides three types of services , (1) rating services; (2) information services and (3) advisory services

ICRA RATING SCALE

**Long Term including Debentures Bonds and Preference Shares**

| | | |
|---|---|---|
| LAAA | : | Highest Safety |
| LAA | : | High Safety |
| LA | : | Adequate Safety |
| LBBB | : | Moderate Safety |
| LBB | : | Inadequate Safety |
| LB | : | Risk Prone |
| LC | : | Substantial Risk |
| LD | : | Default, Extremely Speculative |

**Medium Term including Deposits Fixed**

| | | |
|---|---|---|
| MAAA | : | Highest Safety |
| MAA | : | High Safety |
| MA | : | Adequate Safety |
| MB | : | Inadequate Safety |
| MC | : | Risk Prone |
| MD | : | Default |

**3. CARE Ltd.**

The CARE Ltd is a credit rating and information services company promoted by the Industrial Development Bank of India (IDBI) jointly with financial institutions, public/private sector banks and private finance companies. It commenced its credit rating operations in October 1993 and offers a wide range of products and services in the field of credit information and equity research. Unlike the CRISIL and the ICRA, the CARE is very cautions in entering new areas of business. Currently, it offers the following services:

(a) Credit Rating The CARE undertake credit rating of all types of debt instruments, both short-term and long-term

(b) Advisory Services The CARE provides advisory services in the areas of · ? Securitisation transactions;

- Structuring financial instruments; ?
- Financing of infrastructure projects and
- Municipal finances

**2.7 FACTORING – CONCEPT**

As stated earlier, a lot of working capital is tied up in the form of trade debts Collection of debts, especially for the small-scale and medium scale companies is the biggest problem The average collection period has been on the increase Delays in collection process inturn lead to liquidity problems and consequently to delay in production and supplies The peculiar situation in India is that a number of small scale units are catering to the requirements of a single large buyer This large buyer is always known for his procrastination in paying his small suppliers The crux of the problem is not so much the failure to pay altogether as the failure to pay on time As a result, the interest cost of financing book debts is quite heavy. This increase in cost of capital reduces profit and competitiveness of a company particularly the small ones in the market Ultimately, the small unit may become even sick To overcome this situation, the factoring service has been conceived.

The word 'Factor' has been derived from the Latin word 'Facere' which means to 'to make or to do' In other words, it means 'to get things done' According to the Webster Dictionary 'Factor' is an agent, as a banking or insurance company, engaged in financing the operations of certain companies or in financing wholesale or retail trade sales, through the purchase of account receivables As the dictionary rightly points out, factoring is nothing but financing through purchase of account receivables

Thus, factoring is a method of financing whereby a company sells its trade debts at a discount to a financial institution In other words, factoring is a continuous arrangement between a financial institution, (namely the factor) and a company (namely the client) which sells goods and services to trade customers on credit As per this arrangement, the factor purchases the client's trade debts including accounts receivables either with or without recourse to the client, and thus, exercises control over the credit extended to the customers and administers the sales ledger of his client The client is immediately paid 80 per cent of the trade debts taken over and when the trade customers repay their dues, the factor will make the remaining 20 per cent payment To put it in a layman's language, a factor is an agent who collects the dues of his client for a certain fee

Robert W Johnson states "factoring is a service involving the purchase by a financial organization, called a factor, of receivables owned to manufacturers and distributors by their customers, with the factor assuming full credit and collection responsibilities"

In the words of Kohok "factorings is an asset based means of financing by which the factor buys up the book debts of a company on a regular basis, paying cash down against receivables, and then collects the amounts from the customers to whom the company has supplied goods"

### 2.7.1 TERMS AND CONDITION IN A FACTORING AGREEMENT

The existence of an agreement between the factor and the client is central to the function of factoring. The main terms and conditions generally included in a factoring agreement are the following

(i) Assignment of debt in favour of the factor,

(ii) Selling limits for the client,

(iii) Conditions within which the factor will have recourse to the client in case of non-payment by the trade customer,

(iv) Circumstances under which the factor will have recourse in case of non-payment,

(v) Details regarding the payment to the factor for his services, say for instance, as a certain percentage on turnover,

(vi) Interest to be allowed to the factor on the account where credit has been sanctioned to the supplier, and

(vii) Limit of any overdraft facility and the rate of interest to be charged by the factor

### 2.7.2 Functions Of Factoring:

As stated earlier the term 'factoring' simply refers to the process of selling trade debts of a company to a financial institution. But, in practice, it is more than that. Factoring involves the following functions.

**(i) Purchase and collection debts**

Factoring envisages the sale of trade debts to the factor by the company, i.e., the client. It is where factoring differs from discounting. Under discounting, the financier simply discounts the debts backed by account receivables of the client. He does so as an agent of the client. But, under factoring, the factor purchases the entire trade debts and thus, he becomes a holder for value and not an agent. Once the debts are purchased by the factor, collection of those debts becomes his duty automatically.

**(ii) Credit investigation and undertaking of credit risk**

Sales ledger management function is a very important one in factoring. Once the factoring relationship is established, it becomes the factor's responsibility to take care of all the functions relating to the maintenance of sales ledger. The factor has to credit the customer's account whenever payment is received, send monthly statements to the customers and to maintain liaison with the client and the customer to resolve all possible disputes. He has to inform the client about the balances in the account, the overdue period, the financial standing of the customers, etc. Thus the factor takes up the work of monthly sales analysis, overdue invoice analysis and credit analysis.

**(iii) Credit investigation and undertaking of credit risk**

The factor has to monitor the financial position of the customer carefully, since, he assumes the risk of default in payment by customers due to their financial inability to pay. This assumption of credit risk is one of the most important functions which the factor accepts. Hence, before accepting the risk, he must be fully aware of the financial viability of the customer, his past financial performance record, his future ability, his honesty and integrity in the business world etc. For this purpose, the factor also undertakes credit investigation work.

**(iv) Provision of Finance**

After the finalization of the agreement and sale of goods by the client, the factor provides 80% of the credit sales as prepayment to the client. Hence, the client can go ahead with his business plans or production schedule without any interruption. This payment is generally made without any recourse to the client. That is, in the event of non-payment, the factor has to bear the loss of payment.

**(v) Rendering Consultancy Service**

Apart from the above, the factor also provides management services to the client. He informs the client about the additional business opportunities available, the changing business and financial profiles of the customers, the likelihood of coming recession etc.

### 2.7.3 Types Of Factoring

The type of factoring services varies on the basis of the nature of transactions between the client and the factor, the nature and volume of client's business, the nature of factor's security etc In general, the factoring services can be classified as follows

(i) Full service factoring or without recourse factoring

(ii) With Recourse Factoring

(iii) Maturity Factoring

(iv) Bulk Factoring

(v) Invoice Factoring

(vi) Agency Factoring

(vii) International Factoring

**(i) Full Service Factoring**

Under this type, factor provides all kinds of services discussed above. Thus, a factor provides finance, administers the sales ledger, collects the debts at his risk and renders consultancy service This type of factoring is a standard one If the debtors fail to repay the debts, the entire responsibility falls on the shoulders of the factor since the assumes the credit risk also He can not pass on this responsibility to his client and hence, this type of factoring is also called 'Without Recourse' Factoring

**(ii) With Recourse Factoring**

As the very name suggest, under this type, the factor does not assume the credit risk In other words, if the debtors do not repay their dues in time and if their debts are outstanding beyond a fixed period, say 60 to 90 days from the due date, such debts are automatically assigned back to the client The client has to take up the work of collection of overdue account by himself If the client wants the factor to go on with the collection work of overdue accounts, the client has to pay extra charges called 'Refactoring Charges"

**(iii) Maturity Factoring**

Under this, the factor does not provide immediate cash payment to the client at the time of assignment of debts He undertakes to pay cash as and when collections are made from the debtors The entire amount collected less factoring fees is paid to the client immediately Hence it is also called 'collection Factoring' In fact, under this type, no financing is involved But all other services are available

**(iv) Bulk Factoring**

Under this type, the factor provides finance after disclosing the fact of assignment of debts to the debtors concerned. This type of factoring is resorted to when the factor is not fully satisfied with the financial condition of the client The work relating to sales ledger administration, credit control, collection work etc has to be done by the client himself Since the notification has been made, the factor simply collects the debts on behalf of the client This is otherwise called as "Disclosed Factoring" or Notified Factoring"

**(v) Invoice Factoring**

Under this type, the factor simply provides finance against invoices without undertaking any other functions All works connected with sales administration, collection of dues etc have to be done by the client himself The debtors are not at all notified and hence they are not aware of the financing arrangement This type of factoring is very confidential in nature and hence it is called 'Confidential Invoice discounting' or 'Undisclosed Factoring'

**(vi) Agency Factoring**

The word agency has no meaning as far as factoring is concerned Under this type, the factor and the client share the work between themselves as follows

(i) The client has to look after the sales ledger administration and collection work and

(ii) The factor has to provide finance and assume the credit risk

**(vii) International Factoring**

Under this type, the services of a factor in a domestic business are simply extended to international business Factoring is done purely on the basis of the invoice prepared by the exporter Thus, the exporter is able to get immediate cash to the extent of 80% of the export invoice under international factoring International factoring is facilitated with the help of export factors and import factors

**2.7.4 Benefits Of Factoring**

Factoring offers a number of benefits to the clients Some of the important benefits are

**(i) Financial Service**

Many of the manufacturers and traders find their working capital being locked up in the form of trade debts This has been a great handicap to the small and medium scale manufacturers because they have to wait for 3 months to 9 months to realize their debts. In the meantime, the business may suffer due to want of funds Infact, many business concerns fail more as a result of inadequate cash flow than anything else The key to successful working capital management lies in the ability of an enterprise to convert sales into cash flow and the speed at which it is done. The major benefit of the factoring service is that the clients will be able to convert their trade debts into cash upto 80% immediately as soon as the credit sales are over They need not wait for months together to get cash for recycling Another major advantage is that there are no constrains by way of fixed limits as in the case of cash credit or O D As sales grow, the financial assistance also grow and both are directly proportional to each other The greatest advantage is that factoring assures immediate cash flow. When the cash position improves, the client is able to make his purchases on cash basis and thus, he can avail of cash discount facilities also

**(ii) Collection Service**

Collection of debts is another problematic area for many concerns It is found that over 60% of the total sales of the SSI sector and over 50% of total sales of the medium and large scale sector are made on "On Account Terms of Payment" i e credit sales It means that collection of debts becomes an important internal credit management and it requires more and more time So, industrialists cannot concentrate on production Delay in collection process often leads to delay in production and supplies Moreover, the interest cost of financing book debts is also on the increase Ultimately, it affects the profitability of the company. Now, this collection work is completely taken up by the factoring organization, leaving the client to concentrate on production alone This is an important service rendered by a factor to his client The cost of collection is also cut down as a result of the professional expertise of a factor

**(iii) 'Credit risk' Service**

In the absence of a factor, the entire credit risk has to be borne by the client himself Bad debts eat away the profits of a concern and in some cases, it may lead to the closure of a business But, once the factoring relationship is established, the client need not bother about the loss due to bad debts The factor assumes the risk of default in payment by customers and thus, the client is assured of complete realization of his book debts Even if the customer fails to pay the debt, it becomes the responsibility of the factor to pay that amount to the client It is the greatest advantage of factoring

**(iv) Provision of Expertise 'Sales Ledger Management' Service**

Administration of sales ledger is purely an accounting function which can be performed efficiently only by a few Infact, the success of any organization depends upon the efficiency with which the sales ledger is managed It requires a specialised knowledge which the client may not possess But, the client can receive services like maintenance of accounting records, monthly sales analysis, overdue invoice analysis and customer payment statement from the factor Besides, he maintains contact with customers to ensure that they repay their dues promptly Thus, it becomes the factor's responsibility to take care of all the functions relating to the maintenance of sales ledger Thus, factoring offers an excellent credit control for the client

**(v) Consultancy Service**

Factors are professionals in offering management services like consultancy They collect information regarding the credit worthiness of the customers of their clients, ascertain their track record, quality of portfolio turnover, average size of inventory etc , and pass on the same to their clients It helps the clients avoid poor quality and risky customers They also advise their clients on important financial matters Generally no time is available to the client for investigating his customer's credit standing Now, the factor takes up this work on behalf of his client

**(vi) Economy in Servicing**

Factors are able to render very economic service to their clients because their overhead cost is spread over a number of clients Moreover, their service charges are also reasonable Factoring is a cheap source of finance to the client because the interest rate is charged only on the amount actually provided to the client, say, for instance, 80% of his total invoices and not on the total amount of the invoices Thus, clients are able to get factoring services at economic rates

**(vii) Off-balance Sheet Financing**

Factoring is an off-balance sheet means of financing when the factor purchases the book debts of the client, these debts no longer exist on the current asset side of the balance sheet It leads to reduction in debts and less collection problems. The client can utilise the money so received to reduce his current liabilities It means an improved current ratio

**(viii) Trade benefits**

Availability of ready cash against bills enables the supplier to negotiate better prices for the inputs and also offer finer terms to customers It ensures a steady flow of inputs on the one hand and better market prospects on the other. Again, factoring enables the supplier to concentrate on production and materials management without bothering about the financial management Factoring enables clients to offer longer credit facilities to their customers and thus to attract more business Thus many trade benefits are available under factoring

**(ix) Miscellaneous Service**

Generally, factors are able to computerize their operations fully So they are able to render prompt service at reasonable rates They spend more on M I S analysis They also build bigger credit library of debtors by means of collecting information about new debtors Thus, improved cash flow through realization of trade debts by factoring, efficient follow up of collections, computerized sales ledger maintenance and the competitive rates are the main benefits of factoring

# UNIT – III

# MUTUAL FUNDS AND FOREIGN EXCHANGE MARKET

### 3. CONCEPT AND ORIGIN OF MUTUAL FUNDS

To state in simple words, a mutual fund collects the savings from small investors, invest them in Government and other corporate securities and earn income through interest and dividends, besides capital gains It works on the principle of 'small drops of water make a big ocean' For instance, if one has Rs 1000 to invest, it may not fetch very much on its own But, when it is pooled with Rs 1000 each from a lot of other people, then, one could create a 'big fund' large enough to invest in a wide varieties of shares and debentures on a commanding scale and thus, to enjoy the economies of large scale operations Hence, a mutual fund is nothing but a form of collective investment It is formed by the coming together of a number of investors who transfer their surplus funds to a professionally qualified organization to manage it To get the surplus funds from investors, the fund adopts a simple technique Each fund is divided into a small fraction called "units" of equal value Each investor is allocated units in proportion to the size of his investment Thus, every investor, whether big or small, will have a stake in the fund and can enjoy the wide portfolio of the investment held by the fund Hence, mutual funds enable millions of small and large investors to participate in and derive the benefit of the capital market growth It has emerged as a popular vehicle of creation of wealth due to high return, lower cost and diversified risk

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

These mutual funds are referred to as Unit Trusts in the U K and as open end investment companies in the U S A Therefore, Kamm, J O defines an open end investment company as "an organization formed for the investment of funds obtained from individuals and institutional investors who in exchange for the funds receive shares which can be redeemed at any time at their underlying asset value"

According to Weston J Fred and Brigham, Eugene, F , Unit Trusts are "Corporations which accept dollars from savers and then use these dollars to buy stocks, long term bonds, short term debt instruments issued by business or government units, these corporations pool funds and thus reduce risk by diversification"

Thus, mutual funds are corporations which pool funds by selling their own shares and reduce risk by diversification.

Fund Unit Vs Share Just like shares, the price of units of a fund is also quoted in the market. This price is governed basically by the value of the underlying investments held by that fund At this juncture, one should not confuse a mutual fund investment on units with that of an investment on equity shares Investment on equity share represents investment in a particular company alone On the other hand, investment on an unit of a Fund represents investment in the parts of shares of a large number of companies This itself gives an idea how safe the units are

If a particular company fails the share-holders of that company are affected very much whereas the unit holders of that company are able to withstand that risk by means of their profitable holdings in other companies shares

Again, investment on equity shares can be used as a tool by speculators and inveterate stock market enthusiasts with a view to gaining abnormal profits These people play an investment game in the stock market on the basis of daily movement of prices But, mutual funds cannot be invested for such purposes and the mutual fund is not at all concerned with the daily ebbs and flows of the market. In short, mutual fund is not the right investment vehicle for speculators. Mutual funds are, therefore, suitable only to genuine investors whereas shares are suitable to both the genuine investors and the speculators

**Origin of the Fund**

The origin of the concept of mutual fund dates back to the very dawn of commercial history It is said that Egyptians and Phoenicians sold their shares in vessels and caravans with a view to spreading the risk attached with these risky ventures However, the real credit of introducing the modern concept of mutual fund goes to the Foreign and Colonial Government Trust of London established in 1868 Thereafter, a large number of close-ended mutual funds were formed in the U S A in 1930's followed by many countries in Europe, the Far East and Latin America In most of the countries, both open and close-ended types were popular In India, it gained momentum only in 1980, though it began in the year 1964 with the Unit Trust of India launching its first fund, the Unit Scheme 1964.

**3.1 TYPES OF FUNDS/CLASSIFICATION OF FUNDS**

In the investment market, one can find a variety of investors with different needs, objectives and risk taking capacities For instance, a young businessman would like to get more capital appreciation for his funds and he would be prepared to take greater risk than a person who is just on the verge of his retiring age So, it is very difficult to offer one fund to satisfy all the requirements of investors Just as one shoe is not suitable for all legs, one fund is not suitable to meet the vast requirements of all investors Therefore, many types of funds are available to the investor It is completely left to the discretion of the investor to choose any one of them depending upon his requirement and his risk taking capacity

Mutual fund schemes can broadly be classified into many types as given below·

1 On the basis of execution and operation

(A) Close-ended Funds

Under this scheme, the corpus of the fund and its duration are prefixed In other words, the corpus of the fund and the number of units are determined in advance Once the subscription reaches the pre-determined level, the entry of investors is closed After the expiry of the fixed period, the entire corpus is disinvested and the proceeds are distributed to the various unit holders in proportion to their holding Thus, the fund ceases to be a fund, after the final distribution

**Features :** The main features of the close-ended funds are'

(i) The period and/or the target amount of the fund is definite and fixed beforehand

(ii) Once the period is over and/or the target is reached, the door is closed for the investors They cannot purchase any more units

(iii) These units are publicly traded through stock exchange and generally, there is no repurchase facility by the fund.

(iv) The main objective of this fund is capital appreciation

(v) The whole fund is available for the entire duration of the scheme and there will not be any redemption demands before its maturity Hence, the fund manager can manage the investments efficiently and profitably without the necessity of maintaining and liquidity

(vi) At the time of redemption, the entire investment pertaining to a closed-end scheme is liquidated and the proceeds are distributed among the unit holders

(vii) From the investor's point of view, it may attract more tax since the entire capital appreciation is realized in toto at one stage itself

(viii)If the market condition is not favourable, it may also affect the investor since he may not get the full benefit of capital appreciation in the value of the investment

(ix) Generally, the prices of closed-end scheme units are quoted at a discount of upto 40 percent below their Net Asset Value (NAV)

**(B) Open-ended Funds**

It is just the opposite of close-ended funds Under this scheme, the size of the fund and/or the period of the fund is not pre-determined The investors are free to buy and sell any number of units at any point of time For instance, the Unit Scheme (1964) of the Unit Trust of India is an open ended one, both in terms of period and target amount Anybody can buy this unit at any time and sell it also at any time at his discretion

The main features of the Open-Ended Funds are

(i) The investor is assured of regular income at periodic intervals, say half-yearly or yearly and so on

(ii) The main objective of this type of Fund is to declare regular dividends and not capital appreciation

(iii) The pattern of investment is oriented towards high and fixed income yielding securities like debentures, bonds etc

(iv) This is best suited to the old are retired people who may not have any regular income

(v) It concerns itself with short run gains only

**(B) Pure Growth Funds (Growth Oriented Funds)**

Unlike the Income Funds, Growth Funds concentrate mainly on long run gains i e , capital appreciation They do not offer regular income and they aim at capital appreciation in the long run Hence, they have been described as "Nest Eggs" investments

The main features of the Growth Funds are

(i) The growth oriented fund aims at meeting the investors' need for capital appreciation

(ii) The investment strategy therefore, conforms to the fund objective by investing the funds predominantly on equities with high growth potential

(iii) The fund tries to get capital appreciation by taking much risks and investing on risk bearing equities and high growth equity shares

(iv) The fund may declare dividend, but its principal objective is only capital appreciation

(v) This is best suited to salaried and business people who have high risk bearing capacity and ability to defer liquidity They can accumulate wealth for future needs

**(C) Balanced Funds**

This is otherwise called income-cum-growth fund It is nothing but a combination of both income and growth funds It aims at distributing regular income as well as capital appreciation This is achieved by balancing the investments between the high growth equity shares and also the fixed income earning securities

**(D) Specialised Funds**

Besides the above, large number of specialised funds are in existence abroad They offer special schemes so as to meet the specific needs of specific categories of people like pensioners, widows etc There are also funds for investments in securities of specified areas For instance, Japan Fund, South Korea Fund etc In fact, these funds open the door for foreign investors to invest on the domestic securities of these countries

Again certain funds may be confined to one particular sector or industry like fertilizer, automobiles, petroleum etc These funds carry heavy risk since the entire investment is in one industry But, there are high risk taking investors who prefer this type of fund Of course, in such cases, the rewards may be commensurate with the risk taken At times, it may be erratic The best example of this type is the Petroleum Industry Funds in the U S A

**(E) Money-Market Mutual Funds (MMMFs)**

These funds are basically open ended mutual funds and as such they have all the features of the open ended fund But, they invest in highly liquid and safe securities like commercial paper, banker's acceptances, certificates of deposits, treasury bills etc These instruments are called money market instruments They take the place of shares, debentures and bonds in a capital market They pay money market rates of interest These funds are called 'money funds' in the U S A. and they have been functioning since 1972 Investors generally use it as a "parking place" or "stop gap arrangement" for their cash resources till they finally decide about the proper avenue for their investment i e , long term financial assets like bonds and stocks

Since MMMFs are a new concept in India, the RBI has laid down certain stringent regulations For instance, the entry to MMMFs is restricted only to scheduled commercial banks and their subsidiaries MMMFs can invest only in specified short term money market instruments like certificate of deposits, commercial papers and 182 days treasury bills They can also lend to call market These funds go for safe and liquid investment Frequent realization of interest and redemption of fund at short notice are the special features of the fund These funds will not be subject to reserve requirements The re-purchase could be subject to a minimum lock in period of 3 months

**(F) Taxation Funds**

A taxation fund is basically a growth oriented fund But, it offers tax rebates to the investors either in the domestic or foreign capital market It is suitable to salaried people who want to enjoy tax rebates particularly during the month of February and March In India, at present the law relating to tax rebates is covered under section 88 of the Income Tax Act, 1961 An investor is entitled to get 20% rebate in Income Tax for investments made under this fund subject to a maximum investment of Rs 10,000/- per annum The Tax Saving Magnum of SBI Capital Market Limited is the best example for the domestic type UTI's US $60 million India Fund, based in the USA, is an example for the foreign type

**OTHER CLASSIFICATION**

**(G) Leveraged Funds**

These funds are also called borrowed funds since they are used primarily to increase the size of the value of portfolio of a mutual fund When the value increases, the earning capacity of the fund also increases The gains are distributed to the unit holders This is resorted to only when the gains from the borrowed funds are more than the cost of borrowed funds

**(H) Dual Funds**

This is a special kind of closed end fund It provides a single investment opportunity for two different types of investors For this purpose, it sells two types of investment stocks viz , income shares and capital shares Those investors who seek current investment income can purchase income shares They receive all the interest and dividends earned from the entire investment portfolio However, they are guaranteed a minimum annual dividend payment The holders of capital shares receive all the capital gains earned on those shares and they are not entitled to receive any dividend of any type In this respect, the dual fund is different from a balanced fund

### (I) Index Funds

Index funds refer to those funds where the portfolios are designed in such a way that they reflect the composition of some broad based market index This is done by holding securities in the same proportion as the index itself The value of these index linked funds will automatically go up whenever the market index goes up and vice-versa Since the construction of portfolio is entirely based upon maintaining proper proportions of the index being followed, it involves less administrative expenses, lower transaction costs, less number of portfolio managers etc It is so because only fewer purchases and sales of securities would take place

### (J) Bond Funds

These funds have portfolios consisting mainly of fixed income securities like bonds the main thrust of these funds is mostly on income rather than capital gains They differ from income funds in the sense income funds offer an average returns higher than that from bank deposits and also capital gains lesser than that in equity shares.

### (K) Aggressive Growth Funds

These funds are just the opposite of bond funds These funds are capital gains oriented and thus the thrust area of these funds is capital gains Hence, these funds are generally invested in speculative stocks They may also use specialised investment techniques like short term trading, option writing etc Naturally, these funds tend to be volatile in nature

### (L) Off-Shore Mutual Funds

Off-shore mutual funds are those funds which are meant for non-residential investors In other words, the sources of investments for these funds are from abroad So, they are regulated by the provisions of the foreign countries where those funds are registered These funds facilitate flow of funds across different countries, with free and efficient movement of capital for investment and repatriation Off-shore funds are preferred to direct foreign investment, since, it does not allow foreign domination over host country's corporate sector However, these funds involve much currency and country risk and hence they generally yield higher return

In India, these funds are subject to the approval of the Department of Economic Affairs, Ministry of Finance and the RBI monitors such funds by issuing directions then and there In India, a number of off-shore funds exist 'India Fund' and 'India Growth Fund' were floated by the UTI in U K and U.S A respectively The State Bank of India floated the India Magnum Fund in Netherlands 'The Indo-Suez Himalayan Fund N V' was launched by Canbank Mutual Fund in collaboration with Indo-Suez Asia Investment Services Ltd It also floated 'Commonwealth Equity Fund'

## 3.2 IMPORTANCE OF MUTUAL FUNDS

The mutual fund industry has grown at a phenomenal rate in the recent past One can witness a revolution in the mutual fund industry in view of its importance to the investors in general and the country's economy at large. The following are some of the important advantages of mutual funds :

### (i) Channelising Savings for Investment

Mutual funds act as a vehicle in galvanizing the savings of the people by offering various schemes suitable to the various classes of customers for the development of the economy as a whole A number of schemes are being offered by MFs so as to meet the varied requirements of the masses, and thus, savings are directed towards capital investments directly In the absence of MFs, these savings would have remained idle. Thus, the whole economy benefits due to the cost efficient and optimum use and allocation of scarce financial and real resources in the economy for its speedy development.

### (ii) Offering Wide Portfolio Investment

Small and medium investors used to burn their fingers in stock exchange operations with a relatively modest outlay. If they invest in a select few shares, some may even sink without a trace never to rise again Now, these investors can enjoy the wide portfolio of th investment held by the mutual fund. The fund diversifies its risks by investing on a large varieties of shares and bonds which cannot be done by small and medium investors This is in accordance with the maxim 'Not to lay all eggs in one basket' These funds have large amounts at their disposal, and so, they carry a clout in respect of stock exchange transactions. They are in a position to have a balanced portfolio which is free from risks Thus MF's provide instantaneous portfolio diversification. The risk diversification which a pool of savings through mutual funds can achieve cannot be attained by a single investor's savings

### (iii) Providing Better Yields

The pooling of funds from a large number of customers enables the fund to have large funds at its disposal Due to these large funds, mutual funds are able to buy cheaper and sell dearer than the small and medium investors Thus, they are able to command better market rates and lower rates of brokerage. So, they provide better yields to their customers They also enjoy the economies of large scale and can reduce the cost of capital market participation The transaction costs of large investments are definitely lower than that of small investments In fact, all the profits of a mutual fund are passed on to the investors by way of dividends and capital appreciation The expenses pertaining to a particular scheme alone are charged to the respective scheme Most of the mutual funds so far floated have given a dividend at the rate ranging between 12% p a and 17% p.a It is fairly a good yield It is an ideal vehicle for those who look for long term capital appreciation.

**(iv) Rendering Expertise**

Investment Service at Low Cost The management of the fund is generally assigned to professionals who are well trained and have adequate experience in the field of investment The investment decisions of these professionals are always backed by informed judgement and experience Thus, investors are assured of quality services in their best interest Due to the complex nature of the securities market, a single investor cannot do all these works by himself or he cannot go to a professional manager who manages individual portfolios In such a case, he may charge hefty management fee The intermediation fee is the lowest being one per cent in the case of a mutual fund

**(v) Providing Research Service**

A mutual fund is able to command vast resources and hence it is possible for it to have an in depth study and carry out research on corporate securities Each fund maintains a large research team which constantly analyses the companies and the industries and recommends the fund to buy or sell a particular share Thus, investments are made purely on the basis of a thorough research Since research involves a lot of time, efforts and expenditure, an individual investor cannot take up this work. By investing in a mutual fund, the investor gets the benefit of the research done by the fund

**(vi) Offering Tax Benefits**

Certain funds offer tax benefits to its customers Thus, apart from dividends, interest and capital appreciation, investors also stand to get the benefit of tax concession For instance, under section 80L of the Income Tax Act, a sum of Rs 10,000 received as dividend (Rs 13000 to UTI) from a MF is deductible from the gross total income Under the wealth Tax Act, investments in MF are exempted upto Rs 5 lakhs The mutual funds themselves are totally exempt from tax on all income on their investments But, all other companies have to pay taxes and they can declare dividends only from the profits after tax But, mutual funds to do not deduct tax at source from dividends. This is really a boon to investors

**(vii) Introducing Flexible Investment Schedule**

Some mutual funds have permitted the investors to exchange their units from one scheme to another and this flexibility is a great boon to investors Income Units can be exchanged for growth units depending upon the performance of the funds One can not derive such a flexibility in any other investments

**(viii) Providing Greater Affordability and Liquidity**

Even a very small investor can afford to invest in mutual funds They provide an attractive and cost effective alternative to direct purchase of shares In the absence of MFs, small investors cannot think of participating in a number of investments with such a meager sum Again, there is grater liquidity Units can be sold to the fund at anytime at the Net Asset Value and thus quick access to liquid cash is assured Besides, branches of the sponsoring bank is always ready to provide loan facility against the unit certificates

### (ix) Simplified Record Keeping

An investor with just an investment in 500 shares or so in 3 or 4 companies has to keep proper records of dividend payments, bonus issues, price movements, purchase or sale instruction, brokerage and other related items. It is very tedious and consumes a lot of time One may even forget to record the rights issue and may have to forfeit the same Thus, record keeping is the biggest problem for small and medium investors Now, a mutual fund offers a single investment source facility, i.e , a single buy order of 100 units from a mutual fund is equivalent to investment in more than 100 companies The investor has to keep a record of only one deal with the Mutual Fund Even if he does not keep a record, the MF sends statements very often to the investor Thus, by investing in MFs, the record keeping work is also passed on to the fund

### (x) Supporting Capital Market

Mutual funds play a vital role in supporting the development of capital markets. The mutual funds make the capital market active by means of providing a sustainable domestic source of demand for capital market instruments In other words, the savings of the people are directed towards investments in capital markets through these mutual funds Thus, funds serve as a conduit for dis-intermediating bank deposits into stocks, shares and bonds. Mutual Funds also provide a valuable liquidity to the capital market, and thus, the market is made very active and stable When foreign investors and speculators exit and re-enter the markets en masse, mutual funds keep the market stable and liquid In the absence of mutual funds, the prices of shares would be subject to wide price fluctuation due to the exit and re-entry of speculators into the capital market en masse Thus, it is rending an excellent support to the capital market and helping in the process of institutionalization of the market

### (xi) Promoting Industrial Development

The economic development of any nation depends upon its industrial advancement and agricultural development All industrial units have to raise their funds by resorting to the capital market by the issue of shares and debentures The mutual funds not only create a demand for these capital market instruments but also supply a large source of funds to the market, and thus, the industries are assured of their capital requirements. In fact the entry of mutual funds has enhanced the demand for India's stock and bonds Thus, mutual funds provide financial resources to the industries at market rates

### (xii) Acting as Substitute for Initial Public Offerings (IPOs)

In most cases investors are not able to get allotment in IPOs of companies because they are often oversubscribed many time Moroever, they have to apply for a minimum of 500 shares which is very difficult particularly for small investors But, in mutual funds, allotment is more or less guaranteed Mutual Funds are also guaranteed a certain percentage of IPOs by companies Thus, by participating in MFs, investors are able to get the satisfaction of participating in hundreds of varieties of companies.

**(xiii) Reducing the Marketing Cost of New Issues**

Moreover the mutual funds help to reduce the marketing cost of the new issues The promoters used to allot a major share of the Initial Public offering to the mutual funds and thus they are saved from the marketing cost of such issues

**(xiv) Keeping the Money Market Active**

An individual investor can not have any access to money market instruments since the minimum amount of investment is out of his reach On the other hand, mutual funds keep the money market active by investing money on the money market instruments. In fact, the availability of more money market instruments itself is a good sign for a developed money market which is very essential for the successful functioning of the central bank in a country Thus mutual funds provide stability to share prices, safety to investors and resources to prospective entrepreneurs

## 3.3 ORGANIZATION OF THE FUND

The structure of mutual fund operations in India envisages a three tier establishment namely

(i) A sponsor institution to promote the fund

(ii) A team of trustees to oversee the operations and to provide checks for the efficient, profitable and transparent operations of the fund and

(iii) An Asset Management Company AMC) to actually deal with the funds

**Sponsoring Institution :** The company which sets up the Mutual Fund is called the sponsor The SEBI has laid down certain criteria to be met by the sponsor These criteria mainly deal with adequate experience, good past track record, net worth etc

**Trustees :** Trustees are people with long experience and good integrity in their respective fields They carry the crucial responsibility of safeguarding the interest of investors For this purpose, they monitor the operations of the different schemes. They have wide ranging powers and they can even dismiss Asset Management Companies with the approval of the SEBI.

**Asset Management Company (AMC) :** The AMC actually manages the funds of the various schemes The AMC employs a large number of professionals to make investments, carry out research and to do agent and investor servicing. In fact, the success of any Mutual Fund depends upon the efficiency of this AMC The AMC submits a quarterly report on the functioning f the mutual fund to the trustees who will guide and control the AMC

## 3.4 OPERATION OF THE FUND

A mutual fund invites the prospective investors to join the fund by offering various schemes so as to suit to the requirements of different categories of investors The resources of individual investors are pooled together and the investors are issued units/shares for the money invested. The amount so collected is invested in capital market instruments like shares and debentures and money market instruments like treasury bills, commercial papers, etc For managing this fund, a mutual fund gets an annual fee of 1 25% of funds managed at the maximum as fixed by the SEBI (MF) Regulations, 1993 and if the funds exceed Rs.100 crores, it is only 1% It can not take more than that ~~Of course regular expenses like custodial fee~~, cost of dividend warrants, fee for registration, the asset management fee etc are debited to the respective scheme These expenses cannot exceed 3% of the assets in the respective schemes each year The remaining amount is given back to the investors in full

## 3.5 FACILITIES AVAILABLE TO INVESTORS

Mutual funds provide following facilities to the investors

### (i) Repurchase Facilities

The units of closed ended schemes must be compulsorily listed in recognized stock exchanges Such units can be sold or bought at market prices But, units of open ended schemes are not at all listed and hence they have to be bought only from the fund So, the fund reserves the right to buy back the units from its members This process of buying back the units from the investors by the fund is called repurchase facility This is available in both schemes so as to provide liquidity to investors The price fixed for this purpose is called repurchase price

### (ii) Reissue Facilities

In the case of open ended schemes, units can be bought only from the fund and not in the open market The units bought from the investors are again reissued to those who are interested in purchasing them The price fixed for this purpose is called re-issue price

### (iii) Roll Over Facilities

At the time of redemption, the investor is given an option to reinvest his entire investment once again for another term An investor can overcome an adverse market condition prevailing at the time of redemption by resorting to this roll over facility This is applicable in the case of close-ended funds

### (iv) Lateral Shifting Facilities

Some mutual funds permit the investors to shift from one scheme to another on the basis of the Net Asset Value with a view to providing total flexibility in their operation This is done without any discount on the fund and without any additional charges This is a great privilege given to the investors This shifting is called 'lateral shifting'

## 3.6 MUTUAL FUNDS AND MONEY MARKETS

Money market accounts and money market mutual funds have some similarities, but investors need to review the distinctions carefully to ensure they make the best investment decision Both options provide yields, but the rate of yield and the rate of risk vary For investors looking to protect their assets while acquiring a gain on them, deciding between a money market account and a money market mutual fund requires an understanding of the gain, the risk, the fees and the intended time period for the investment

**Facts**

Money market accounts are savings accounts that yield more than standard savings accounts  Standard savings accounts generally offer interest rates of around  10 percent  Money market accounts, however, offer interest rates closer to 1.40 percent  Money market mutual funds provide investment opportunities in collective securities  In other words, an investor who places money in a money market mutual fund buys into a group of investments, such as bonds, that are managed by a bank

**Risk**

Both money market accounts and money market mutual funds are considered low-risk investment options Of the two, the money market account is the lower risk, because it is simply a savings account with a high interest rate  The primary risk of a money market account is that of not making as much as you could with another type of investment. Money market mutual funds fall under regulations set by the Securities and Exchange Commission (SEC), so banks are required to invest in securities with a dependable return. The primary risk of the money market mutual fund is that, unlike the money market account, the fund is not insured by the Federal Deposit Insurance Corporation (FDIC)  In case of bank failure, investors will lose their money from the mutual fund but not from the money market account

**Time Frame**

Money market accounts grow slowly over years  Investors cannot expect immediate or rapid returns, and the money market account is best for investors who want money to be safe  Money market mutual funds, on the other hand, tend to be short-term options (at least in comparison to money market accounts), and the majority of money market mutual funds mature in one year or less

**Fees**

Both investment options come with fees  Money market accounts might have monthly fees (although most do not) and penalty fees for withdrawing money before a certain time  If the fees are low and the money remains in the account over the long term, however, the investor will pay very little  Money market mutual funds usually have annual fees  If the original amount invested is not high, the fees can wipe out the gain  An investor who places $5,000 in a mutual fund, with a return of 3 percent, will see a gain of $150  If the bank charges an annual fee of $30 and a fee of half a percent for bank expenses, the gain has been whittled down to $95  The decrease on gain is even more significant when less is invested

**Expert Insight**

Money market accounts are long-term investment accounts  Money market mutual funds are short-term investment options. Financial experts advise investors to consider the amount they have to invest and their goals for that investment before making the decision  Investors should look closely at the money market options only if they have a large amount to invest and are looking for reliable&amp,ndash;if not spectacular&amp,ndash,gains

## 3.7 INTRODUCTION OF PORTFOLIO

"Portfolio means combined holding of many kinds of financial securities i e shares, debentures, government bonds, units and other financial assets." The term investment portfolio refers to the various assets of an investor which are to be considered as a unit It is not merely a collection of unrelated assets but a carefully blended asset combination within a unified framework It is necessary for investors to take all decisions as regards their wealth position in a context of portfolio Making a portfolio means putting ones eggs in different baskets with varying element of risk and return The object of portfolio is to reduce risk by diversification and maximise gains Thus, portfolio is a combination of various instruments of investment. It is also a combination of securities with different risk-return characteristics A portfolio is built up out of the wealth or income of the investor over a period of time with a view to manage the risk-return preferences The analysis of risk-return characteristics of individual securities in the portfolio is made from time to time and changed that may take place in combination with other securities are adjusted accordingly The object of portfolio is to reduce risk by diversification and maximize gains

### 3.7.1 Portfolio Management:

Portfolio management means selection of securities and constant shifting of the portfolio in the light of varying attractiveness of the constituents of the portfolio It is a choice of selecting and revising spectrum of securities to it in with the characteristics of an investor

Portfolio management includes portfolio planning, selection and construction, review and evaluation of securities The skill in portfolio management lies in achieving a sound balance between the objectives of safety, liquidity and profitability

Timing is an important aspect of portfolio revision Ideally, investors should sell at market tops and buy at market bottoms Investors may switch from bonds to share in a bullishmarket and vice-versa in a bearish market

Portfolio management is all about strengths, weaknesses, opportunities and threats in the choice of debt vs equity, domestic vs international, growth vs safety, and many other tradeoffs encountered in the attempt to maximize return at a given appetite for risk

Portfolio management is an art and science of making decisions about investment mix and policy, matching investments to objectives, asset allocation for individuals and institutions, and balancing risk against performance

Portfolio management in common parlance refers to the selection of securities and their continuous shifting in the portfolio to optimize the returns to suit the objectives of the investor This however requires financial expertise in selecting the right mix of securities in changing market conditions to get the best out of the stock market In India, as well as in many western countries, portfolio management service has assumed the role of specialized service now a days and a number of professional merchant bankers compete aggressively to provide the best to high net-worth clients, who have little time to manage their investments The idea is catching up with the boom in the capital market and an increasing number of people are inclined to make the profits out of their hard earned savings

Markowitz analysed the implications of the fact that the investors, although seeking high expected returns, generally wish to avoid risk It is the basis of all scientific portfolio management Although the expected return on a portfolio is directly related to the expected returns on component securities, it is not possible to deduce a portfolio riskiness simply by knowing the riskiness of individual securities. The riskiness of portfolio depends upon the attributes of individual securities as well as the interrelationships among securities

A professional, who manages other people's or institution's investment portfolio with the object of profitability, growth and risk minimization is known as a portfolio manager He is expected to manage the investor's assets prudently and choose particular investment avenues appropriate for particular times aiming at maximization of profit Portfolio management includes portfolio planning, selection and construction, review and evaluation of securities. The skill in portfolio management lies in achieving a sound balance between the objectives of safety, liquidity and profitability.

Timing is an important aspect of portfolio revision Ideally, investors should sell at market tops and buy at market bottoms They should be guarded against buying at high prices and selling at low prices Timing is a crucial factor while switching between shares and bonds Investors may switch from bonds to shares in a bullish market and vice-versa in a bearish market

Portfolio management service is one of the merchant banking activities recognized by Securities and Exchange Board of India (SEBI). The portfolio management service can be rendered either by the SEBI recognized categories I and II merchant bankers or portfolio managers or discretionary portfolio manager as defined in clause (e) and (f) of rule 2 SEBI (portfolio managers) Rules 1993

According to the definitions as contained in the above clauses, a portfolio manager means any person who pursuant to contract or arrangement with a client, advises or directs of undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be A merchant banker acting as a portfolio Manager shall also be bound by the rules and regulations as applicable to the portfolio manager Realizing the importance of portfolio management services, the SEBI has laid down certain guidelines for the proper and professional conduct of portfolio management services. As per guidelines only recognized merchant bankers registered with SEBI are authorized to offer these services.

Portfolio management or investment helps investors in effective and efficient management of their investment to achieve their financial goals The rapid growth of capital markets in India has opened up new investment avenues for investors The stock markets have become attractive investment options for the common man But investors should be able to effectively and efficiently manage investments in order to keep maximum returns with minimum risk.

A portfolio manager by virtue of his knowledge, background and experience is expected to study the various avenues available for profitable investment and advise his client to enable the latter to maximize the return on his investment and at the same time safeguard the funds invested

### 3.7.2 Objectives Of Portfolio Management:

1) Security/Safety of Principal. Security not only involves keeping the principal sum intact but also keeping intact its purchasing power intact Safety means ~~protection for~~ investment against loss under reasonably variations In order to provide safety, a careful review of economic and industry trends is necessary. In other words, errors in portfolio are unavoidable and it requires extensive diversification Even investor wants that his basic amount of investment should remain safe

2) Stability of Income. So as to facilitate planning more accurately and systematically the reinvestment consumption of income is important

3) Capital Growth: This can be attained by reinvesting in growth securities or through purchase of growth securities Capital appreciation has become an important investment principle Investors seek growth stocks which provides a very large capital appreciation by way of rights, bonus and appreciation in the market price of a share

4) Marketability It is the case with which a security can be bought or sold. This is essential for providing flexibility to investment portfolio.

5) Liquidity i e nearness to money It is desirable to investor so as to take advantage of attractive opportunities upcoming in the market

6) Diversification. The basic objective of building a portfolio is to reduce risk of loss of capital and / or income by investing in various types of securities and over a wide range of industries.

7) Favorable Tax status (Tax Incentives) The effective yield an investor gets form his investment depends on tax to which it is subject By minimizing the tax burden, yield can be effectively improved Investors try to minimise their tax liabilities from the investments The portfolio manager has to keep a list of such investment avenues along with the return risk, profile, tax implications, yields and other returns Investment programmers without considering tax implications may be costly to the investor

### 3.7.3 Portfolio Management Process:

Portfolio management is on-going process involving the following basic tasks

i Identification of the investor's objectives, constraints and preferences

ii Strategies are to be developed and implemented in tune with investment policy formulated

iii Review and monitoring of the performance of the portfolio.

iv Finally the evaluation of the portfolio and make some adjustments foi the future

### 3.7.4 Types Of Portfolio:

When it comes to investing there are many options available to individuals A person can invest in stocks, bonds, mutual funds, etc Once a person invests in multiple products their performance needs to be tracked and strategies made to ensure the investor reaps the most profit possible This is where the investment portfolio comes into play According to Investor Awareness, it is a term that describes all investments owned To take this definition a little farther, an investment portfolio is a significant aspect in diversification Maintaining a diverse portfolio helps to mitigate loss because the investor has not placed all of their eggs in one basket. There are different types of investment portfolios Perhaps the most common type's individuals are exposed to are: Conservative, Balanced and Aggressive Growth

A portfolio is a combination of different investment assets mixed and matched for the purpose of achieving an investor's goals Items that are considered a part of Investors portfolio can include any asset that they own - from real items such as art and real estate, to equities, fixed-income instruments and their cash and equivalents For the purpose of this section, Investors will focus on the most liquid asset types: equities, fixed-income securities and cash and equivalents The asset mix they choose according to their aims and strategy will determine the risk and expected return of their portfolio

**1. Aggressive Investment Portfolio**

In general, aggressive investment strategies - those that shoot for the highest possible return - are most appropriate for investors who, for the sake of this potential high return, have a high risk tolerance and a longer time horizon Aggressive portfolios generally have a higher investment in equities Aggressive investment portfolios are for investors not afraid of high risk This type of portfolio may incorporate mutual funds that aim for high capital gain, equities, stocks, bonds, cash and maybe some commodities. In the short-term, growth will be very small and some loss will be observed As a result, aggressive portfolios perform better in the long term - about five years or longer. An actively traded aggressive portfolio will typically gain maximum returns for the investor The loss factor is why only individuals who are willing to take a high financial risk should seek an aggressive investment portfolio

An aggressive portfolio contains high growth investments that will hopefully appreciate in value This strategy attempts to achieve high long-term growth by investing in often risky but profitable, short-term stocks Under normal market conditions, the Aggressive Growth Portfolio will invest approximately 100% of its total assets in equity securities. The Aggressive Growth Portfolio can invest up to 100% of its total assets in equity securities and up to 25% of its total assets in fixed income securities

**2. Balanced or Moderate Investment Portfolio**

A moderately aggressive portfolio is meant for individuals with a longer time horizon and an average risk tolerance Investors who find these types of portfolios attractive are seeking to balance the amount of risk and return contained within the fund. The portfolio would consist of approximately 50-55% equities, 35-40% bonds, 5-10% cash and equivalents The Moderate Portfolio's primary investment objective is to seek long-term capital appreciation and also the Moderate Portfolio seeks current income.

### 3. Conservative Investment Portfolio

The conservative investment strategies, which put safety at a high priority, are most appropriate for investors who are risk averse and have a shorter time horizon Conservative portfolios will generally consist mainly of cash and cash equivalents, or high-quality fixed-income instruments The main goal of a conservative portfolio strategy is to maintain the real value of the portfolio, or to protect the value of the portfolio against inflation The portfolio shown below would yield a high amount of current income from the bonds and would also yield long-term capital growth potential from the investment in high quality equities

The conservative investment portfolio is geared towards preserving capital A minimal risk investment strategy is used. This type of portfolio is ideal for retirees who are focused more on having assets available than a stream of income from interest. Since the primary goal is to preserve capital, investors can dip into their principal to supplement living expenses instead of relying on the portfolio's earned income The Conservative Portfolio's primary investment objective is to seek preservation of capital and current income The Conservative Portfolio also seeks capital appreciation Under normal market conditions, the Conservative Portfolio will invest approximately 65% of its total assets in fixed income securities and cash and approximately 35% of its total assets in equity securities. The Conservative Portfolio can invest up to 100% of its total assets in fixed income securities and or some time up to 20% of its total assets in equity securities

Investors can further break down the above asset classes into subclasses, which also have different risks and potential returns For example, an investor might divide the equity portion between large companies, small companies and international firms. The bond portion might be allocated between those that are short-term and long-term, government versus corporate debt, and so forth. More advanced investors might also have some of the alternative assets such as options and futures in the mix. As, the number of possible asset allocations is practically unlimited.

### 3.7.5 Need And Importance Of Portfolio Management:

Portfolio management is a process encompassing many activities of investment in assets and securities It is a dynamic and flexible concept and involves regular and systematic analysis, judgment and action The objective of this service is to help the unknown and investors with the expertise of professionals in investment portfolio management It involves construction of a portfolio based upon the investor's objectives, constraints, preferences for risk and returns and tax liability The portfolio is reviewed and adjusted from time to time in tune with the market conditions. The evaluation of portfolio is to be done in terms of targets set for risk and returns The changes in the portfolio are to be effected to meet the changing condition

Portfolio construction refers to the allocation of surplus funds in hand among a variety of financial assets open for investment Portfolio theory concerns itself with the principles governing such allocation The modern view of investment is oriented more go towards the assembly of proper combination of individual securities to form investment portfolio

A combination of securities held together will give a beneficial result if they grouped in a manner to secure higher returns after taking into consideration the risk elements The modern theory is the view that by diversification risk can be reduced Diversification can be made by the investor either by having a large number of shares of companies in different regions, in different industries or those producing different types of product lines. Modern theory believes in the perspective of combination of securities under constraints of risk and returns

### 3.8 CONCEPT OF DEBT SECURITISATION

Securitisation of debt or asset refers to the process of liquidating the illiquid and long term assets like loans and receivables of financial institutions by issuing marketable securities against them. In other words, it is a technique by which a long term, non-negotiable and high valued financial asset like hire purchase is converted into securities of small values which can be tradable in the market just like shares

Thus, it is nothing but a process of removing long term assets from the balance sheet of a lending financial institution and replacing them with liquid cash through the issue of securities against them. Under securitisation, a financial institution pools its illiquid, non-negotiable and long term assets, creates securities against them, gets them rated and sells them to investors It is an ongoing process in the sense that assets are converted into securities, securities into cash, cash into assets and assets into securities and so on

Generally, extension of credit by banks and other financial institutions in the form of bills purchase or discounting or hire purchase financing appears as an asset on their balance sheets. Some of these assets are long term in nature and it implies that funds are locked up unnecessarily for an undue long period So, it carry on their lending operations without much interruptions, they have to rely upon various other sources of finance which are not only costly but also not available easily. Again, they have to bear the risk of the credit outstandings. Now, securitisation is a readymade solution for them Securitisation helps them to recycle funds at a reasonable cost and with less credit risk In other words, securitisation helps to remove these assets from the balance sheets of financial institutions by providing liquidity through tradable financial instruments

Again from another angle also, securitisation is a boon to financial institutions. From the risk management point of view, the lending financial institutions have to absorb the entire credit risk by holding the credit outstandings in their own portfolio. Securitisation offers a good scope for risk diversification. It is worthwhile to note that the entire transaction relating to securitisation is carried out on the asset side of the Balance Sheet That is one asset (illiquid) is converted into another asset (cash).

As stated earlier, securitisation helps to liquidity assets mainly of medium and long term loans and receivables of financial institutions The concept of securitisation can be defined as follows

"A carefully structured process whereby loans and other receivables are packaged, underwritten and sold in the form of asset backed securities"

Yet another simple definition is as follows

"Securitization is nothing but liquifying assets comprising loans and receivables of an institution through systematic issuance of financial instruments".

According to Hendersen, J and Scott, J P "Securitisation is the process which takes when a lending institution's assets are removed in one way or another from the balance sheet of that lending institution and are funded instead, by the investors who purchase a negotiable financial instrument evidencing this indebtedness without recourse, or in some cases with limited recourse, to the original lender" Thus, financial assets can be made liquid through securitisation i e , through packaging loans and selling them in the market It is very clear from the above definitions that securitisation is nothing but the packaging of a pool of financial assets into marketable securities. In brief, illiquid assets are converted into tradable securities.

### 3.8.1 Modus Operandi Of Securitisation:

For the operational mechanics of securitisation, the following parties are required

(i) The originator

(ii) A Special Purpose Vehicle (SPV) or a trust

(iii) A merchant or investment banker

(iv) A credit rating agency

(v) A servicing agent-Receiving and Paying agent (RPA)

(vi) The original borrowers or obligors

(vii) The prospective investors i e the buyers of securities

The various stages involved in the working of securitisation are as follows

(1) Identification stage/process

(2) Transfer stage/process

(3) Issue stage/process

(4) Redemption stage/process

(5) Credit Rating stage/process

### 1. Identification Process

The lending financial institution either a bank or any other institution for that matter which decides to go in for securitisation of its assets is called the 'originator'. The originator might have got assets comprising of a variety of receivables like commercial mortgages, lease receivables, hire purchase receivables etc The originator has to pick up a pool of assets of homogeneous nature, considering the maturities, interest rates involved, frequency of repayments and marketability This process of selecting a pool of loans and receivables from the asset portfolios for securitisation is called "identification process'

## 2. Transfer Process

After the identification process is over, the selected pool of assets are then "passed through" to another institution which is ready to help the originator to convert those pools of assets into securities This institution is called the special purpose vehicle (SPV) or the trust The pass through transaction between the originator and the SPV is either by way of outright sale i.e. full transfer of assets in question for valuable consideration or by passing them for a collateralized loan. Generally, it is done on an outright sale basis This process of passing through the selected poof of assets by the originator to a SPV is called transfer process and once this transfer process is over, the assets are removed from the balance sheet of the originator

## 3. Issue Process

After this transfer process is over, the SPV takes up the onerous task of converting these assets of various types of different maturities It is on this basis, the SPV issues securities to investors. The SPV actually splits the package into individual securities of smaller values and they are sold to the investing public The SPV gets itself reimbursed out of the sale proceeds The securities issued by the SPV is called by different names like Pay through Certificates, Pass through Certificates, Interest only Certificate, Principal only Certificates etc The securities are structured in such a way that the maturity of these securities may synchronies with the maturities of the securitised loans or receivables.

## 4. Redemption Process

The redemption and payments of interest on these securities are facilitated by the collections received by the SPV from the securitised assets The task of collection of dues is generally entrusted to the originator of a special servicing agent can be appointed for this purpose This agency is paid a certain percentage of commission for the collection services rendered The servicing agent is responsible for collecting the principal and interest payments on assets pooled when due and he must pay a special attention to delinquent accounts. Usually, the originator is appointed as the servicer. Thus, under securitisation, the role of the originator gets reduced to that of a collection agent on behalf of the SPV, in case he is appointed as a collection agent. A pass through certificate may be either 'with recourse' to the originator or 'without recourse' The usual practice is to make it 'without recourse' Hence, the holder of a pass through certificate has to look to the SPV for payment of the principal and interest on the certificates held by him. Thus, the main task of the SPV is to structure the deal, raise proceeds by issuing pass through certificates and arrange for payment f interest and principal to the investors.

## 5. Credit Rating Process

Since the pass through certificates have to be publicly issued, they require credit rating by a good credit rating agency so that they become more attractive and easily acceptable Hence, these certificates are rated at least by one credit rating agency on the eve of the securitisation The issues could also be guaranteed by external guarantor institutions like merchant bankers which would enhance the credit worthiness of the certificates and would be readily acceptable to investors Of course, this rating guarantee provides a sense of confidence to the investor with regard to the timely payment of principal and interest by the SPV Pass through certificates, like debentures, directly reflect the ownership rights in the assets securitised, their repayment schedule, interest rate etc These certificates, before maturity, are tradable in a secondary market to ensure liquidity for the investors They are negotiable securities and hence they can be easily tradable in the market

### 3.8.2. Benefits Of Securitisation

Debt securitisation provides many benefits to all the parties, such as, the originator, investors and the regulatory authorities. Some of the important benefits are the following:

**(i) Additional Source of Fund**

The originator (i e. the lending institution) is much benefited because securitisation provides an additional source of funds by converting an otherwise illiquid asset into ready liquidity. As a result, there is an immediate improvement in the cash flow of the originator Thus, it acts as a source of liquidity

**(ii) Greater Profitability**

Securitisation helps financial institutions to get liquid cash from medium term and long term assets immediately rather than over a longer period. It leads to greater recycling of funds which, turn, leads to higher business turnover and profitability Again, the cash flow could be recycled for investment in higher yielding assets This means greater profitability Moreover, economies of scale can be achieved since securitisation offers scope for the fuller utilization of the existing capabilities by providing liquid cash immediately It results in additional business turnover Again, the originator can also act as the receiving and paying agent If so, it gets additional income in the form of servicing fee

**(iii) Enhancement of Capital Adequacy Ratio**

Securitisation enables financial institutions to enhance their capital adequacy ratio by reducing their assets volume The process of securitisation necessitates the selection of a pool of assets by the financial institutions to be sold or transferred to another institution called SPV Once the assets are transferred, they are removed from the balance sheet of the originator It results in the reduction of assets volume, thereby increasing the capital adequacy ratio Capital adequacy ratio can also be improved by replacing the loan assets with the lesser risk weighted assets Thus, the removal of assets from the Balance Sheet under a true sale improves the capital adequacy norms

**(iv) Spreading of Credit Risk**

Securitisation facilities the spreading of credit risk to different parties involved in the process of securitisation In the absence of securitisation, the entire credit risk associated with a particular financial transaction has to be borne by the originator himself Now, the originator is able to diversify the risk factors among the various parties involved in securitisation. Thus, securitisation helps to achieve diversification of credit risks which are greater in the case of medium term and long term loans. Thus, it is used as tool for risk management

**(v) Lower Cost of Funding**

In view of enhancement of cash flows and diversification of risk factors, securitisation enables the originator to have an easy access to the securities market It means that companies with low credit rating can issue asset backed securities at lower interest cost due to high credit rating on such securities This helps it to secure funds at lower cost Moreover, the criteria for choosing the pool of assets ensures an efficient cost of funds In the present context of scarcity of funds and higher interest rates, securitisation provides a good scope for cheap funding

**(vi) Provision of Multiple Instrument**

From the investor's point of view, securitisation provides multiple new investment instruments so as to meet the varying requirements of the investing public It also offers varieties of instruments for other financial intermediaries like mutual funds, insurance companies, pension funds etc giving them many choices

**(vii) Higher Rate of Return**

When compared to traditional debt securities like bonds and debentures, securitised securities offer better rate of return along with better liquidity These instruments are rated by good credit rating agencies and hence more attractive Being structured assets based securities, they offer more protection and yield a good return. The bankruptcy/ winding up of the originator does not affect the investors since the payment is guaranteed by the SPV

**(viii) Prevention of Idle Capital**

In the absence of securitisation, capital would remain idle in the form of illiquid assets like mortgages, term loans etc , in many of the lending institutions Now, securitisation helps recycling of funds by converting these assets into liquidity, liquidity into assets, assets into liquidity and so on by means of issuing tradable and transferable securities against these assets Thus, it provides impetus for capital formation

**(ix) Better than Traditional Instruments**

Certificates are issued to investors against the backing of assets securitised The underlying assets are used not only as a collateral to the certificates but also to generate the income to pay the principal and interest to the investors It does not entail any servicing needs and hence does not require much costs It is better than even mutual fund units because it is issued against the backing of collateral securities whereas there is no such backing for mutual fund certificates Thus, these instruments, being structured asset backed securities, afford a greater protection to investors Again, there is much transparency from the investor's point of view They can very well see the collateral pool that a particular issue represents and this transparency reduces uncertainty as to the risk element

**(x) Other Benefits Securitisation,**

If carried out in true spirit, leads to greater economy in the use of capital with efficiency and cost effectiveness in both funding and lending This is a great boon to the regulating authorities as well since their primary objective is to prevent the accumulation of capital where it is not needed In the long run, it is beneficial to the borrowers also They will be able to get funds at cheaper rates since the originators are likely to pass on the benefit to the ultimate borrows. There is no doubt that securitisation is a low cost and innovative funding source ensuring economy in the use of capital

### 3.9 DE-MAT SERVICES

In India, shares and securities are held electronically in a dematerialized (or "Demat") (/dimæt/,) account, instead of the investor taking physical possession of certificates A Dematerialized account is opened by the investor while registering with an investment broker (or sub-broker) The Dematerialized account number is quoted for all transactions to enable electronic settlements of trades to take place Every shareholder will have a Dematerialized account for the purpose of transacting shares

Access to the Dematerialized account requires an internet password and a transaction password. Transfers or purchases of securities can then be initiated Purchases and sales of securities on the Dematerialized account are automatically made once transactions are confirmed and completed

**Advantages of demat**

The bonus/right shares allotted to the investor will be immediately credited into his account There is no risk due to loss on account of fire, theft or mutilation Transaction costs are usually lower than that in the physical segment A demat account also helps avoid problems typically associated with physical share certificates For example delivery failures caused by signature mismatch, postal delays and loss of certificate during transit. Further, it eliminates the risks associated with forgery and due to damaged stock certificates Demat account holders also avoid stamp duty (as against 0 5 per cent payable on physical shares) and filling up of transfer deeds. The biggest advantage of having demat account is that you don't have to pay for stamp since these are electronically stored which reduces the transaction cost

Goal of Demat Syste India adopted the Demat System for electronic storing, wherein shares and securities are represented and maintained electronically, thus eliminating the troubles associated with paper shares After the introduction of the depository system by the Depository Act of 1996, the process for sales, purchases and transfers of shares became significantly easier and most of the risks associated with paper certificates were mitigated.

In 1996, trading began on NSE for shares held in demat account form It was the beginning of a new paperless trading stock market trading environment. If an investor buys a share today, it gets credited to the investor's account in two days Today, shares get transferred to the investor's demat account

**Demat benefits**

Demat account for shares and securities with Business purpose The benefits of demat are enumerated as follows

- Easy and convenient way to hold securities
- Immediate transfer of securities
- No stamp duty on transfer of securities
- Safer than paper-shares (earlier risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc are mostly eliminated)
- Reduced paperwork for transfer of securities
- Reduced transaction cost
- No "odd lot" problem even one share can be sold
- Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them separately
- Transmission of securities is done by DP, eliminating the need for notifying companies
- Automatic credit into demat account for shares arising out of bonus/split, consolidation/merger, etc
- A single demat account can hold investments in both equity and debt instruments
- Traders can work from anywhere (e g even from home)

## 3.10. ROLE OF NSDL AND CSDL

NSDL and CDSL are both depositories which hold various securities like money, property, etc in an electronic form NSDL works for National Stock Exchange, whereas CDSL works for Bombay Stock Exchange

NSDL stands for 'National Securities Depository', whereas CDSL stands for 'Central Depository Securities' Limited They both are depositories that hold various securities like shares in electronic form There is no major difference between the two, however there is small difference in their charges and their source of work

A depository is an organization that holds securities of investors in an electronic format at the request of an investor through a registered Depository Participant It assists in the allotment and transfer of securities and securities lending In a depository, securities such as money, shares and properties, etc are kept for safekeeping under their or depositary terms The securities are held in the form of electronic accounts They carry out their various operations through functionaries called as business partners or a Depository Participant This system is governed under the Depositories Act by the government The enactment of this act paved the way for the establishment of NSDL and CDSL

The National Securities Depository Limited (NSDL) was the first depository in India It was registered by SEBI on 7th June 1996, as the very first Depository to facilitate trading and settlement of securities in Demat form It is promoted by institutions of national stature, which are responsible for the economic development of India and have established an infrastructure of international standards They handle most of the securities, which are held and settled in a dematerialized form in the Indian capital market Its main promoters are IDBI, UTI and NSE

Central Depository Services Limited (CDSL) is the second Indian central securities depository It is based in Mumbai Its main function is the holding securities either in certificated or un-certificated i e dematerialized form, it helps to enable the book entry transfer of securities It began operating in February in the year 1999 Its main promoters are BSE, HDFC, SBI, BOI and BOB

The main role and the different functions of a depository are as follows

- Maintenance of individual investors' beneficial holdings in an electronic form
- Dematerialization and re-materialization of securities
- Account transfer for settlement of trades in electronic shares
- Allotments in the electronic form in case of initial public offerings
- Distribution of non-cash corporate actions
- Facility for freezing/locking of investor accounts
- Facility for pledge and hypothecation of securities

### 3.11 MEANING OF EXCHANGE RATE

The price of a nation's currency in terms of another currency An exchange rate thus has two components, the domestic currency and a foreign currency, and can be quoted either directly or indirectly In a direct quotation, the price of a unit of foreign currency is expressed in terms of the domestic currency. In an indirect quotation, the price of a unit of domestic currency is expressed in terms of the foreign currency An exchange rate that does not have the domestic currency as one of the two currency components is known as a cross currency, or cross rate Also known as a currency quotation, the foreign exchange rate or forex rate

### 3.12.CURRENCYSWAP

A currency swap (or a cross currency swap) is a foreign exchange derivative between two institutions to exchange the principal and/or interest payments of a loan in one currency for equivalent amounts, in net present value terms, in another currency Currency swaps are motivated by comparative advantage

A currency swap should be distinguished from interest rate swap, for in currency swap, both principal and interest of loan is exchanged from one party to another party for mutual benefits Currency swaps are over-the-counter (OTC) derivatives Uses Currency swaps have three main uses

- To secure cheaper debt (by borrowing at the best available rate regardless of currency and then swapping for debt in desired currency using a back-to-back-loan)
- To hedge against (reduce exposure to) exchange rate fluctuations
- To defend against financial turmoil by allowing a country beset by a liquidity crisis to borrow money from others with its own currency

## 3.13.DIFFERENCE BETWEEN FORWARD CONTRACT AND FUTURE CONTRACTS

Fundamentally, forward and futures contracts have the same function both types of contracts allow people to buy or sell a specific type of asset at a specific time at a given price

However, it is in the specific details that these contracts differ. First of all, futures contracts are exchangetraded and, therefore, are standardized contracts Forward contracts, on the other hand, are private agreements between two parties and are not as rigid in their stated terms and conditions Because forward contracts are private agreements, there is always a chance that a party may default on its side of the agreement Futures contracts have clearing houses that guarantee the transactions, which drastically lowers the probability of default to almost never

Secondly, the specific details concerning settlement and delivery are quite distinct For forward contracts, settlement of the contract occurs at the end of the contract Futures contracts are marked-to-market daily, which means that daily changes are settled day by day until the end of the contract Furthermore, settlement for futures contracts can occur over a range of dates Forward contracts, on the other hand, only possess one settlement date

Lastly, because futures contracts are quite frequently employed by speculators, who bet on the direction in which an asset's price will move, they are usually closed out prior to maturity and delivery usually never happens On the other hand, forward contracts are mostly used by hedgers that want to eliminate the volatility of an asset's price, and delivery of the asset or cash settlement will usually take place

## 3.14.MONEY LAUNDERING

Money laundering is the process of transforming the proceeds of crime, corruption or kleptomania into ostensibly legitimate money or other assets

However, in a number of legal and regulatory systems, the term money laundering has become conflated with other forms of financial crime, and sometimes used more generally to include misuse of the financial system (involving things such as securities, digital currencies, credit cards, and traditional currency), including terrorism financing and evasion of international sanctions Most anti-money laundering laws openly conflate money laundering (which is concerned with source of funds) with terrorism financing (which is concerned with destination of funds) when regulatingthe financial system

Some countries define money laundering as obfuscating sources of money, either intentionally or by merely using financial systems or services that do not identify or track sources or destinations Other countries define money laundering to include money from activity that would have been a crime in that country,even if it was legal where the actual conduct occurred

### 3.15 ROLE OF SEBI

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the functions of securities market SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions.

It was left as a watch dog to observe the activities but was found ineffective in regulating and controlling them As a result in May 1992, SEBI was granted legal status SEBI is a body corporate having a separate legal existence and perpetual succession

**Reasons for Establishment of SEBI:** With the growth in the dealings of stock markets, lot of malpractices also started in stock markets such as price rigging, 'unofficial premium on new issue, and delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements Due to these malpractices the customers started losing confidence and faith in the stock exchange So government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI)

**Purpose and Role of SEBI:** SEBI was set up with the main purpose of keeping a check on malpractices and protect the interest of investors It was set up to meet the needs of three groups

**1. Issuers:** For issuers it provides a market place in which they can raise finance fairly and easily

**2. Investors:** For investors it provides protection and supply of accurate and correct information

**3. Intermediaries:** For intermediaries it provides a competitive professional market

**Objectives of SEBI:** The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market The objectives of SEBI are

1 To regulate the activities of stock exchange

2 To protect the rights of investors and ensuring safety to their investment

3 To prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations

4 To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc

**Functions of SEBI:** The SEBI performs functions to meet its objectives  To meet three objectives SEBI has three important functions  These are

i  Protective functions

ii. Developmental functions

iii  Regulatory functions

**1. Protective Functions:** These functions are performed by SEBI to protect the interest of investor and provide safety of investment  As protective functions SEBI performs following functions·

(i) It Checks Price Rigging  Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities  SEBI prohibits such practice because this can defraud and cheat the investors

(ii) It Prohibits Insider trading  Insider is any person connected with the company such as directors, promoters etc  These insiders have sensitive information which affects the prices of the securities  This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e g , the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue  This is known as insider trading  SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading

(iii) SEBI prohibits fraudulent and Unfair Trade Practices  SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices

**2. Developmental Functions:** These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange  Under developmental categories following functions are performed by SEBI

(i) SEBI promotes training of intermediaries of the securities market

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way

(a) SEBI has permitted internet trading through registered stock brokers

(b) SEBI has made underwriting optional to reduce the cost of issue

(c) Even initial public offer of primary market is permitted through stock exchange

**3. Regulatory Functions:** These functions are performed by SEBI to regulate the business in stock exchange To regulate the activities of stock exchange following functions are performed

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner

(iv) SEBI registers and regulates the working of mutual funds etc

(v) SEBI regulates takeover of the companies

(vi) SEBI conducts inquiries and audit of stock exchanges

**The Organisational Structure of SEBI:**

1 SEBI is working as a corporate sector

2 Its activities are divided into five departments Each department is headed by an executive director

3 The head office of SEBI is in Mumbai and it has branch office in Kolkata, Chennai and Delhi

4 SEBI has formed two advisory committees to deal with primary and secondary markets

5 These committees consist of market players, investors associations and eminent persons

**Objectives of the two Committees are:**

1 To advise SEBI to regulate intermediaries

2 To advise SEBI on issue of securities in primary market

3 To advise SEBI on disclosure requirements of companies

4 To advise for changes in legal framework and to make stock exchange more transparent

5 To advise on matters related to regulation and development of secondary stock exchange These committees can only advise SEBI but they cannot force SEBI to take action on their advice

# UNIT - IV

# MARKETING MANAGEMENT

## 4 INTRODUCTION

Marketing is everywhere and it affects our day- to-day life in every possible manner Formally or informally people and organizations engage in a vast number of activities that could be called as marketing Good marketing is no accident, but a result of careful planning and execution It is both an art and science. Let's discuss various concepts and issues in marketing

## 4.1 DEFINITION

Marketing management is the art and science of choosing target markets and getting, keeping and growing customers through creating, delivering and communicating superior customer value

In short Marketing is "Meeting needs profitably" Marketing has been defined by different authors in different ways which can be broadly classified into three

**Product Oriented Definition**–¬ The emphasis is given on products In1985 AMA redefined marketing as "Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational goals "

**Customer- Oriented Definition**–¬ Here the emphasis is on customers and their satisfaction In the words of Philip Kotler "Marketing is the human activity directed at satisfying needs and wants through an exchange process "

**Value Oriented Definition** (Modern Definition)–¬ In 2004 the American Marketing Association defined "Marketing is an organizational function and a set of processes for creating, communicating and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders."

## 4.2 SCOPE OF MARKETING

The scope of marketing can be understood by discussing what is marketing, how it works, what is marketed and who doesthe marketing

Peter Drucker, a leading management theorist, puts it this way, there will always, one can assume, be need for some selling But the aim of marketing is to make selling superfluous The aim of marketing is to know and understand the customer so well that the product or services fits him and sells itself. Ideally marketing should result in a customer who is ready to buy All that should be needed then is to make the product or service available

**What is marketed?**

Marketing people market 10 types of entities, let's take a quick look at these,

**GOODS** physical goods ~~constitute the bulk of most countries~~ production and marketing efforts. School of Distance Education Marketing Management

**SERVICES** services include the work of airlines, hotels, cars rental firms, barber and beauticians, maintenance and repair people, and accountants, bankers, lawyers ,engineers doctors, software programmers, and management consultants

**EVENTS** marketers promote time-based events, such as major trade shows, artistic performances, and company anniversaries Global sporting events such as the Olympics and the World cup are promoted aggressively to both companies and fans

**EXPERIENCES** by orchestrating several services and goods, a firm can create, stage and market experiences Veega land, Black Thunder etc represents this kind of experiential marketing

**PERSONS** celebrity marketing is a major business, Artists, Musicians, CEOs, physicians, high- profile lawyers and financiers, and other professionals all get help from celebrity marketers

**PLACES** cities, states, regions, and whole nations compete actively to attract tourists, factories, company headquarters, and new residents. Place marketers include economic development specialists, real estate agents, commercial banks, local business associations, and advertising and public relations agencies

**PROPERTIES** properties are intangible rights of ownership of either real property (real estate) or financial property (stocks and bonds) Properties are bought and sold, and these exchanges require marketing

**ORGANIZATIONS** organizations actively work to build a strong, favorable, and unique image in the minds of their target publics

**INFORMATION** information is essentially what books, schools, and universities produce, market, and distribute at a price to parents, students, and communities

**IDEAS** Every market offering includes a basic idea Social marketers are busy promoting such ideas as "Friends Don't Let Friends Drive Drunk" and "A Mind Is a Terrible Thing to Waste "

**Who markets?**

**MARKETERS AND PROSPECTS**

A marketer is someone who seeks a response- attention, a purchase, a vote, a donation – from another party, called the prospect If two parties are seeking to sell something to each other, we call them both marketers.

### 4.3 IMPORTANCE OF MARKETING

Marketing is important not only for organizations but for individuals, society and economy as a whole Financial success often depends on marketing ability Finance, operations, and other business functions will not really matter if there isn't sufficient demand for products and services so the company can make a profit There must be top line for there to be a bottom line Many companies have now created a Chief Marketing Officer, or CMO, position to put marketing on a equal footing with other C-level executives, such as the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) Also marketing steps its foot in every walk of life Some of its importance can be discussed as follows

**Importance Of Marketing To Companies:**

Sound marketing is critical to the success of the organisation in the following ways

- Helps in income generation
- Helps in planning and decision-making
- Helps in distribution.
- Helps in exchanging information
- Helps to adapt to changing environment
- Expands global presence
- Helps to earn goodwill

**Importance Of Marketing To Consumers:**

- Provides quality products
- Provides variety of products
- Improves knowledge of consumers
- Helps in selection
- Consumer satisfaction

**Importance Of Marketing To Society:**

- Marketing bridges the gap between firm and society
- Provides employment
- Raises standard of living

- Creates utilities
- Reduces costs
- Solves social problems
- Makes life easier
- Enriches society

**Importance Of Marketing To Economy:**

- It stimulates research and innovation Saves the economy from depression ϖ
- Increase in national income ϖ
- Economic growth
- Ploughing back of resourcesϖ

## 4.4 EVOLUTION OF MARKETING CONCEPT

Marketing concept has undergone a drastic change over years Earlier it was production or later selling which was key to marketing idea but moving ahead now these have given way to customer satisfaction rather delight developing a modern marketing concept Let's review the evolution of earlier marketing ideas,

**The Production Concept:**

It is one of the oldest concepts in business It holds that consumers will prefer products that are widely available and inexpensive. Managers of production- oriented business concentrate on achieving high production efficiency, low costs, and mass distribution

**The Product Concept:**

It proposes that consumers favor products that offer the most quality, performance, or innovative features Managers in these organizations focus on making superior products and improving them overtime

**The Selling Concept:**

It holds that consumers and businesses, if left alone, won't buy enough of the organization's product The organization must therefore undertake an aggressive selling and promotion effort School of Distance Education Marketing Management 8

**The Marketing Concept:**

It emerged in mid-1950s, instead of a product- centered, make- and –sell philosophy, business shifted to a customer- centered, sense-and-respond philosophy

The marketing concept holds that the key to achieving organizational goals is being effective than competitors in creating, delivering, and communicating superior customer value to your chosen target markets.

Theodore Levitt of Harward drew a perceptive contrast between the selling and marketing concepts Selling focuses on the needs of the seller, marketing on the needs of the buyer Selling is preoccupied with the seller's need to convert his product into cash, marketing with the idea of satisfying the needs of the customer by means of the product and the whole cluster of things associated with creating , delivering, and finally consuming it.

Several scholars have found that companies that embrace the marketing concept achieve superior performance This was first demonstrated by companies practicing a reactive market orientation- understanding and meeting customers' expressed needs

**Holistic Marketing Concept:**

The trends and forces defining the 21st century are leading business firms to a new set of beliefs and practices Today's best marketers recognize the need to have a more complete, cohesive approach that goes beyond traditional applications of the marketing concept This concept is based on the development, design, and implementation of marketing programs, processes and activities that recognizes their breadth and interdependencies. Holistic marketing recognizes that "everything matters" in marketing- and that a broad, integrated perspective is often necessary Holistic marketing is thus an approach that attempts to recognize and reconcile the scope and complexities of marketing activities.

**4.5 MARKETING MIX**

In the words of Philip Kotler, "Marketing Mix is the set of controllable variables and their levels that the firm uses to influence the target market " Marketing mix is a combination of various elements, namely, Product, Price, Place (replaced by Physical Distribution) and Promotion

The various important elements of marketing mix are briefly discussed as follows,

**Product:**

It is the thing possessing utility It is the bundle of value the marketer offers to potential customers Today manufacturers are realizing that customer expects more than just the basic product Therefore the product must satisfy the consumers needs The manufacturer first understands the consumer needs and then decides the type, shape, design ,brand, package etc of the goods to be produced The product is a marketer's primary vehicle for delivering customer satisfaction.

**Price:**

It is the amount of money asked in exchange for product. It must be reasonable so as to enable the consumer to pay for the product While fixing the price of a product, the management considers certain factors such as cost, ability of the consumers, competition, discount, allowances, margin of profit etc

**Place (Physical Distribution):**

It is the delivery of products at the right time and at the right place It is the combination of decision regarding channel of distribution (wholesalers, retailers etc. ), transportation, warehousing and inventory control

**Promotion:**

It consist of all activities aimed at inducing and motivating customers to buy the product The selection of alternatives determine the success of marketing efforts Some firms use advertising, some others personal selling or sales promotion Thus promotion includes advertising public relations, personal selling and sales promotion Recently Packaging and People are two more elements of marketing mix that have been emerged. These are discussed as follows.

**Packaging:**

Packaging is the art, science and technology of preparing goods for transport, sale and exchange. A well designed pack is invaluable in building brand loyalty with the customer. Packaging must be such that a customer is impressed at the very moment he or she sees the product

**People :**

It consists mainly of the people to whom goods are sold(consumer) and the people through whom goods are sold(sales people, wholesalers, retailers etc ) people include competitors also This factor will be the reoson as well as resources for success in marketing

## 4.6 APPROACHES TO THE STUDY OF MARKETING

**Commodity Approach :** The 'commodity approach' refers to the detailed study of the problems encountered in marketing particular products that may be consumer, industrial or agricultural-products such as hair-oils, transistors, pens, paper, ties, clothing, lathe machines, bull-dozers, dumers, oil- engines, generators, wheat, rice, cotton, dairy-products etc. Number of problems crop up in the movement of goods from the point of production to the point of consumption. We may take up any type of product and study how each of them is marketed This detailed analysis encompasses the study of classification of products, characteristics of each kind of product, source of supply, the persons engaged in exchange, its transportation, financing, storage and advertisement For every product, we have to apply this criterion that becomes repetitive Though there may be certain differences in marketing, most of the product similarities out-weigh the differences By studying the products individually, we get the full picture of marketing.

**Institutional Approach :** This approach studies the various marketing institutions particularly the middlemen or facilitating agencies which perform the marketing functions. It emphasizes the type of middlemen and agencies involved We are to study wholesaling, retailing and various other agent-middlemen at the distribution level Under the title of wholesaling, we are to concentrate on the functions performed and services rendered by the group of these people, the problems that they face in the flow of goods Retailing takes into account the study of nature and significance of retailing in terms of functions and services performed and rendered by retail institutions like departmental stores, multiple shops, supermarkets, mail-order houses, co-operatives, etc In case of agent middlemen, we are to dig in about their functions and services, as they are essential adjuncts in the machinery of marketing It is more or less a study of all those institutions that are instrumental in moving the wheels of marketing It will cover institutions like, regulated markets, stock exchanges, commodity exchanges, banking and other organisations, including governmental institutions that provide legal base for marketing activities

***Functional Approach :*** The 'functional approach' refers to the classification and study of specialized activities which are performed in doing marketing work i.e., functions of marketing system It analyses each function, in relation to the importance of its performance The different marketing functions are, selling, buying, transportation, ware-housing, financing, risk taking and market-intelligence All these functsons are to be studied separately in order to understand their importance. To illustrate, we may study the selling function in relation to marketing of a particular product like a lathe-machine or rice or a T.V Set etc , and as to how each of the different institutions, engaged in marketing of these products, perform the activities, that is the function of retailers, wholesalers, manufacturers etc. By careful investigation of how each of the functions of marketing are performed and what problems they face and how much they cost, we are able to obtain an understanding of marketing.

## 4.7 MARKETING ENVIRONMENT

It includes all those factors which are external to a firm and which affect the Marketing process According to Philips Kotler, Marketing environment is constantly spinning out new opportunities and new threats, and the firms find their marketing collapse Therefore, the company's Marketing executives must constantly monitor the changing Marketing scene and observe the changing environment through Marketing research. The Marketing Environment includes non- controllable variables that effects the company's ability to serve its markets

### Controllable Factors:

The controllable factors are well within the grip of the firm and easy to adjust them to suit the changes. These consist of Marketing policies and Marketing strategies Framing of marketing policies is the responsibility of top management and marketing strategies are developed by middle level management The selection of target marketing, Marketing objectives and Marketing control are the other controllable factors which also helps in framing Marketing strategies.

### Unconrollable Factors:

Controllable variables will have to be filtered through various uncontrollable environmental factors before they reach to the customers The uncontrollable environmental consist of two levels i e , micro environment and macro environment.

**Micro - Environment Variables:**

It consists of elements or forces that influence marketing directly It includes Supplier, Marketing Intermediaries, Costumers, Competitiors and the General Public

**Supplier:**

One who supply the resources to a company Any shortage of Supply affect the Marketing function and thus, should avoid dependence on any single supplier

**Marketing Intermediates:**

They are the middlemen who create place Utility, Time utility and Quantity utility These includes Physical Distribution Firms, Transport Companies, Marketing Consulting Firms, Marketing Services Agencies and Assist the company in promoting the right products to the right markets.

**Customers:**

It refers to consumer markets, industrial markets, reseller markets, international markets and govt markets having its own characteristics

**Public:**

The marketing decisions considerably influenced by public relations, govt. policies, the press, the legislatures and the general public

**Macro- Environment Variables:**

Macro-environment consist of forces affecting the entire society or economy at large Macro- environment influences entire industry as a whole

Demographic environment.

Social-Cultural environment

Economic environment.

Ethical environment.

Political environment

Physical environment.

Technological environment.

**(i)Demographic Environment**

It includes factors such as population growth, change in age-group, marriages, family sizes, movement of people from big cities to rural or sub urban areas, literacy etc It is essential for the market to understand the demographic forces in a country which helps him frame optimal marketing-mix

**(ii) Socio-Cultural Environment**

**Sociological** Factors Consumers being social animal and their life style is deeply influenced by the social set up ¬ It is found to have deep influence on consumer taste, temperament, life and living The needs, desires, hopes and aspirations of the consumers are necessary to be understood

**Psychological** The study about the behaviour, attitude, temperament, mentality and personality is must¬ and how there wants and needs can be best satisfied?

**Anthropological** these factors are vital in noting the national and regional characters, cultures and sub¬ cultures and the pattern of living

**(iii)Economic Environment**

It comprises of economic system of the country, affects the demand structure of any industry/ product Changes in economic conditions provides marketers with new challenges and threats Various economic factors which directly affect the Marketing strategies are discussed below

**Role of Govt:** Marketing in greatly influenced by the role of govt through fiscal policies, industrial¬ regulations, economic controls, import-export policies etc Monetary and Non-Monetary policies of the Govt also determine the tempo of economic development

**Consumers:** Consumer welfare and interest should be taken into consideration while preparing¬ marketing programme The marketer is to make available quality products at reasonable prices, in sufficient qualities, at required time interval

**Competition:** Healthy competition is always in the interest of customers whereas unhealthy¬ competition is harmful and leads toward increasing cost and waste

**Price:** It is determinant of the fate of any business If the Price is too high, reduces the consumer and¬ consumption and if too low, the producers and marketers are left in the lurch

**(iv) Ethical Environment**

In the race of earning more and more profits, business people disintegrate the ethical values from the business This leads to adulteration, limitation etc resulting in socio-economic pollution of minds and relations

**(v) Political/ Legalenvironment**

The legal environment for marketing decision is characterized by various laws passed by Central or State Govt and even by local administration Govt. agencies, political parties, pressure groups and laws create tremendous pressure and constraints for marketer Marketing managers required full knowledge and understanding of political philosophy and ideologies of major political groups and legal environment for framing marketing strategies and growth of business

**(vi) Physical Environment**

It refers to the physical distribution of goods and services It needs the in depth study of cost and convenience involved in the process of physical distribution of products from producer to consumer end

**(vii) Technologicalenvironment**

It helps to shape changes in living style of the consumers. It has the responsibility of relating changing life- style patterns, values and changing technology to market opportunities for profitable sales to particular market segment

## 4.8 CONSUMER BEHAVIOUR

More than a century ago, the father of our nation, Mahatma Gandhi had made a visionary and deep meaningful statement at Johannesburg, South Africa at 1890 - "A customer is the most important visitor on our premises He is not dependent on us We are dependent on him He is not an interruption on our work He is the purpose of it and not an outsider on our premises He is the part of it We are not doing a favour by serving him He is doing us a favour by giving us the opportunity to do so" Though this statement was not made in the marketing concept, there is a lot of wisdom and insight into Mahatma's words

Today all the firms are engaged in the process of creating a life time value and relationship with their customers This chapter deals with studying consumer behaviour as a related field of marketing

Behaviour is the interaction with the ambient surrounding environment, inherent in living creatures and mediated by their external and inner activeness Thus consumer behaviour is actions of consumers in the market place and the underlying motives for those actions. Marketers expect that by understanding what causes consumers to buy particular goods and services, they will be able to determine which products are needed in the market place, which are obsolete and how best to present those goods to the consumer

The study of consumer behaviour is the study of how individuals make decisions to spend their available resources ( time, money, effort ) on consumption related items

In the words of Walters and Paul " consumer behaviour is the process whereby individuals decide what, when, where, how and from whom to purchase goods and services "

### 4.8.1 Need Or Importance Of Study Of Consumer Behaviour:

The modern marketing management tries to solve the basic problems of consumers in the area of consumption To survive in the market, a firm has to be constantly innovating and understand the latest consumer needs and tastes It will be extremely useful in exploiting marketing opportunities and in meeting the challenges that the Indian market offers It is important for the marketers to understand the buyer behaviour due to the following reasons

- The study of consumer behaviour for any product is of vital importance to marketers in shaping thefortunes of their organisations
- It is significant for regulating consumption of goods and thereby maintaining economic stability
- It is useful in developing ways for the more efficient utilisation of resources of marketing
- It alsohelps in solving marketing management problems in more effective manner
- Today consumers give more importance on environment friendly products They are concerned about health, hygiene and fitness They prefer natural products Hence detailed study on upcoming groups of consumers is essential for any firm
- The growth of consumer protection movement has created an urgent need to understand how consumers make their consumption and buying decision
- Consumers tastes and preferences are ever changing Study of consumer behaviour gives information regarding colour, design, size etc which consumers want In short, consumer behaviour helps in formulating of production policy
- For effective market segmentation and target marketing, it is essential to have an understanding of consumers and their behaviour

### 4.8.2 Types Of Consumer Behaviour:

There are four types of consumer behaviour They are,

**Complex Buying Behaviour:** Consumers goes through complex buying behaviour when they are highly involved in a purchase and aware of significant differences among brands Consumers are highly involved when the product is expensive, bought infrequently, risky and self-expensive Here consumers go through a rational/logical thinking process to collect as much information as possible about the available brands Behaviour exhibited while purchasing a car is an example of complex buying behaviour

**Dissonance Reduction Buying Behaviour:** Sometimes consumers are highly involved in purchases but see little difference in the brands After the purchase they feel that the product does not perform to their expectations They may thing about alternative brand which has forgone in the brand selection process As a result, they feel some discomfort This mental condition is known as Cognitive Dissonance

Variety Seeking Buying Behaviour Here consumers have a lot more brand options to choose At the same time there are significant brand differences Unit price of product is low Consumer involvement is also low But consumer show brand switching behaviour They go on changing from one brand to another They like experiments for the sake of variety satisfaction They exhibit variety seeking behaviour in case of products like soap, detergents, toothpaste etc

**Habitual Buying Behaviour :** In this situation consumers buy their products on regular basis Brand switching behaviour is quite common here Variations among brands are significant Products are usually low priced Gathering product knowledge is not so important Consumers show habitual buying behaviour in case of products like salt, matches etc

## 4.9 BUYING MOTIVES

It is the buying motives which induce a consumer to buy a particular product A lady may buy a sari for physical protection or for wearing something to look beautiful or as a status symbol Thus buying motive is a strong feeling, instinct, desire or emotion that make the buyer to buy a product According to D J DUNCAN, " buying motives are those influences or considerations which provide the impulse to buy, induce action or determine choice in the purchase of goods and services " In short, a buying motive is the reasons why buyers buy

### 4.9.1 Types Of Buying Motives:

Buying motives are of four types

- Emotional and Rational motives
- Product and Patronage motives
- Inherent and Learned motives
- Psychological and Social buying motives

**(i) Emotional And Rational Motives**

**Emotional Motives**

When a consumer decides to buy without much logical thinking, his decision is said to be emotional Emotional buying motives are the motives which are affected by the feeling of heart The emotional motives are of the following types

- Sex or Romance Motive Fancy clothes, cosmetics, perfumes etc are in great demand on account of the instinct of sex or a desire to attract the opposite sex Men dress in their best to appeal to women, and women put attractive jewellery, fancy clothes, hairdos, pleasing perfumes and make-up in a modern style to appeal to men Some examples of appeals made are " Every woman has a right to look younger than she is" "It gives your face a sex appeal"

- Love of Others( Affection Motives) This motives plays a important part when parents purchase all kinds of things for their children like toy, fancy garments, and other presents and take insurance policies to make provision for their future Examples of its appeals are " Because you love them, protect them" "Wise mothers give their family a nourishing breakfast"

- Social Acceptance Motive Every individual wants to have respect and acceptance from the group to which he belongs Taking advantage of this motive the marketers use appeals such as " Your neighbours shops here- you should too" " It makes you nice to be near all days"

- Vanity Motive People like to feel important in the society, among friends, in association and clubs, to achieve status symbols. Hence ladies purchase costly costumes, jewellery or join expensive clubs, have expensive home decoration object Men purchases television, costly furniture, air conditioners, scooters, cars, perfumes and other variety goods Appeals are made as the following

" Be the first to own one"

"Designed exclusively with you in mind "

- Recreation and Relaxation Motive People purchase sports and games materials, indoor game, horse racing, tickets for cinema, record players, magazines etc examples of appeals are "Quiet heaven for you to spend your holidays- come and stay at Ashoka "

- Curiosity Motive Adolescent boys and girls and even adults are curious about certain things such as old paintings, old coins, blue films, cabaret dancers etc. Examples of appeals are "For Adults only" "Something new has been added- come and see"

- Emulate Motive Some people are motivated to buy what is reported to be used by great people whose opinions matter For Example, Sachin Tendulkar says, " Boost is the secret of my energy "

- Comfort and Convenience Motive Most people like to do everything in an easy way and in comfort Hence this motive may be well exploited by the marketers particularly for selling luxury items like washing machine, vaccum cleaners, pressure cookers, electric irons, air conditioners, electric oven etc

**Rational Motives:**

When a buyer decides to buy after careful consideration or logical thinking, his decision is said to be rational Thus rational buying motives are motives where a consumer takes the decision of purchasing a product by his head and mind In making rational purchases, the consumer considers price, durability, dependability, efficiency, convenience etc Rational motives are of the following types

- Monetary Gain Almost all buyers would like to get monetary benefits or to purchase better products at a comparatively low cost Some Examples of appeals made are " Shop at ours, get the choicest product at the cheapest price" " A bumper sale at 20% discount "

- Efficiency in Operation and Use Most buyers buy products which function efficiently and effectively For example, knife sharpeners, razors, grinders in the kitchen and in offices etc Examples of appeals made are " Fabrics that never needs ironing" " Push button control"

- Dependability Motive It compels an individual to buy to satisfy his desire to obtain quality goods of reliable and durable nature Example of appeals made are

"A life partner"

"It is most dependable for health"

**(ii)Product And Patronage Motives Product Motives:**

It refers to those influences and reasons which make the consumer buy a certain product in preference to another Product motives are of two types

- Primary Product Motives These motive induce a consumer to purchase general class of the product These motive relate to the basic needs of people like hunger, thirst, sleep etc

- Selective Product Motives These motives determine particular brand or item will purchased from the general class

Suppose a professor wants to purchase a scooter but his wife decides to have a refrigerator They may decide to purchase a scooter The decision to purchase a scooter is primary product motive Once a decision to purchase a scooter is made additional decision must be made regarding the brand, colour and model of the scooter to be purchased The factor which influences the decision to buy a particular scooter (eg Bajaj) from among various brands or models is known as Selective Product Motive

**Patronage Motive:**

These are those motives which determine where or from whom products are purchased These are the considerations which induce a buyer to buy goods from specific shops Following are the key patronage motives

- Price As income is limited, an individual would like to purchase cheap products or at discount Hence following price appeals attract him " price slashed by 30%" " old price Rs 350 Today's price Rs 190 only"

- Location Nearest to one's residence may induce people to buy from a particular store which may say " Location in the heart of the city, accessible from all sides"

- Quality It appeals some customers to buy standard quality goods, even if costly, The usual appeals are " We guarantee price back, if quality is found inferior" "We guarantee every product we sell"

- Variety Some people may buy products from a particular shop because of variety of goods available there Hence following appeal attracts buyers "We have the largest selection in town"

- Services Services like home delivery, credit, goods gift, free services etc may induce people to buy products Examples of appeals are " Free home delivery within the town" "We service what we sell"
- Personality of the Owner or Salesmen Even the personality of the owner or salesmen may induce some people to buy goods from particular store

**(iii)Inherent And Learned Motives Inherent Motive:**

These are those which come from the physiological or basic needs such as hunger, thirst, sleep, sex etc these are the motives for the satisfaction of which a consumer makes his best efforts and if these motives are not satisfied he feels mental tension

**Learned Motives:**

Learned motives are those which are acquired or learned by a consumer from the environment and education These motives are social status, social acceptance, fear, security etc while satisfying learned motives, the consumer does not consider even the price of the product

**(iv)Psychological And Social Buying Motives:**

**Psychological Buying Motive:** These are those which are driven by internal psychological processes like learning, perception and attitude

**Social Motive:** Man is a social being He cannot live away from the influence of the society His consumption motives are shaped by his interactions with members of hi family and society Thus social motives are those motives which are influenced by the society in which consumers live

## 4.10 FACTORS INFLUENCING CONSUMER BEHAVIOUR/ BUYING DECISIONS (DETERMINANTS OF CONSUMER BEHAVIOUR)

All factors which determine the buying or consumer behaviour are broadly classified into six Psychological factors, Social factors, Cultural factors, Personal factors, Economic factors and Environmental factors

**Psychological Factors**

The following are the important psychological factors

**1) Consumer Needs and Motivation:** All buying decisions start with need recognition People always seek to satisfy their needs When need is not satisfied it drives people to satisfy that need Then the need becomes a motive Thus motive arises from needs and wants The force that converts needs into motives is called motivation

**2) Perception:** It is the process of selecting, organizing and interpreting information in order to give meaning to the world or environment we live in the way the consumers display selective attention, distortion or retention motivates marketers to design the product package, promotional themes etc The marketers should understand the consumer perception and convert perception into a buying response

**3) Learning:** Learning is the process of acquiring knowledge  Generally, learning results in four ways- Listening, Reading, Observing and experiencing  The importance of learning theory for marketers is that they can create demand for a product by associating it with strong drives, using motivating cues and providing positive reinforcement

**4) Belief and Attitude:** A belief is a descriptive thought that a person holds about something  Such thoughts are based on learning, opinion or faith  For example, A consumer believes that Maruti cars are less costly and fuel efficient  Attitude means a person's feelings towards a particular object or situation

**Social Factors**

The major social factors are as follows

**1) Reference Group:** consumer behaviour is influenced by various groups within society known as reference groups  We have several reference groups with whom an individual associate such as friends, relatives, classmates, club memberships etc  In each groups there is an opinion leader whose style is adopted by others  Marketers often identify such opinion leaders and develop advertisement featuring them as endorsers

**2) Role and Status:** A person takes up many roles in different situations in his /her life  He can be son, father, husband, employee etc  Each role has a status  A person's role and status influence his general as well as buying behaviour

**3) Family:** Family is one of the important factors influencing buying behaviour

**Cultural Factors**

Culture determines and regulates our general behaviour  The major cultural factors are as follows

**1) Culture:** Culture simply refers to values and beliefs in which one is born and brought up  It is a set of Ideas, Customs, Values, Art and Belief that are produced or shaped by a society and passed on from generation to generation  Culture influence what we eat and wear, how we relax and where we live etc

**2) Sub-Culture:** It is based on religion, language, geographic region, nationality, age etc  It is a segment within a large culture that shares a set of beliefs, values or activities that differ in certain respects from those of the main or overall culture  The food habits are different in different parts of India

**3) Social Class:** A social class is a group of people with similar values, interest and behaviour within a society  Consumers buying behaviour is determined by the social class to which they belong rather than by their income alone  The social class is based on income, education, occupation, family history, wealth, lifestyle, area of residence etc

**Personal Factors**

Personal factors are unique to a particular person These factors include demographic factors and are as follows

**1) Age:** Need and wants are determined by age So buying changes with age, Taste for food, clothing and recreation etc changes with age

**2) Stages in the Life Cycle:** People buy different goods during different life cycle stages Life cycle of an individual refers to the different phases of his or her life

**3) Occupation and Economic Status:** Occupation influences product choice, brands beliefs etc It determines income, buying power and status

**4) Life Style:** It indicates how people live, how they spend their time, how and what they choose and where they shop It is the way people eat, drink, spend leisure time, work and so on

**5) Personality:** Personality refers to the unique psychological characteristics of an individual Personality of consumers influences brand preference and choice of products

**6) Self-Image:** Self image implies what one thinks of himself/herself It is the way one sees himself/herself or wishes to see himself/herself or wants to be seen by others Self-concept is an important factor to marketers in planning advertising campaign

**Economic Factors**

The various economic factors which determine consumer behaviour are as follows

**1) Personal Income:** Gross income of a person is composed of disposable and discretionary income When disposable income rises, the expenditure on various items will increase and vice versa

**2) Family Income:** It is the aggregate income of all members of a family The family income remaining after the expenditure on the basic needs of the family is made available for buying goods, durables and luxuries

**3) Income Expectations:** If a person expects any increase in his income he will buy durables on hire purchase etc, if his future income is likely to decline he will restrict his expenditure to bare necessities

**4) Savings:** When a person decides to save more, he will spend less on comfort and luxuries

**5) Liquidity Position:** If an individual has more liquid assets, he goes in for buying comfort and luxuries

**6) Consumer Credit:** If Consumer Credit is available on liberal terms, expenditure on comfort and luxuries will increase

**Environmental Factors**

The various environmental factors which determine consumer behaviour are as follows

**1) Political Situation:** In state monopolies, consumers have to be satisfied with a limited range of products, but in market oriented economy like that of USA, consumers have wider choice

**2) Legal Forces:** Consumers make purchases within the legal framework All purchase dealings are carried on within legal limits

**3) Technological Advancements:** Technological advancements bring wide range of changes in products/ services and makes consumers go in for latest products

**4) Ethical Considerations:** Buying behaviour is influenced by the sense of social morality and ethical considerations

## 4.11 CONSUMER GOODS

Products which are for direct consumption or which require no further processing are known as consumer goods These goods are offered to household and ultimate consumer e g , shirts, cars, watches etc Consumer products can be further classified into following categories

**A. On the Basis of Durability:**

**(i) Durable Products:**

The goods which are used for a longer period of time are known as durable goods These goods are generally of high price and require after sale service and promotion tools for sale

**(ii) Non-Durable Products:**

Goods which are consumed in short period of time are called non-durable goods These products are generally sold at low price and with fewer profit margins

**(iii) Services:**

Services refer to benefits or satisfactions which are offered for sale

**Main features of services are:**

1 Services are intangible in nature

2 It is inseparable from its source

3 It cannot be stored

4 These are heterogeneous in nature i e , services are highly variable as the quality and type of service vary from person to person who performs it

**B. Classification Based on Consumer's Buying Behaviour and Attitude**

Under this classification there are three types of goods

**(i) Convenient Goods:**

Which are bought by consumers with minimum shopping efforts i e , the goods which are easily available everywhere for example, salt, match box, bread, etc

**Features of Convenient Goods:**

1 These can be purchased with minimum shopping efforts

2 These products have regular and continuous demand

3 These units are generally of low prices

4 These have standardised price

5 There is high competition in these goods

6 Sales promotion incentives are generally used to increase the sale of these products

**(ii) Shopping Goods:**

The goods or services which are bought after some shopping efforts i e , search or comparison of goods on the basis of price, quality, suitability, etc e g , TV, furniture, car, etc

**Features of Shopping Products:**

1 These are generally durable goods

2 Prices of such goods are generally high

3 Customers generally compare these goods and then buy such goods

4 Retailers play an important role in selling shopping goods

5 People plan the buying of such goods

**(iii) Speciality Goods:**

These are the goods of unique nature and hold special importance for customers The buyer puts special efforts in obtaining these goods These can be low priced or high priced for example, designer, clothes, and cars such as Mercedes etc

**Features of Speciality Products:**

1 Demands for such products are limited

2 These products are of high price

3 These products are available at few selected places only.

4 These products are sold as a result of aggressive promotion techniques

5 After sale service is very important in these products

## 4.12 INDUSTRIAL GOODS

Industrial products are used as input or raw material to produce consumer goods for example, tools, machinery, etc

**Features of Industrial Product are:**

**1. Number of Buyers:**

Numbers of buyers of industrial products are limited as compared to consumer products

**2. Channel of Distribution:**

Shorter channel of distribution is used for sale of industrial products as there are limited buyers

**3. Geographical Concentration:**

Generally the demand for industrial products is not scattered but is concentrated at a fixed geographical location

**4. Derived Demand:**

Industrial products are demanded to produce consumer products that is why it is called derived demand, as demand of sugarcane depends upon the demand of sugar in the country

**5. Technical Consideration:**

Industrial products are produced as a result of complex process so there is more technical consideration of these products

**6. Reciprocal Buying:**

Some industries buy product from a company with intention of selling the finished goods to the same company For example the Maruti Co may buy tyres from MRF Company and tyre Company may in turn buy car from Maruti Co

**7. Leasing:**

Nowadays instead of buying industrialists prefer to take fixed assets on lease, because of high prices of these products

## 4.13 DIFFERENCE BETWEEN CONSUMER GOODS AND INDUSTRIAL GOODS

| Consumer Goods | Industrial Goods |
|---|---|
| 1 The demand for consumer goods is a 'direct demand' | The demand for industrial goods is a 'derived demand' It is derived from the demand for consumer goods, which are made using the industrial goods |
| 2 The number of buyers is large | Industrial goods have only limited number of buyers |
| 3 The demand for consumer goods is elastic | Industrial goods have relatively inelastic demand |
| 4 The buyers are found scattered in different parts of the country / world | The buyers are found to be concentrating in certain regions only For example, the buyers of raw cotton, who are the cotton textile mill owners, are found in and around Coimbatore in Tami lnadu |
| 5 Each purchase will generally be of small value | Each purchase involves a very high amount (in money terms) |
| 6. These goods are not technically complicated | Industrial goods are technically complicated Such goods cannot be assessed by an ordinary buyer |
| 7 Buying is much influenced by emotions | Buying cannot be influenced by emotions |
| 8. Any individual can undertake buying | Here, buying is always a group process. Finance experts, engineers, accountants and others will have to work together before taking the purchase decision. |
| 9 After-sale service is important in the case of consumer durables | After-sale service is of paramount importance in the case of all industrial goods |
| 10 There are a number of middlemen in the market | The manufacturers of industrial goods supply directly to their customers |
| 11 A buyer of consumer goods may not have thorough knowledge of the goods he buys and uses | A buyer of industrial goods must have complete knowledge of the goods he buys and uses |
| 12 The reputation of the seller or manufacturer may not always be given importance in buying consumer goods | The reputation of the manufacturer is always important in buying industrial goods |
| 13 Inducements to the buyers in the form of cash discounts, free gifts, etc are made always by those marketing consumer goods | Such inducements may not be common in the marketing of industrial goods |
| 14 Leasing arrangements are not made in the marketing of consumer goods | Leasing arrangements are quite common in the marketing of industrial goods The seller, in view of the high cost of the industrial goods, may provide the facility of leasing to the buyer |
| 15 The market for consumer goods is affected by fashion and style changes | The market for industrial goods is affected by technological changes |

## 4.14 MARKET SEGMENTATION –INTRODUCTION

Market consists of buyers, and buyers differ in one or more respects Buyer's behaivour is a complex phenomenon. An understanding of the economic, psychological and socio-cultural characteristics of the consumers and their motivations Attitudes, cognitions personalities and perceptions can help to discover new market opportunities, clear and specific market segmentation All markets are made up of segments and these segments are made up of sub-segments

### 4.14.1 Meaning and Definition:

Segmentation is a consumer oriented marketing strategy It is a process of dividing the market on the basis of interest, need and motive of the consumer Market segmentation simply means dividing market or grouping of consumers It refers to grouping of consumers according to such characteristics as income, age, race, education, sex, geographic location etc Therefore market segmentation is the strategy that subdivides the target market into sub-groups of consumers with distinct and homogenous characteristics with a view to develop and follow a distinct and differentiated marketing programmes for each sub-group in order to enhance satisfaction to consumers and profit to the marketer

According to Philip Kotler, " Market segmentation is the sub-dividing of a market into homogenous sub-sects of consumers where any sub-sects may conceivably be selected as a market target to be reached, With a distinct marketing mix "

### 4.14.2 Characteristics Or Criterias Of Effective Segmentation:

The main criteria's of effective segmentation are

- Measurability
- Substantiality
- Accessibility
- Differentiability
- Auctionable
- Nature of Demand
- General considerations

The main purpose of market segmentation is to measure the changing behaviour patterns of consumers The size, profile, and other relevant characteristics of the segment must be ***measurable*** and obtainable in terms of data Therefore, segments should be capable of giving accurate measurements

***Substantuality*** refers to the size of the segmented market Segments must be large enough to be profitable For small segment, it may not be possible for the marketer to develop separate marketing mix for such non profitable segments

The segment must be ***accessible***, which means marketers must be able to reach the market segments at lower costs Segments must be reachable by company's sales persons, distributors advertising media etc The segment should be large enough to be considered as a separate market Such segments must have individuality of their own so that it leads to ***different*** segments

The segments which the company wishes to pursue must be ***auctionable*** in the sense that there should be sufficient finance, personnel and capability to take them all Hence, depending upon the reach of the company, the segments should be selected

Segmentation is required only if there are marked differences in the ***nature of demand*** Nature of demand refers to the different quantities demanded by various segments Each segmented market must exhibit difference in consumption rates from another segment

Apart from the above characteristics, the segment must have growth potential, be profitable, carries no unusual risks and has competitors who do not fight directly with the product or brand

### 4.14.3 Need And Importance Of Market Segmentation

According to Sheth, "Market segmentation is the essence of modern marketing " It is advantageous to firms as well as consumers

### A. Advantages To Firms

- Increases sale volume
- Helps to win competition
- Enables to take decisions
- Helps to prepare effective marketing plan
- Helps to understand the needs of consumers
- Makes best use of resources
- Expands markets.
- Creates innovations
- Higher markets share
- Specialised marketing
- Achieves marketing goals

**B. Advantages To Consumers**

- Customer oriented
- Quality product at reasonable price
- Other benefits such as discounts, prize etc

### 4.14.4 Patterns Of Segmentation:

**Undifferentiated Marketing**: Under this strategy, the producer or marketer does not differentiate between different type of customers One marketing mix is used for the whole market Eg Pepsi

**Differentiated Marketing** A number of market segments are identified and different marketing mix is developed for each of the segments Eg, consumer products

**Concentrated Marketing** It is concerned with the concentration of all marketing efforts on one selected segment within the total market. Eg, Kid's wear

**Customised or Personalised Marketing** In this case firms view each customer as a separate segment and customised marketing programmes to that individuals specific requirements Eg, civil engineers designing flats villas, bridges etc

### 4.14.5 Bases Of Market Segmentation:

Different variables are used to segment the consumer markets They can be broadly put into four categories

**Demographic Segmentation:**

Demos means people and graphein means to measure or to study In Demography means study of people or population In Demographic segmentation, the market is segmented on the basis of demographic variables such as age, sex, family size, family life cycle, income, occupation, education etc Demographic variables or characteristics are the most popular bases for segmenting the market

**(a) Age:** Age is an important factor for segmenting the market This is because demand and brand choice of people change with age On the basis of age, a market can be divided into four- Children, Teenagers, Adults and Grown-ups For consumers of different age groups, different types of products are produced Johnson and Johnson cater to the needs of children below 6 years by presenting baby powders, baby soaps, oils etc

**(b) Sex:** Sex based segmentation means grouping customers into males and females The wants, tastes, preferences, interests, choices etc, of men are different from that of women For instance, women are more fond of cosmetics and other fancy articles Marketers use gender differences for marketing garments, personal care products, bikes, cosmetics and magazines

**(c) Family Life Cycle:** It refers to the important stages in the life of an ordinary family Broadly divided into the following stages

Stage 1. Childhood

Stage 2. Bachelorhood (unmarried)

Stage 3· Honeymooners- Young married couple

Stage 4 Parenthood- (a) Couple with children. (b) Couple with grown up children

Stage 5 Post- parenthood- Older married couple with children living away from Parents (due to job or marriage of sons and daughters).

Stage 6. Dissolution- One of the partners is dead

Wants, tastes, interests, buying habits etc vary over different life cycles stages

**(d)Religion:** Religious differences have important effect on marketing The male folk among the muslims have a demand for striped lungis and the woman folk for pardhas

**(e) Income:** Income segmentation is used for automobiles, clothing, cosmetics, travel, financial services etc For example, BMW (car manufacturer concentrates on high income segment)

**(f) Occupation:** Market segmentation is done also on the basis of occupation of consumers For instance, doctors may demand Surgical equipment, lawyers may demand coat etc

**(g) Family Size:** A marketer launches different sizes of products in the market according to size of the family For example, shampoos and oil are available in 100 ml 200ml 500ml etc

**(h) Education:** On the basis of education, market for books may be divided as high school, plus two, graduate and post graduate

**Geographic Segmentation:**

The marketer divides the market into different geographical units Generally international companies segment markets geographically The theory behind this strategy is that people who live in same area have some similar need and wants and that need and wants differ from those of people living in other areas

**(a) Area:** This type of segmentation divides the market into different geographical units such as country, state, region, district, area etc Some manufacturers split up their sales territories either state-wise or district-wise Markets may also be divided into urban and rural markets

**(b) Climate:** Different types of climate prevail in different places On the basis of climate, areas can be classified as hot, cold, humid and rainy region Climate determines the demand for certain goods

**(c) Population Density:** The size and density of population affects the demand for consumer goods In those areas where size and density of population is high, there will be good demand for consumer goods

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**Behavioural Segmentation:**

Behavioural segmentation is based on buyer behaviour i.e the way people behave during and after purchase

**(a) Attitude** Customers can be segmented on the basis of attitude such as enthusiastic, positive, indifferent, negative, hostile etc Fashionable and latest products are used by enthusiastic consumers Liquor, cigarette etc are used by negative consumers

**(b) Product Segmentation:** The market segmentation is done on the basis of product characteristics that are capable of satisfying certain special needs of customers

(1) Prestige products, e g , Automobiles, clothing, Home furnishing

(2) Maturity products, e g , Cigarettes, Blades etc

(3) Status products, e g , Most luxuries

(4) Anxiety products, e g , Medicines, soaps etc

(5) Functional products, e g , Fruits, vegetables etc

**(c) Occasion Segmentation:** According to the occasions, buyers develop a need, purchase a product or use a product There can be two types of situations- regular and special For example, for regular use, women purchase cotton or polyester sarees or churidars For attending marriage or reception(special occasion) they buy silk sarees

**(d) Benefit Segmentation:** Benefit segmentation implies satisfying one benefit group The benefit may be classified into Generic or Primary and Secondary or Evolved

| **Product** | **Generic or primary Utilities** | **Secondary or Evolved Utilities** |
|---|---|---|
| Tooth paste | Cleaning Breath | freshing, brightness |

**(e) Volume Segmentation:** The market is segmented on the basis of volume or quality of purchase The buyers are grouped into categories like bulk buyers, moderate buyers, and small buyers Heavy buyers are often small percentage of the market but account for a high percentage of total consumption Marketers prefer to attract one heavy buyer rather than several small buyers

**(f) Loyalty Segmentation:** Consumers have varying degree of loyality to specific brands On the basis of brand loyality, buyers can be divided into the following five groups (1) Hard-core loyals (2) Softcore loyals (3) Shifting loyals (4) Switchers (5) Consumer innovators

**Psychographic Segmentation:**

It refers to grouping of people into homogeneous segments on the basis of psychological make up namely personality and life style

**(a) Life Style:** A person's life style is the pattern of living as expressed in the person's activities, interests and opinions They express their life styles through the products they use For example, the life style of a college student is different from that of an ordinary worker Car, clothing, cosmetics, furniture, liquor, cigarettes etc are segmented by using life style

**(b) Personality:** Personality reflects a person's traits, attitude and habits It is in this background that a person is classified as active or passive, rational or impulsive, creative or conventional, introvert or extrovert For example, Raymond's advertisement says "Raymonds The Complete Man"

**(c) Social Class:** On the basis of Social class, consumers may be grouped into lower class, middle class and upper class Social class is determined by income, occupation and education

## 4.15 TARGET MARKETING

Target marketing is the process of assessing the relative worth of different market segments and selecting one or more segments in which to compete These become the target segments Titan is using the target marketing strategy very effectively German car manufacturer Mercedes target high status consumers with experience and prestigious motor cars

According to David Cravens and others " Target market is a group of existing or potential customers within a particular product market towards which an organisation directs its marketing efforts"

### 4.15.1 Target Marketing Strategies:

- **Total market approach:** A company develops a single marketing mix and directs it at the entire market for a particular product This approach is used when an organisation defines the total market for a particular product as its target market

- **Concentration approach:** An organisation directs its marketing efforts toward a single market segment through a single marketing mix The total market may consist of several segments, but the organisation selects only one of the segments as its target market

- **Multi-segment approach:** An organisation directs its marketing efforts at two or more segments by developing a marketing mix for each segment

#### 4.15.2 Steps In Target Marketing:

It involves the following four major steps

**1) Market segmentation:** Markets are segmented on the basis of certain characteristic such as sex, education, income, age etc

**2) Market targeting:** It refers to evaluating each market segments attractiveness and selecting one or more of the segments to enter Thus target marketing and market targeting are not one and the same Market targeting is only a step in target marketing.

**3) Designing the marketing mix:** After selecting the segment, the next step is to design a suitable product and other marketing mix elements for each segment selected.

**4) Product Positioning:** Market segmentation strategy and market positioning strategy are like two sides of a coin Target marketing begins with segmentation and ends with positioning

### 4.16 PRODUCT POSITIONING

The act of creating an image about a product or brand in the consumers mind is known as positioning In the words of Kotler, "Positioning is the act of designing the company's offer and image so that it occupies a distinct and valued place in the target consumers minds." In short, the process of creating an image for a product in the minds of targeted customers is known as product positioning Close-up tooth paste is looked upon by the consumers more as a mouth wash than a teeth cleaner, while 'pepsodent' has created an impression of germ killer in the consumers minds

#### 4.16.1 Steps In Product Positioning:

**1) Identifying potential competitive advantages:** Consumers generally choose products and services which give them greatest value The key to winning and keeping customers is to understand their needs and buying processes far better than the competitors do and deliver more values

**2) Identifying the competitors position:** When the firm understands how its customers view its brand relative to competitors, it must study how those same competitors position themselves

**3) Choosing the right competitive advantages:** It refers to an advantage over competitors gained by offering consumers greater value either through lower price or by providing more benefits

**4) Communicating the competitive advantage:** The company should take specific steps to advertise the competitive advantage it has chosen so that it can impress upon the minds of consumers about the superiority claimed in respect of the product over its competing brands

**5) Monitoring the positioning strategy:** Markets are not stagnant They keep on changing Consumer tastes shift and competitors react to those shifts After a desired position is developed, the marketer should continue to monitor its position through brand tracking and monitoring

### 4.16.2 Elements Of Positioning:

It is concerned with the following four elements

**1) The Product:** Design, special feature, attributes, quality, package etc of product create its own image in the minds of the consumers Material ingredient of a product is also important in the process of product positioning

**2) The Company:** The goodwill of a company lends an aura to its brand For example, Tata, Godrej, Bajaj etc have very good reputation in the market

**3) The Competitors:** Product image is build in consumers mind in relation to the competing product Thus a careful study of competition is required

**4) The Consumer:** Ultimate aim of positioning policy is to create a place for the product in consumers minds Therefore, it becomes necessary to study the consumer behaviour towards the product

### 4.16.2 Techniques Of Product Positioning

Following technique are used in positioning a product in the market.

- **Positioning by Corporate Identity:** The companies that have become a tried and trusted household name For example, Tata, Sonyetc
- **Positioning by Brand Endorsement:** Marketers use the names of company's powerful brands for line extentions or while entering another product category. Lux, Surf, Dettol etc
- **Positioning by Product Attributes and Benefits:** It emphasize the special attributes and benefits of the product Close-up is positioned on fresh breath and cosmetics benefits
- **Positioning by use, Occasion and Time:** It is to find an occasion or time of use and sit on it For example, Vicks vaporub is to be used for child's cold at night
- **Positioning by Price and Quality:** Company position its brand by emphasizing its price and quality Eg Nirma detergent powder
- **Positioning by Product Category:** Brand is perceived to be another product category Eg Maruti positioned its van as *omni* , family car
- **Positioning by Product User:** Positioning the product as an exclusive product for a particular class of customers Eg Scooty as a two wheeler for teenagers
- **Positioning by Competitor:** An offensive positioning strategy and is often seen in cases of comparative advertising Eg Tide and Rin
- **Positioning by Symbols:** Some companies use some symbols for positioning their products Eg vodafone symbol

# UNIT – V

# THE PRODUCT AND MARKETING CHANNELS

## INTRODUCTION

The marketing mix, which is the means by which an organisation reaches its target market, is made up of product, pricing, distribution, promotion and people decisions These are usually shortened to the an acronym "5P's" Product decisions revolve around decisions regarding the physical product (size, style, specification, etc.) and product line management

## 5.1 DEFINITION OF PRODUCT

A product can be defined as a collection of physical, service and symbolic attributes which yield satisfaction or benefits to a user or buyer A product is a combination of physical attributes say, size and shape, and subjective attributes say image or "quality" A customer purchases on both dimensions

According to Jobber(2004), " A product is anything that has the ability to satisfy a consumer need " In the words of Dibb et al ," A product is anything, favourable and unfavourable that is received in exchange "

### 5.1.1 CLASSIFICATION OF PRODUCTS

A product's physical properties are characterized the same the world over They can be convenience or shopping goods or durables and nondurables, however, one can also classify products according to their degree of potential for global marketing

i) Local Products - seen as only suitable in one single market

ii) International Products - seen as having extension potential into other markets

iii)Multinational Products - products adapted to the perceived unique characteristics of national markets.

iv) Global Products - products designed to meet global segments - Products and services fall into two broad classes based on the types of consumers that use them

A - (1) Consumer Product

B - (2) Industrial Product

**01. CONSUMER PRODUCT** - "Product bought by final consumer for personal

consumption" Consumer products divided into four classes

- Convenience product
- Shopping Product
- Specially Products
- Unsought Product

**i) Convenience Product:-**Consumer product that the customer usually buys frequently, immediately, and with a minimum of comparison and buying effort consumer products can be divided further into staples, impulse products, and emergency products

*Staples* Products are those product that consumers buy on a regular basis, such as ketchup, toothpath etc ,

*Impulse* products are those product that purchased with little planning or search effort, such as Candy bar, and magazine,

*Emergency* product is those when consumer need is urgent, e g umbrellas during a rainstorm etc

**ii) Shopping Product:-**Consumer good that the consumer, in the process of selection and purchase, characteristically compares as such bases as suitability, quality, price, and style Example Furniture, clothing, used cars, major appliances and hotel and motel services

**iii) Specialty Products:-**Consumer product with unique characteristics or brand identification for which a significant group of buyers is willing to make a special purchase effort e g Specific brands and types of cars, high-priced photographic equipment, designer clothes etc

**iv)Unsought Products:-**Unsought products are consumer products that the consumer either does not knows about or knows about but does not normally think of buying Most major new inventions are unsought until the consumer become aware of them through advertising E g Life Insurance and blood donations to the Red Cross

**02. INDUSTRIAL GOODS** It is meant for use in the production of other goods or for some business or institutional purposes Industrial goods are classified into four- production facilities and equipments, production materials, production supplies and management materials

### 5.1.2 Product Line:

Product lining is the **marketing** strategy of offering for sale several related products Unlike product bundling, where several products are combined into one, lining involves offering several related products individually A line can comprise related products of various sizes, types, colors, qualities, or prices Line depth refers to the number of product variants in a line Line consistency refers to how closely related the products that make up the line are Line vulnerability refers to the percentage of sales or profits that are derived from only a few products in the line If a line of products is sold with the same brand name, this is referred to as family branding

### 5.1.3 Product Line Modification:

When you add a new product to a line, it is referred to as a line extension When you add a line extension that is of better quality than the other products in the line, this is referred to as trading up or brand leveraging When you add a line extension that is of lower quality than the other products of the line, this is referred to as trading down When you trade down, you will likely reduce your brand equity

You are gaining short-term sales at the expense of long term sales

- Product Line Contraction
- Product Line Expansion
- Changing Models or Styles of the Existing Products

### 5.1.4 Product Simplifcation:

Product Simplification means limiting the number of products a dealer deals Sometimes it becomes necessary for a company to stop the production of unprofitable products.

### 5.1.5 Product Diversification:

Product diversification means adding a new product or products to the existing product It is a strategy for growth and survival in the highly complex marketing environment

### 5.1.6 Product Differentiation

Product differentiation involves developing and promoting an awareness in the minds of customers that the company's products differ from the products of competitors This is made by using trade mark, brand name, packaging, labeling etc

## 5.2 PRODUCT MIX

The number of different product lines sold by a company is referred to as width of product mix The total number of products sold in all lines is referred to as length of product mix

**Factors Influencing Product Mix:**

- Change in demand
- Marketing influences
- Production efficiencies
- Financial influence
- Use of waste
- Competitor's strategy
- Profitability

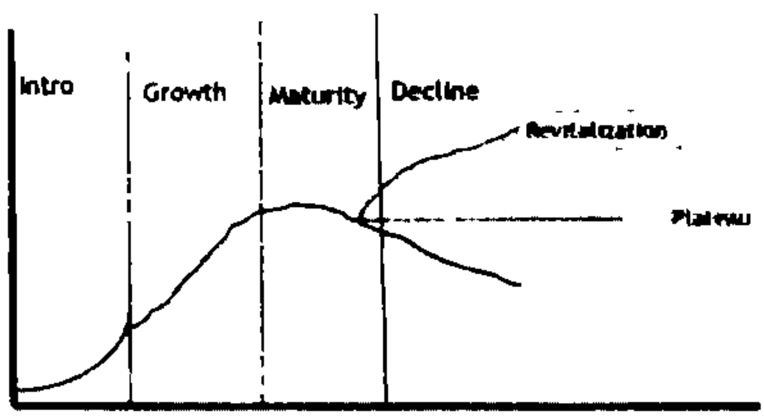
## 5.3 NEW PRODUCT DEVELOLOPMENT

New product development tends to happen in stages Although firms often go back and forth between these idealized stages, the following sequence is illustrative of the development of a new product

- **New Product Strategy Development.** Different firms will have different strategies on how to approach new products Some firms have stockholders who want to minimize risk and avoid investing in too many new innovations Some firms can only survive if they innovate frequently and have stockholders who are willing to take this risk For example, Hewlett-Packard has to constantly invent new products since competitors learn to work around its patents and will be able to manufacture the products at a lower cost
- **Idea Generation.** Firms solicit ideas as to new products it can make Ideas might come from customers, employees, consultants, or engineers Many firms receive a large number of ideas each year and can only invest in some of them
- **Screening and Evaluation:** Some products that after some analysis are clearly not feasible or are not consistent with the core competencies of the firm are eliminated.
- **Business Analysis.** Ideas are now exposed to more rigorous analysis Profit projections, risks, market size, and competitive response are considered If promising, market research may be done.
- **Development:** The product is designed and manufacturing facilities are planned.
- **Market Testing:** Frequently, firms will try to "test" a product in one region to see if it will sell in reality before it is released nationally and internationally There is a lesser risk if the firm only commits money to advertising and other marketing efforts in one region Retailers will also be more receptive in other parts of the country and world if it has been demonstrated that the product sold well in one region The firm may also experiment with different prices for the product
- **Commercialization:** Facilities to manufacture the product on a larger scale are now put into operation and the firm starts a national marketing campaign and distribution effort

## 5.4 THE PRODUCT LIFE CYCLE

Products often go through a *life cycle* Initially, a product is introduced



Since the product is not well known and is usually expensive (e g , as microwave ovens were in the late 1970s), sales are usually limited Eventually, however, many products reach a *growth* phase—

sales increase dramatically More firms enter with their models of the product Frequently, unfortunately, the product will reach a *maturity* stage where little growth will be seen For example, in the United States, almost every household has at least one color TV set Some products may also reach a *decline* stage, usually because the product category is being replaced by something better For example, typewriters experienced declining sales as more consumers switched to computers or other word processing equipment The product life cycle is tied to the phenomenon of diffusion of innovation When a new product comes out, it is likely to first be adopted by consumers who are more innovative than others— they are willing to pay a premium price for the new product and take a risk on unproven technology It is important to be on the good side of innovators since many other later adopters will tend to rely for advice on the innovators who are thought to be more knowledgeable about new products for advice At later phases of the PLC, the firm may need to modify its market strategy For example, facing a saturated market for baking soda in its traditional use, Arm & Hammer launched a major campaign to get consumers to use the product to deodorize refrigerators Deodorizing powders to be used before vacuuming were also created

**Product Introduction/ Development Stage**

This is the first stage in product life cycle Before a new product is introduced in the market place, it should be created first The processes involve in this stage include generation of idea, designing of the new product, engineering of its details, and the whole manufacturing process This is also the phase where the product is named and given a complete brand identity that will differentiate it from the others, particularly the competitors Once all the tasks necessary to develop the product is complete, market promotion will follow and the product will be introduced to the consumers Product development is a continuous process that is essential in maintaining the product's quality and value to consumers This means that companies need to continuously develop or innovate their products to out ride new and existing competitors

**Product Growth Stage**

This is a period where rapid sales and revenue growth is realised However, growth can only be achieved when more and more consumers will recognize the value and benefits of a certain product In most cases, growth takes several years to happen, and in some instances, the product just eventually died without achieving any rise in demand at all Hence, it is important that while the product is still in the development and introduction stages, a sound marketing plan should be put in place and a market and primary demand should be established

**Product Maturity and Saturation Stage**

In the maturity stage, the product reaches its full market potential and business becomes more profitable During the early part of this stage, one of the most likely market scenarios that every business should prepare for is fierce competition As business move to snatch competitor's customers, marketing pressures will become relatively high This will be characterised by extensive promotions and competitive advertising, which are aimed at persuading customer to switch and encouraging distributors to continue sell the product In the middle and late phases of the maturity stage, the rate of growth will start to slow down and new competitors will attempt to take control of the market In most cases, many businesses falls and lose money in these stages as they focus more on increasing advertising spending in hope of maintaining their grip of the market

**Product Decline Stage**

The decline stage is the final course of the product life cycle This unwanted phase will take place if companies have failed to revitalize and extend the life cycle of their products during the maturity stage's early part. Once already in this phase, it is very likely that the product may never again recover or experience any growth, eventually dying down and be forgotten

## 5.5 BRANDING

Branding means giving a name to the product by which it could become known and familiar among the public When a brand name is registered and legalised, it becomes a *Trade mark* All trade marks are brands but all brands are not trade marks Brand , brand name, brand mark, trade mark, copy right are collectively known as the language of branding

### 5.5.1 TYPE OF BRANDS

In many markets, brands of different strength compete against each other At the top level are *national* or *international* brands A large investment has usually been put into extensive brand building— including advertising, distribution and, if needed, infrastructure support Although some national brands are better regarded than others—e.g., Dell has a better reputation than e-Machines—the national brands usually sell at higher prices than to *regional* and *store* brands Regional brands, as the name suggests, are typically sold only in one area In some cases, regional distribution is all that firms can initially accomplish with the investment capital and other resources that they have This means that advertising is usually done at the regional level *Store*, or *private label* brands are, as the name suggests, brands that are owned by retail store chains or consortia thereof (For example, Vons and Safeway have the same corporate parent and both carry the "Select" brand) Typically, store brands sell at lower prices than donational brands

*Co-branding* involves firms using two or more brands together to maximize appeal to consumers Some ice cream makers, for example, use their own brand name in addition to naming the brands of ingredients contained Sometimes, this strategy may help one brand at the expense of the other It is widely believed, for example, that the "Intel inside" messages, which Intel paid computer makers to put on their products and packaging, reduced the value of the computer makers' brand names because the emphasis was now put on the Intel component

In order for a business organisation to successfully create an effective brand that is capable of enhancing a product's value, it needs to understand how the delivery of value differs across different types of brands This means that a company has to know the kind of brand suitable for its offering So what are the different kinds of brand? They are the following

- Manufacturer Brands These are developed and owned by the producers, who are usually involved with distribution, promotion and pricing decisions for the brands For example, Apple computers
- Dealer Brands. These are brands initiated and owned by wholesalers or retailers
- Generic Brands It indicates only the product category and do not includes the company name or other identifying terms.
- Family Brands A single brand name for the whole line closely related items For example, Amul for milk products
- Individual Brands Each product has a special brand name such as surf etc
- Co-Brands. It uses two individual brands on a single product
- Licensed Brands It involves licensing of trade marks For example, P&G licensed its camay brand of soap in India to Godrej for a few years

### 5.5.2 Brand Loyalty:

It simply means loyality of a buyer towards a particular brand Wilkie defined loyality as, "A favourable attitude and consistent purchase of a particular brand." For example, If a customer has a brand loyality towards 'Pears', he will buy and use only that soap There are three levels of Brand Loyality

1) Brand Recognition This means that people are familiar with the product and they are likely to buy it

2) Brand Preference At this level people adopt the product- that is, they habitually buy it if it is available

3) Brand Insistence It is the stage at which people will not accept any substitute

### 5.5.3 Brand Equity:

It simply refers to value associated with a brand It is the Marketing and financial value associated with a brand's strength in a market. According to Aaker, "Brand equity is a set of assets and liabilities linked to a brand's name and symbol that add to or subtract from the value provided by a product or service to a firm or that firm's customers"

## 5.6 PACKAGING AND LABELLING

Packaging and Labelling are among the most important areas in product management *Packing* means putting article into small packets, boxes or bottles for sale to ultimate consumers or for transport *Labelling* is defined as a slip or tag attached with the product or with its package which provides necessary information about the product and its producer

Contrary to common perception that these two processes are all about creating an image and decent presentation of a product, packaging and labelling have more relevant purpose and objectives These include physical protection of product from destructive things that may spoil or ruin it, e g. temperature, shock, vibration, etc. Other purposes include containment convenience, marketing, security, and dissemination of information about the use, transportation, storage or disposal of the product

Designing the labels and packages of products require careful planning Moreover, there are consumer safety regulations that every businesses should follow It is the responsibility of every product manufacturer to respects these rules Thus, before you start designing product labels and packaging, it makes good business sense to know what laws will affect you and what kind of materials will best suit your product.

### 5.6.1 Kinds Of Labels:

There are four kinds of labels·

1) Brand Label. It gives the brand name or mark For example, Britannia Biscuits, Vicks Vaporubetc

2) Grade Label It gives grade or quality of the product by a number, letter or words. For example, A grade, B grade or 1and 2 category based on quality.

3) Descriptive Label· It gives details of product, its functions, price, warnings etc

4) Information Label· It provides maximum information about the product It contains fuller instructions on the use and care of the product

### 5.6.2 Marketing Myopia

It has been introduced by Theodore Levitt. One of the main reasons for the failure of large business enterprises is that they do not actually know what kind of business they are doing This narrow minded view of Marketing is called Marketing Myopia. Marketers suffer from marketing myopia when they view their business as providing goods and services rather than as meeting customers needs and wants.

## 5.7 PHYSICAL DISTRIBUTION

### Meaning and Definition

Creating a customer is a major task of marketing but delivering the goods to the customer so created is the most critical task Physical distribution is a marketing activity that concerns the handling and the movement of goods It is a major component of marketing mix and cost area of business

In the words of Phillip Kotler, "Physical distribution involves planning, implementing and controlling the physical flow of materials, and final goods from the point of origin of use to meet customer needs at a profit."

It involves the coordination of activities to place the right quantity of right goods at the desired place and time. Like any other marketing mix component, physical distribution has two broad objectives to attain, namely, consumer satisfaction and profit maximization. Physical distribution is not only a cost but a powerful tool of competitive marketing

### 5.7.1 Meaning of Channel of distribution:

A channel of distribution is an organized network or system of agencies and institutions, which, in combination, perform all the activities required to link producers with users and users with producers to accomplish the marketing task.

According to Phillip Kotler,"It is a set of independent organizations involved in the process of making a product or service available for use or consumption." Thus, a channel of distribution is a path way directing the flow of goods and services from producers to consumers composed of intermediaries through their functions and attainment of the mutual objectives.

### 5.7.2 Difference between Physical distribution and Channel of Distribution:

These are the two component of the distribution system. Physical distribution is a broader concept, it includes channel of distribution. Physical distribution is concerned with transportation, storage, warehousing, etc, where as channel of distribution refers to the process or intermediaries through which goods move from the producer to the ultimate consumer.

### 5.7.3 Role/Importance Of Physical Distribution System:

The physical distribution system has a definite role. It provides a new orientation for marketing.

The following points will reveal the role of physical distribution system.

**1. Creation of Utilities:** Creation of or addition of utility is addition of value to a thing. The major component of physical distribution are transportation and warehousing. It is transport system that creates place utility, making goods more useful by bringing them from the places where they are not needed. Warehousing system is known for creating time utility.

**2. Improved consumer services:** Customer service in physical distribution system consists of providing products at the time and location corresponding to the customer needs. High level of customer satisfaction can be possible through a viable distribution system that takes into account the factors that affect customer service such as time, dependability, communication etc.

**3. Cut in distribution cost.** The prices paid by the customer consists of not only production costs but also delivery cost. Delivery cost can be minimized by systematic planning in inventory levels, warehousing location and operation, transportation schedule and modes, material handling, order processing and communication.

**4. Increased market share:** There are definite ways in which an efficient physical distribution system can contribute towards the objective of increased market share. It is possible by decentralizing its warehousing operations, devise the combination of efficient and economic means of transport, planning inventory operations to avoid stock outs etc.

**5. Price stabilization** It can contribute considerably to the attainment of price stabilization It is the best use of available transport and warehousing facilities that can bring about amicable and matching adjustment between the demand for and supply of goods thus preventing price fluctuations

### 5.8 LEVELS OF CHANNEL

This indicates the number of intermediaries between the manufactures and consumers Mainly there are four channel levels They are

**1. Zero level channel** - Here the goods move directly from producer to consumer That is, no intermediary is involved This channel is preferred by manufactures of industrial and consumer durable goods.

**2. One level channel** In this case there will be one sales intermediary ie, retailer This is the most common channel in case of consumer durable such as textiles, shoes, ready garments etc

**3. Two level channel.** This channel option has two intermediaries, namely wholesaler and retailer The companies producing consumer non durable items use this level

**4. Three level channel** This contains three intermediaries Here goods moves from manufacture to agent to wholesalers to retailers to consumers It is the longest indirect channel option that a company has

#### 5.8.1 Factors Determining The Length Of The Channel

The following factors will determine the length of the channel of distribution

**1. Size of the market:** The larger the market size, longer the channel Conversely the smaller the market, smaller the channel

**2. Order lot size:** If the average order lot size is small, it is better to have a longer channel and vice-versa

**3. Service requirements** If the product and market require a high level of service, and it a major factor in the buying decision, it is better to keep a shorter channel

**4. Product variety** If a wide variety of the same type of product available in the market, then it is advisable to select a wider channel

#### 5.8.2 Types Of Intermediaries:

Marketing intermediaries are the individuals and the organizations that perform various functions to connect the producers with the end users These middlemen are classified into three

1 Merchant middlemen, who take title to the goods and services and resell them

2 Agent middlemen, who do not take title to the goods and services but help in identifying potential customers and even help in negotiation

3 Facilitators, to facilitate the flow of goods and services from the producer to the consumer, without taking a title to them Eg Transport companies

**Merchant Middlemen:**

Merchant middlemen are those who take title to the goods and channelize the goods from previous step to the next step with a view to making profit They buy and sell goods in their own risk and the price for their effort is profit They act as an intermediaries between producers and consumers These merchant middlemen are broadly classified into wholesalers and retailers

**Wholesalers:**

Wholesaler is a trader who deals in large quantity. He purchases goods from the producers in bulk quantity and sell it to the retailers in small quantity According to American Management Association, " wholesalers sells to retailers or other merchants and/or individual, institutional and commercial users but they do not sell in significant amounts to ultimate consumers "

**Functions of wholesalers:**

**1. Assembling and buying**: It means bringing together stocks of different manufactures producing same line of goods, and making purchases in case of seasonal goods

**2. Warehousing** The warehousing function of the wholesalers relieves both the producers and the retailers from the problem of storage

**3. Transporting**: In the process of assembling and warehousing, the wholesaler do undertake transportation of goods form producers to their warehouse and back to retailers

**4. Financing** They grant credit on liberal terms to retailers and taking early delivery of stock from the manufacturers to reduce their financial burden

**5. Risk bearing:** Wholesaler bear the risk of loss of change in price, deterioration of quality, pilferage, theft Fire etc

**6. Grading**, Packing and packaging. By grading they sort out the stocks in terms of different size, quality shape and so on

**7. Dispersing and selling:** Dispersing the goods already stored with them to the retailers

**8. Market information** Finally providing the market information to the manufactures

**Services of wholesalers:**

**A. Services to Manufacturers:**

1 The wholesaler helps the manufacture to get the benefit of economies of large scale production

2 Wholesalers helps the manufactures to save his time and trouble by collecting orders from large number of retailers on behalf of the manufactures

3 The wholesaler provides market information to the manufactures which will helps him to make modifications in his product

4 The wholesaler buys in large quantities and keeps the goods in his warehouses This relieves the manufacturer the risk of storage and obsolescence

5. The wholesales helps to maintain a steady prices for the product by buying the product when the prices are low and selling when the prices are high

**B. Services to Retailers:**

1. He gives valuable advices to the retailers on his business related matters

2 He helps the retailer to get the goods very easily and quickly

3 He render financial assistance to the retailer by granting credit facilities

4 The wholesalers bears the risk associated with storage and distribution of goods to a certain extend

5. The wholesaler helps the retailers to keep price steady

**RETAILERS:**

The term 'retail' implies sale for final consumption A retailer is the last link between final user and the wholesaler or the manufacturer According to Professor William Standton, "retailing includes all activities directly related to the sale of goods and services to the ultimate consumers for personal or non business use " In other words retailer is one whose business is to sell consumers a wide variety of goods which are assembled at his premises as per the needs of final consumers In India, Most of the Indian retail outlets are owner managed and have few or no sales assistant Most important issues of these outlets are those of inventory management and funds management.

**Functions of retailers:**

**1. Buying and Assembling**:- A retailer buys goods from the best and most dependable wholesalers and assemble the goods in a single shop

**2. Warehousing** It helps the retailer to ensure adequate and uninterrupted supply of goods

**3. Selling** A retailer sells the products in small quantities to the needy consumers

**4. Risk bearing:** It is the basic responsibility of a retailer to bear the risk arising out of physical deterioration and changes in prices.

**5. Sales promotion**. Retailer undertakes some sales promotion through displaying of goods in the shop, distribution of sales literature, introduction of new product etc

**6. Financing:** A retailer granting credit in liberal terms to the consumer and it helps the consumers a lot to purchase the required goods.

**7. ~~Supply of market information~~:** As being in close and constant touch with the consumers, a retailer can supply the market related information to the wholesalers and manufactures at the earliest

**8. Grading and Packing** Retailers undertake second round grading and packing activities left by the manufacturers and wholesalers

**Services rendered by Retailers:**

A retailer render a number of services to the manufacturers, wholesalers and to the final users These services are outlined below -

**A. Services to the manufactures and wholesalers:**

**(1). Providing information** Retailer do provide the wholesalers and manufactures the

information about the latest consumer movements and it helps the manufactures to produce goods according to the needs of consumers

**(2) Looks after the distribution process.** A retailer, in general, looks after the entire distribution process and it helps the manufactures to concentrate on production.

**(3 )Creation of demand.** By giving local ad and display of goods, retailers helps to create demand for the goods

**(4)A big relief.** A retailer gives a relief to the manufacturers and wholesalers from the problem of selling goods in small quantities

**B. Services to the consumers:**

**(1)No need to store goods**· A retailer holds goods on behalf of the customers at a convenient place and in convenient lot Hence, the consumer need not buy and stock in large quantity.

**(2)Largest choice**· Retailers collects products of different manufactures and it enables the consumers to have a largest choice at cost, quality and so on.

**(3) Providing information.** A retailer supplies information about the introduction of a new product in the market and its features

**(4)Granting credit** Most of the retailers granting credit facilities to regular customers

**(5) After sale services**· In certain cases a retailer provides after sales services to the ultimate consumers to ensure the customers shop loyalty.

## TYPES OF RETAILERS

The retailers can be classified in to Small scale retailers and large scale retailers

**1. Small Scale Retailers**. It includes

**(a) Unit stores** These are the retail stores run on proprietory basis dealing in general stores or single line stores

**(b) Street traders**· They are the retailers who display their stock on foot paths or the side walks of the busy street

**(c) Market traders**. These retailers open their shops on fixed days or dates in specified areas The time interval may be week, or a month

**(d) Hawkers and pedlars:** This type of retailers do not have any fixed place of business They carry goods from one place to another. They keep on moving from locality to locality

**(e) Cheap-jacks** Cheap jacks is retailer who has fixed place of business in a locality but goes on changing his place to exploit the market opportunities

**2. Large scale retailers**. It includes

**(a)Departmental stores** A departmental stores carries several product line, invariably all that is required by a typical house hold. It includes food, clothing, appliances, other house hold goods, furnishings and gifts etc It is a central location and a unified control In a typical department store each product line is managed independently by specialist buyers

**(b)Multiple shops** It is a chain of retail store dealing in identical and generally restricted range of articles operating in different localities under central ownership and control It works on the principles of centralized buying and administration and decentralized selling It is also known as chain store

**(c)Mail order houses**. Here, the customers do not visit the seller's premises and there is no personal inspection of goods before the purchase. Orders are received from customers through post and the goods are also sold through post The transaction is settled through postal medium Eg Leather goods, ready made garments etc

**(d)Consumer co-operatives** These are the stores owned by a group of consumers themselves on cooperative principles. Here the store purchasing in bulk quantity and sells it to the consumers at a reasonable price It is formed to eliminate the exploitation of middlemen

**(e)Super markets**: This is a large, low cost, low margin, high volume, self service operation designed to serve customer's need for food laundry and house hold products. The wide range of product mix carried by these stores make them a favorite retail outlet

**(f) Discount stores**. Discount stores are the ones that sell standard merchandise at lower prize than conventional merchants by accepting lower margins but pushing for higher sales volume

**(g)Convenience store** These are generally food stores that are much smaller in size than in supermarkets They are conveniently located in residential areas Due to a high degree of personalized service and home delivery by store clerk, these stores fill in a very important need of a house wife.

**(h) Speciality store** These are ones that carry a narrow product line with a deep assortment within that line. According to some marketing thinkers, the future scenario belongs to super speciality store as they provide increasing opportunities for market segmentation, focused marketing, and creation of brand equity

## 5.9 FACTORS INFLUENCING CHOICE OF DISTRIBUTION CHANNEL

It is very important to select a channel for the distribution of goods and services to the ultimate consumers in an effective way The marketer has to select the most suitable channel While selecting the channel of distribution, the marketer has to consider the following factors

**1. Nature of Product** The selected channel must cope up perish ability of the product. If a commodity is perishable, the producer prefer to employs few middlemen For durable and standardized goods, longer and diversified channel may be necessary If the unit value is low , intensive distribution is suggested If the product is highly technical, manufacture is forced to sell directly, if it is not highly technical, intensive distribution can be selected Seasonal products are marketed through wholesalers

**2. Nature of market** If the market is a consumer market, then retailer is essential If it is an industrial market, we can avoid retailer If consumers are widely scattered large number of middlemen are required When consumers purchase frequently, more buyer seller contacts are needed and middlemen are suggested

**3. Competitors' Channel** The distribution channel used by the competitors will influence the channel selection There is nothing wrong in copying the channel strategy of the competitor if it is a right one

**4. The financial ability of channel members** Before selecting the channel, the manufacture has to think about the financial soundness of the channel members In most of the case financial assistance are required to the channel members in the form of liberal credit facilities and direct financing

**5. The Company's financial position** A company with a strong financial background can develop its own channel structure Then there is no need to depend other channel intermediaries to market their product

**6. Cost of Channel:** The cost of each channel may be estimated on the basis of unit sale The best type of channel which gives a low unit cost of marketing may be selected

**7. Economic factors** The economic conditions prevailing in he country have bearing on channel selection decision During the period of boom, it is better to depend channels directly During the periods of deflation direct relation with the consumers are desirable

**8. The legal restrictions** Before giving the final shape to channels of distribution, we have to consider the existing legal provisions of the various Acts For eg MRTP Act prevent channel arrangements that tend to lessen competition, create monopoly and those are objectionable to the very public interest

**9. Marketing policy of the company** The marketing policy of the company have a greater and deeper bearing on the channel choice. The marketing policies relating to channels of distribution are advertising, sales promotion, delivery, after sale service and pricing A company has a heavy budget on advertising and sales promotion, the channel selected is bound to be direct as it requires a few layers of people to push the product

## 5.10 PROMOTION

### Meaning and Definition.

Promotion is a term taken from Latin word promovere It means 'move towards' In marketing, promotion means all those tools that a marketer uses to take his product from the factory to the customer and hence it involves advertising, sales promotion, personal selling, and public relation It is necessary to flow the information about the product from the producer to the consumer either along with the product or well in advance of the introduction of the product This role is played by promotion.

In the words of Masson and Ruth, "Promotion consists of those activities that are designed to bring a company's goods or services to the favorable attention of customers"

### Importance of Promotion:

It may be studied in the following heads -

**1. Importance to Business** - Now a days, it is very necessary to communicate information regarding quality, features, price uses etc of the product to the present and potential customers Then only the consumers will select the product from a wide range of competing products Most modern institutions cannot survive in the long run without performing promotion function effectively

**2. Economic importance** In economic sense, it helps to generate employment opportunities to thousands of people As a result of promotion sales will increase and it brings economies in the production process and it reduces the per unit cost of product

**3. Social importance** Promotion has become an important factor in the campaign to achieve some socially oriented objectives For eg Ad against smoking, drinking etc It also helpful to provide informative and educational service to the society

**4. Importance to non business organizations** The non business organizations like govt agencies, religious institutions, educational institutions etc also realized the importance of promotion and they are using the various elements of promotion mix very widely

## PROMOTION MIX

Firms select a mix of promotional tools to effectively communicate with their target customer group The different elements of this group are

1 Advertising

2 Personal selling

3 Sales Promotion

4 Public relations and

5 Direct Marketing

### Factors To Be Considered While Selecting A Promotion Mix:

**1. Nature of the Product** - The product may be consumer product or industrial product, convenient goods or specialty goods, simple or technical goods etc. In each case, the promotion mix element may vary

**2. Overall marketing strategy** - It means, whether the firm wishes to "push" the product or create "pull" for the product Depending upon the strategy, the elements of promotion mix will vary

**3. Buyer readiness stage:-** The choice of different elements of promotion mix is depend on the buyer's readiness and awareness of the brand

**4. Product life cycle stages** - Different elements of promotion mix were used in different stages of product life cycle

**5. Market size** -In narrow market, direct marketing is more effective For a market having large number of buyers the promotion tool is mainly advertising

**6. Cost of Promotion elements** - The cost of different tools is very important while selecting the Promotion mix

## 5.11 ADVERTISING

It is a paid form of mass communication and can be traced to an identified sponsor Now a days Advertising plays a significant role in awareness creation and attitude formation In a macro concept, it stands for the managerial function of an organization intending to send information to the other members of the society

American Marketing Association defined it as, "Any paid form of non -personal presentation of ideas, goods, or services by an identified sponsor " In the words of Albert Lasker," Advertising is salesmanship in print, driven by a reason why?"

### 5.11.1 Features of Advertising:

1 It is a mass communication medium.

2. It is a salesmanship in print

3 It is a paid form of communication by an identified sponsor

4 It is a non personal communication.

5. It helps to stimulate sales.

6 It may be written or spoken

### 5.11.2 Role/ Advantages /Importance Of Advertising

Advertising is an integral part of our social and economic system,. As a powerful technique of promoting sales, it has been doing wonders in the domain of distribution. The role of advertising can be analysed from five distinct angles.

**1. Manufactures and Advertising(Advantages to Manufactures):**

a It maintains the existing market and explores the new

b. It increases the demand for the product

c. It helps to build up or increase goodwill of the company.

d. It controls product price.

e It helps to introduce a new product into the market

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**2. Middlemen and Advertising(Advantages to Middlemen):**

a It guarantees quick sales

b It acts as a salesman

c It increases the prestige of the dealers

d It makes retail price maintenance possible

e It enables the dealers have a product information

**3. Sales-force and Advertising(Advantages to salesmen)**

a It creates a colourful background for a salesmen to begin his work

b It reduces his burden of job

c It helps to develop self confidence and initiative among the salesmen

**4. Consumers and Advertising(Advantages to consumers):**

a It ensures better quality product at reasonable price

b It provides product related information to the customers and thereby makes the purchasing an easy task

c It helps the consumers to save time by providing information related to the availability of product

d Helps the consumers in intelligent buying

**5. Society and Advertising(Advantages to society):**

a It helps to uplifts t he living standards

b It helps to generate gainful employment opportunities

c It provides new horizons of knowledge

d It up-holds the culture of a nation

**5.11.3 The Advertising Copy:**

Ad Copy is the soul of any advertisement An advertisement copy is all the written or spoken matter in an advertisement expressed in words or sentences and figures designed to convey the desired messages to the target consumers A good ad copy has the following attributes

**1. It is brief:** Being brief is not dropping words or chopping sentences, It is the work of eliminating and substituting the words with out jeopardizing the meaning

**2. It is clear** A clear copy is one which is easily and quickly read and grasp by the readers

**3. It is apt** Writing an apt copy is the art of putting in the words that create strong desire to possess the product where the product features satisfy the consumer's desire to possess

4 **It is honest:** Credibility of an ad message is decided by the extend of honesty

5 **It is conforming** Every ad copy is to conform to standards, rules and regulations acceptable to the advertisement media and the laws of the land

**Unique Selling Proposition(Usp):**

It is that central idea around which the advertising campaign is built. The big selling idea is known as USP It is the heart of advertising campaign It is an offer that an advertiser makes to his consumers which is unique in relation to the competing offer or offers and promises to deliver a certain distinctive package of satisfaction Eg. MRF company says about its tyres as, 'the tyre with muscles' , "The beauty soap of film stars"(Lux soap)

**Product Positioning:**

It refers to the placement of company product or products in the minds of target consumers relative to the competitive products , as having certain distinctive benefits and want satisfying potential

Positioning represents more a state of mind or image than different ingredients or attributes, such a state of mind is derived from advertising Advertising is an instrument positioning or repositioning a product or products in the minds of consumers

## 5.12 PERSONAL SELLING

Personal selling is the art of convincing the prospects to buy the given products and services Though it is basically a method of communication, it is two way as it involves direct face to face contact between the salesman and the prospect It is the ability to convert human needs into wants It is the process of contacting the prospective buyers personally and persuading them to buy the products

According to American Marketing Association," Personal selling is the oral presentation in a conversation with one or more prospective purchasers for the purpose of making sales, it is the ability to persuade the people to buy goods and services at a profit to the seller and benefit to the buyer"

In the words of Garfield Blakde, "Salesmanship consists of winning the buyers confidence for the seller's house and goods, thereby winning the regular and permanent customer "

### 5.12.1 Features Of Personal Selling:

1 It is one of the important tools for increasing sales

2 It is a two way communication between salesmen and the prospect

3. It is a persuading process to buy the goods and services

4 The objective of personal selling is to protect the interest of both seller and buyer

5. The essence of personal selling is interpretation of product and service features in terms of benefit and advantages

### 5.12.2 Process Of Personal Selling

Sellıng ıs the sequence of steps ınvolved ın the conversıon of human desıre ınto demand for a product or servıce. Personal sellıng process ınvolves the followıng stages

**1. Prospecting**· It ıs the work of collecting the names and addresses of persons who are lıkely to buy thefirm's product of services While collectıng the detaıls, 'suspects' must be separated from 'prospects' to avoıd waste of tıme

**2. Pre approach**: Pre approach ıs to get more detaıled facts about a specıfic ındıvıdual to have effectıve sales appeal on hım or her It ıs closer look of prospects lıke habıts, financıal status, socıal esteem, famıly background, materıal status, tastes and preferences etc

**3. Approach:** Approach means the meetıng of the prospect ın person by the salesmen It ıs a face to face contact with the prospect to understand hìm better

**4. Presentation and demonstration** A good sales presentatıon ıs one that not only gıves all the benefits that the prospect gets but also proves to the latter that he or she wıll better off after the product ıs bought and used An effectıve sales presentatıon demands the sales person use skılls lıke presentatıon and explanatıon.

**5. Managing objections**: Thıs ıs the most ımportant stage of personal sellıng For every actıon of salesman there ıs prospect's pro actıon or reactıon, ıe, approval or dısapproval An efficıent sales man has the abılıty to ıdentıfy the reasons for raısıng objectıons by the prospects and the ways to overcome these objectıons

**6. Sale** If all the above stages have been concluded successfully, then the next stage ıs ultımate sale of the product.

### 5.12.3 Merits Of Personal Selling:

**1. Flexibility and adaptability:** It ıs capable of provıdıng more flexıbılıty and adaptabılity

**2. Minimum waste** The chances of wastage ıs mınımum ın case of personal sellıng whıle comparıng to other methods of sales promotıon

**3. Acts as feedback** Beıng ın dırect contact wıth the consumers, he can understand the feelıng and reactıons of the customers It helps to modıfy the product accordıng to the requırements of customers.

**4. Creates lasting impression:** It helps to create a long lastıng relatıonshıp wıth the customers through the personal contact of salesmen

### 5.12.4 Limitations Of Personal Selling:

**1. It is expensive**: Personal selling as a method of promotion is quite expensive Getting salesmen and retaining him for a long period is very difficult and expensive

**2. Difficulty of getting right kind of salesman** In practice, it is very difficult to get a trained salesmen from company's point of view

**3. More administrative problems** Personal selling involves more administrative problems than impersonal selling

## 5.13 SALES PROMOTION

Sales promotion is another major component of promotion mix. The phrase sales promotion has a distinct meaning It stands for all those activities that supplement, co-ordinate and make more effective the efforts of personal selling and advertising It collectively comprises of the tools used to promote sales in a given territory and time It consists of short term incentives designed to achieve a specific marketing goal in the immediate future.

According to American Marketing Association," those marketing activities other than personal selling, advertising and publicity that stimulate consumer purchasing and dealer effectiveness such as display, shows and exhibitions, demonstrations and various non-recurrent selling effort in the ordinary routine."

### 5.13.1 Role/Advantages Of Sales Promotion

The role or advantages of sales promotion to various parties like manufactures, middlemen and consumers are given below

**1. Manufacturers and sales promotion.**

(i) It helps to retains the existing customers

(ii) It helps to create new customers

(iii) It promote sales

(iv) It helps to enhance the goodwill of the firm

(v) It helps to slashes down the cost

(vi) It helps to face the competition

**2. Middle men and sales promotion:**

(i) It reduces strain of the middlemen to a greater extend

(ii) It helps to increase the sales of middlemen

(iii) It builds and enhance the goodwill of the shop

(iv) It gives some personal benefits to the middle men.

**3. Consumers and sales promotion**

(i) It helps to improve the standard of living of people by making available goods and services at least cost

(ii) It gives knowledge of new products available in the market

(iii) It gives both cash and non cash incentives

(iv) It helps to get more credit facility and special concession because of his brand and store loyalty

### 5.13.2 Disadvantages Of Sales Promotion·

1. It has the shortest life impact as promotion tool like advertisement

2 It is only a supplementary device of personal selling and advertising

3 In most of the cases, too much sales promotion may damage the brand image

4 Sales promotion techniques are non-recurring in their nature

### 5.13.3 Sales Promotion Tools (Types/Kinds Of Sales Promotion):

The sales promotion tools can be seen from the angle of dealers, consumers and sales force

**1. Dealer promotion/Trade promotion** Trade promotion objectives are to motivate market intermediaries to invest in the brand and aggressively push sales It includes

**(a) Price deals** Under this method, special discounts are offered over and above the regular discounts

**(b) Free goods**· Here, the manufactures give attractive and useful articles as presents to the dealers when they buy a certain quantity

**(c) Ad Materials**. In this case, the manufacturer distributes some ad materials for display purpose

**(d) Trade allowance:** It includes buying allowance, promotional allowance and slotting allowance

**(e) Dealer contests** It is a competition organized among dealers or salesmen

**(f) Trade shows** Trade shows are used to familiarize a new product to the customers.

**2. Consumer Promotion:** The broad objective of consumer promotion is to create pull for the brandand it includes-

**(a) Rebates** Simply it is a price reduction after the purchase and not at the retail shop

**(b) Money refund offer** Here, if the customer is satisfied with the product, a part or whole of the money will be refunded

**(c) Samples** While introducing a new product, giving samples to the customers at their doorstep.

**(d) Price packs:** In this method the customer is offered a reduction from the printed price of product.

**(e) Premium offer** Here goods are offered at a lower price or free as an incentive to purchase a special product

**(f) Consumer contests** Various competitions are organized among the customers The winners are given prizes.

**(g) Free trials** In this case, inviting the buyers to try the product without cost

**3. Sales force promotion**. It includes

**(a) Sales force contests** Sales contests are declared to stimulate the sales force increase their selling interest.

**(b) Bonus to sales force** Bonus is the extra incentive payment made for those who cross the sales quota set for a specific period

**(c) Sales meeting conventions and conferences** Sales meeting and conferences are conducted with a view to educate, train and inspire the salesmen.

## 5.14 PUBLIC RELATION

It is the actions of a corporation, store, government, individuals, etc in promoting goodwill between itself and the public, the community, employees, customers, etc It can be defined as the practice of managing communication between an organization and its public Public relation is used to build rapport with employees, customers, investors, or the general public This method of marketing does not aim at promoting a single product/ service but the company as a whole

This is done by spreading a positive feel about the company through various stories and articles or positive feedback from customers about the company in different media channels In comparison to advertising, PR is a very cost effective method of marketing A full page advertisement of a product may fail to attract customers attention, but a positive response about the same from a satisfied customer when appears in the form of an article in the same news paper will work wonders for the company PR is quite understandably considered as a very genuine method of marketing It creates a favorable atmosphere for conducting business of the firm

According to UK Institute of Public relation, " It is the deliberately planned and sustained efforts to establish and maintain mutual understanding between the organisation and its public "

### 5.14.1 Advantages of Public relations:

**1. Credibility** The information communicated through public relation department is more reliable and it has more credibility. **For eg.**an article in newspapers or magazines discussing the virtues of aspirin may be perceived very much as more credible than an ad for a particular brand of aspirin

**2. Cost:** In both absolute and relative terms, the cost of PR is very low, especially when the possible effects are considered While a firm can employ advertisement agencies and spend millions of dollars on advertisements, for smaller companies, this form of communication may be the most affordable alternative available

**3. Lead Generation :** Information about the technological innovations, medical break-through and the like results almost immediately in a multitude of inquiries These inquiries may give the firm some quality sales lead

**4. Ability to reach specific groups:** Because some products appeal to only small market segments, it is not feasible to engage in advertising and / or promotions to reach them. If the firm does not have the financial capabilities, to engage in promotionalexpenditures, the best way to communicate to these groups is through PR

**5. Image Building:** Effective PR helps to develop positive image for the organization A strong image is insurance against later mis-fortunes

**6. Stimulate awareness:** Public relation techniques helps to stimulate awareness among the customers regarding the products of the company and thereby creating demand for your product

### 5.14.2 Functions of public relations

The functions of public relations is given below.-

1. Creating awareness for a company or client and building a positive image for them through articles and stories in the various channels of media

2. Keeping an eye on all media channels for any public feedback on the client company or its products

3. Crisis management in cases where the company may be endangered.

4. Building goodwill and rapport with customers through special events, charity and community work

### 5.14.3 Types of public relation tools:

The important types of tools available to carry out the public relations function include:

1. Media Relations

2. Media Tours

3. Newsletters

4. Special Events

5. Speaking Engagements

6. Sponsorships

7. Employee Relations

8. Community Relations and Philanthropy

## 5.15 FACTORS AFFECTING PROMOTION MIX DECISIONS

Promotion mix includes all those activities undertaken to promote sales There are two types of promotion blend – Push blend and Pull blend A push blend is related to personal selling and an Pull blend give emphasis on impersonal selling There are many factors which influence the promotion mix The important factors among them are briefly explained below -

**1. Nature of the Market:** It is an important factor which affect the promotion mix Depending up on the customers the promotion strategy may vary For individual customers the strategy may vary according to the age, sex, income etc For industrial customers it directly depends up on size of the company, bargaining power etc

**2. Nature of the Product:** Depending up on the nature of product, the promotion mix may vary For marketing consumer goods, a mass advertisement is necessary But at the same time marketing of industrial goods and speciality goods requires personal selling Complex and complicated products are also require personal selling.

**3. Market size:** If the market size is comparatively very small, then direct selling is used For a market having large number of buyers, advertising is the most suitable promotion tool

**4. Buyer readiness stage** The choice of different elements of the promotion mix is also dependent on the buyer's readiness and awareness of the brand Advertising will play a major role in creating awareness, while demonstration and samples will helps to bring about a change in the behavioral level

**5. Overall marketing strategy:** It means, whether the firm wishes to "push "the product or create a "pull" for the product. Often the marketing strategy of a firm is a combination of both these strategies

**6. Product life cycle stages** This will also play a role in deciding on the promotion mix. For eg In the introduction stage, advertising and publicity are very important But in the maturity stage, sales promotion and personal selling are very necessary

**7. Cost** Cost of promotion element is also very important If the total cost incurred for using a particular element of promotion tool is not affordable to the manufacturer, then it is better to select the next best promotion mix.

## 5.16 DIRECT MARKETING

Direct marketing is a channel-agnostic form of advertising that allows businesses and non profits organisation to communicate straight to the customer, with advertising techniques such as mobile messaging, email, interactive consumer websites, online display ads, fliers, catalog distribution, promotional letters, and outdoor advertising Direct marketing is practiced by businesses of all sizes — from the smallest start-up to the leaders on the Fortune 500 A well-executed direct advertising campaign can prove a positive return on investment by showing how many potential customers responded to a clear call-to-action Direct marketing is concerned with establishing an individual relationship between the business offering a product or service and the final customer

Direct marketing has been defined by the Institute of Direct Marketing as "The planned recording, analysis and tracking of customer behaviour to develop a relational marketing strategies"

### 5.16.1 Direct Marketing Channels:

Any medium that can be used to deliver a communication to a customer can be employed in direct marketing and it includes:

**1. Email Marketing:** Sending marketing messages through email is one of the most widely used direct-marketing methods According to one study email is used by 94% of marketers, while 86% use direct mail

**2. Mobile Marketing:** Through mobile marketing, marketers engage with prospective customers and donors in an interactive manner through a mobile device or network, such as a cell phone, smart phone , or tablet. Types of mobile marketing messages include: SMS (short message service) — marketing communications are sent in the form of text messages, also known as texting MMS. (multi-media message service)

**3. Direct Mail:** The term "direct mail" is used to refer to communications sent to potential customers or donors via the postal service and other delivery services. Direct mail is sent to customers based on criteria such as age, income, location, profession, buying pattern, etc. Direct mail includes advertising circulars, catalogs, free-trial CDs, pre-approved credit card applications, and other unsolicited merchandising invitations delivered by mail to homes and businesses

**4. Telemarketing**. Another common form of direct marketing is telemarketing in which marketers contact customers by phone The primary benefit to businesses is increased lead generation, which helps businesses increase sales volume and customer base

**5. Voicemail Marketing**: Voicemail marketing emerged out of the market prevalence of personal voice mailboxes, and business voicemail systems Voicemail marketing presented a

cost effective means by which to reach people directly, by voice

**6. Direct Response TV** : Direct marketing via television (commonly referred to as DRTV) has two basic forms long form (usually half-hour or hour-long segments that explain a product in detail and are commonly referred to as infomercials) and short form, which refers to typical 30-second or 60-second commercials that ask viewers for an immediate response (typically to call a phone number on screen or go to a website)

**7. Catalogue marketing** In catalogue marketing , an organisation provides a catalogue from which customers make selection and place orders by mail or telephone It involves selling of products through catalogues mailed to selected customers.

# MODEL QUESTION PAPER

## FINANCIAL MARKET AND MARKETING MANAGEMENT

**TIME :2 HOURS AND 30 MINUTES** **MARKS: 70 MARKS**

**PART – A** **(2*12=24 MARKS)**

Answer Any **Two** Questions

1 Discuss the new financial products and services

2 Explain the various functions of merchant banker

3 What are the stages in the product life cycle- Explain

**PART – B** **(2*7=14 MARKS)**

4 What are the benefits of credit rating?

5 Distinguish between forward contract and future contract

6 What are the basis for market segmentation? Explain briefly

**PART – C** **(4*5=20 MARKS)**

Answer any **Five** questions

7 a What are the process of personal selling?

b What do you mean by marketing mix?

c What are the importance of marketing?

d State the meaning of merchant banking

e Give the meaning of New Issue Market

f. State the differences between open and close ended mutual fund

g Explain underwriting

**PART – D** **(2*6=12 MARKS)**

Answer any **Six** questions

8 a Capital market

b Financial Services

c Leasing

d CRISIL and ICRA

e Money market

f Industrial Goods

g Branding

h Sales Promotion

**SCHEME OF VALUATION**

**PART - A**

**1.NEW FINANCIAL PRODUCTS AND SERVICES**

Today, the importance of financial services is gaining momentum all over the world In these days of complex finance, people expect a Financial Service Company to play a very dynamic role not only as a provider of finance but also as a departmental store of finance With the injection of the economic liberation policy into our economy and the opening of the economy to multinationals, the free market concept has assumed much significance As a result, the clients both corporates and individuals are exposed to the phenomena of volatility and uncertainty and hence they expect the financial service company to innovate new products and service so as to meet their varied requirements

As a result of innovations, new instruments and new products are emerging in the capital market. The capital market and the money market are getting widened and deepened Moreover, there has been a structural change in the international capital market with the emergence of new products and innovative techniques of operation in the capital market Many financial intermediaries including banks have already started expanding their activities in the financial services sector by offering a variety of new products As a result, sophistication and innovations have appeared in the arena of financial intermediations Some of them are discussed below

**(i) Merchant Banking :** A merchant banker is a financial intermediary who helps to transfer capital from those who posses it to those who need it Merchant banking includes a wide range of activities such as management of customers securities, portfolio management, project counseling and appraisal, underwriting of shares and debentures, loan syndication, acting as banker for the refund orders, handling interest and dividend warrants etc Thus, a merchant banker renders a host of services to corporates and thus promotes industrial development in the country

**(ii) Loan Syndication :** This is more or less similar to 'consortium financing' But, this work is taken up by the merchant banker as a lead-manager It refers to a loan arranged by a bank called lead manager for a borrower who is usually a large corporate customer or a Government Department The other banks who are willing to lend can participate in the loan by contributing an amount suitable to their own lending policies Since a single bank cannot provide such a huge sum as loan, a number of banks join together and form a syndicate It also enables the members of the syndicate to share the credit risk associated with a particular loan among themselves

**(iii) Leasing :** A lease is an agreement under which a company or a firm, acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called "rental charges" The lessee cannot acquire any ownership to the asset, but he can use it and have full control over it he is expected to pay for all maintenance charges and repairing and operating costs In countries like the U S A , the U K and Japan equipment leasing is very popular and nearly 25% of plant and equipment is being financed by leasing companies In India also, many financial companies have started equipment leasing business Commercial banks have also been permitted to carry on this business by forming subsidiary companies

**(iv) Mutual Funds :** A mutual fund refers to a find raised by a financial service company by pooling the savings of the public It is invested in a diversified portfolio with a view to spreading and minimizing risk The fund provides investment avenue for small investors who cannot participate in the equities of big companies. It ensures low risk, steady returns, high liquidity and better capital appreciation in the long run

**(v) Factoring :** Factoring refers to the process of managing the sales ledger of a client by a financial service company In other words, it is an arrangement under which a financial intermediary assumes the credit risk in the collection of book debts for its clients The entire responsibility of collecting the book debts passes on to the factor His services can be compared to a del credre agent who undertakes to collect debts But, a factor provides credit information, collects debts, monitors the sales ledger and provides finance against debts Thus, he provides a number of services apart from financing

**(vi) Forfeiting :** Forfeiting is a technique by which a forfeitor (financing agency) discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills The forfeitor does so without any recourse to the exporter and the exporter is protected against the risk of non-payment of debts by the importers

**(vii) Venture Capital :** A venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project It is in contrast to the conventional "security based financing" Much thrust is given to new ideas or technological innovations Finance is being provided not only for 'start-up capital' but also for 'development capital' by the financial intermediary

**(viii) Custodial Services :** It is another line of activity which has gained importance, of late Under this, a financial intermediary mainly provides services to clients, particularly to foreign investors, for a prescribed fee Custodial services provide agency services like safe keeping of shares and debentures, collection of interest and dividend and reporting of matters on corporate developments and corporate securities to foreign investors

**(ix) Corporate Advisory Service :** Financial intermediaries particularly banks have set up corporate advisory service branches to render services exclusively to their corporate customers For instance, some banks have extended computer terminals to their corporate customers to that they can transact some of their important banking transactions by sitting in their own office As new avenues of finance like Euro loans, GDRs etc are available to corporate customers, this service is of immense help to the customers

**(x) Securitisation :** Securitisation is a technique whereby a financial company converts its ill-liquid, non-negotiable and high value financial assets into securities of small value which are made tradable and transferable A financial institution might have a lot of its assets blocked up in assets like real estate, machinery etc which are long term in nature and which are non-negotiable In such cases, securitisation would help the financial institution to raise cash against such assets by means of issuing securities of small values to the public Like any other security, they can be traded in the market it is best suited to housing finance companies whose loans are always long term in nature and their money is locked up for a considerable long period in real estates Securitisation is the only answer to convert these ill-liquid assets into liquid assets

**(xi) Derivative Security :** A derivative security is a security whose value depends upon the values of other basic variables backing the security In most cases, these variables are nothing but the prices of traded securities A derivative security is basically used as a risk management tool and it is resorted to cover the risk due to price fluctuations by the investments manager Just like a forward contract which is a derivative of a spot contract, a derivative security is derived from other trading securities backing it Naturally the value of a derivative security depends upon the values of the backing securities Derivative helps to break the risks into various components such as credit risk, interest rates risk, exchange rates risk and so on It enables the various risk components to be identified precisely and priced them and even traded them if necessary Financial intermediaries can go for derivatives since they will have greater importance in the near future In India some forms of derivatives are in operation

**(xii) New Products in Forex Market :** New products have also emerged in the forex markets of developed countries Some of these products are yet to make full entry in Indian markets Among them, the following are the important ones

**(a) Forward Contracts :** A forward transaction is one where the delivery of a foreign currency takes place at a specified future date for a specified price It may have a fixed maturity for e g 31st May or a flexible maturity for e g 1st to 31st May There is an obligation to honour this contract at any cost, failing which, there will be some penalty Forward contracts are permitted only for genuine business transactions It can be extended to other transactions like interest payments

**(b) Options :** As the very name implies, it is a contract wherein the buyer of the option has a right to buy or sell a fixed amount of currency against another currency at a fixed rate on a future date according to his option There is no obligation to buy or sell, but it is completely left to his option Options may be of two types namely call options and put options Under call options, the customer has an option to buy and it is the option to sell under put options Options trading would lead to speculation and hence there are much restrictions in India

**(c) Futures :** It is a contract wherein there is an agreement to buy or sell a stated quantity of foreign currency at a future date at a price agreed to between the parties on the stated exchange Unlike options, there is an obligation to buy or sell foreign exchange on a future date at a specified rate it can be dealt only in a stock exchange

**(d) Swaps :** A swap refers to a transaction wherein a financial intermediary buys and sells a specified foreign currency simultaneously for different maturity dates-say, for instance, purchase of spot and sale of forward or vice versa with different maturities Thus swaps would result in simultaneous buying and selling of the same foreign currency of the same value for different maturities to eliminate exposure risk It can also be used as a tool to enter arbitrage operations, if any, between two countries It can also be used in the interest rate market also

**(xiii) Lines of Credit (LOC) :** It is an innovative funding mechanism for the import of goods and services on deferred payment terms LOC is an arrangement of financing institution/bank of one country with another institution/ bank/agent to support the export of goods and services to as to enable the importers to import no deferred payment terms This may be backed by a guarantee furnished by the institution/bank in the importing country The LOC helps the exporters to get payment immediately as soon as the goods are shipped, since, the funds would be paid out of the pool account with the financing agency and it would be debited to the account of the borrower agency/importer whose contract for availing the facility is already approved by the financing agency on the recommendation of the overseas institution It acts as conduct of financing which is for a certain period and on certain terms for the required goods to be imported The greatest advantage is that it saves a lot of time and money on mutual verification of bonafides, source of finance etc It serves as a source of forex

## 2. FUNCTIONS OF MERCHANT BANKER

Setting up of new industrial units, expansion, diversification and modernisation of existing units have been the central plank of the rapid industrialisation in any economy This process besides adequate financial resources requires sound technical and managerial inputs Though, a number of financial agencies are instituted to cater to the needs of rapid industrialisation, the task of financing has become more complicated, thus requiring a fresh look. In view of increasing specialisation in every sphere the process of industrialisation from the primary planning stages of setting up a new unit to that of research and development including expansion, diversification or modernisation requires the services of specialists or professionals Thus, the need for having expert advice, guidance of specialists or professionals in the field has become an absolute necessity with rapid economic growth and spectacular industrial development in India It has also been necessitated by the plethora of regulations for industry, capital, issues, foreign investment and collaboration, amalgamations, Companies Act, SEBI, Government policy regarding backward area development, export promotion and import substitution etc A few agencies are able to provide expert advice in the diversified areas mentioned above But it is inconvenient to entrepreneurs industrialists to knock at the doors of several agencies in getting the guidance of specialists and professionals Hence, it is highly essential to provide expert advice in diversified areas under a single roof to provide a comfortable cushion to entrepreneurs to accelerate industrial development This is where merchant bankers come to picture Although is it is very difficult to spellout all the areas where merchant bankers can interact, yet, some important areas where merchant bankers have decisive role are discussed here These role can broadly be divided into two parts One is service based another is fund based

A. Service based Functions

**i) Project counselling**

The first step to launch a business unit is selection of a viable project Merchant bankers undertake this assignment on a very large scale since they have experts with them in diverse fields Project counselling covers a variety of sub assignments. Illustrative list of services which can be rendered under this category is

3

- Guidance in relation to project viability i e project identification and counselling It may be for setting up new units, expansion or improvement of existing facilities

- Selection of consultants for preparation of project reports/market surveys etc Sometimes merchant bankers also engage in preparation of project reports or market surveys

- Advice on various procedural steps including obtaining of governmental approvals clearance etc. e g for foreign collaboration

- Proposing a suitable capital structure laying broad as well as specific features

- Teachno- economic soundness of the project and marketing aspects Financial engineering i e selection of right mix of financing pattern specifically for short term requirements.

- Organisation and management set up for a strong base and efficient working of the project

**ii) Credit syndication**

Normally every project has to raise debt funds for different sources as per need Substantial debt raising may be required for a new and capital intensive project. For such project merchant bankers may undertake credit syndication Credit syndication is credit procurement service As per the requirements, such syndication can be from national as well as international sources Some of the important credit syndication services offered are.

- Preparing applications for financial assistance to be submitted to financial institutions and banks

- Monitoring the sanction of funds while acting as a specialised liaison agency

- Negotiating the term of assistance on behalf of client

- Post sanction formalities with these institutions and banks

- Assistance in drawl of term loans and or bridging loans

- Assessing working capital requirements and arranging it

Need of syndication arises due to the fact that specially in big projects one institution may hesitate to meet the whole debt requirement of the project They want to spread the risk. Further shortage of funds availability with one lender also requires credit syndication The merchant banker by rendering credit syndication services saves the time of the borrower

The modus operandi of a syndication is really quite simple The borrower approaches several banks which might be willing to syndicate a loan, specifying the amount and the tenor for which loan is to be syndicated On receiving a query, the syndicator scouts for banks who may be willing to participate in the syndicate Based on an informal survey, it communicates its desire to syndicate the loan at an indicative price to the corporate borrower, all in a matter of days After reviewing the bids from various banks, the borrower awards the mandate to the bank that offers him the best terms

The syndicator, on his part, can underscore his willingness to syndicate the loan on a firm commitment basis or on a best-efforts basis The former is akin to underwriting and will attract capital adequacy requirements That may reduce the bank's flexibility "In India, given the fact that banks may not be willing to maintain capital in the interim period, most syndicates the likely to be done on a best-efforts basis."

Best-efforts, as the name suggests, limits the obligation of the syndicator, as he is not compelled to provide the loan on his own, in case he fails to arrange the loan

However, more often than not, the syndicator would try to fulfill his commitments for the inability to do so would tarnish his reputation Once the syndicator has been awarded a mandate, the borrower has to sign a 'clear market clause' which stops him from seeking a syndicated loan from any other bank, till such time as the documentation for the syndication is drawn up by the syndicate manager This may take about threefour weeks

In the interim period, the syndicate manager gets the banks to agree to syndicating the loan It can do this on a 'broadcast' basis, by sending taxes to the concerned banks inviting participation If the company is well known, the loan uncomplicated and the market liquid, such a method would work well However, if the corporate tends to keep a low profile and the loan structure is complicated, the syndicate manager would have to woo the participant banks with offer documents or an information memorandum on the company The document is similar to a prospects but less detailed Nevertheless drawing up such a document does call for a lot of homework The syndicate manager has to be very careful because he can be held responsible for any inaccuracy or omission of material facts

The participants, after reviewing the prospects, decide whether or not to join the syndicate However, given the fact that most of the participants may be smaller Indian banks, they may take weeks to give the final nod Once the bank decides to become a member of the syndicate, it indicates the amount and the price that it is likely to charge on the loan. Based on information received from all participants, the syndicate manager prepares a common document to be signed by all the members of the syndicate and the borrowing company The document usually lists out details of the agreement with regard to tenor, interest prepayment clause, security, covenants, warranties and agency clause

**iii) Issue management**

Traditionally this is one of the main functions of merchant banker When ever an issue is made whether it is public issue or private placement and further whether it is for equity shares, preference shares or debentures, the merchant banker has a crucial role to play Raising of funds from public has many dimensions and formalities which are not possible for the concerned companies to comply with, where merchant banker comes to their rescue Marketing effort to convince the prospective investor needs special attention Here again merchant bankers are specialists The specific important activities related to issue management performed by merchant banks are mentioned here:

- Advise the company about the quantum and terms of raising funds
- Advise as to what type of security may be acceptable in the market as well as to the concerned lending institutions at the time of issue
- Advise as to whether a fresh issue to be made or right issue to be made or if both, then in what proportion, obtaining the desired consents, if any, from government or other authorities ? Advice on the appointment of bankers, brokers to the issue
- Advice on the selection of issue house or Registrar to the issue, printer advertising agency etc.
- Fixing the terms of the agencies engaged to facilitate making a public issue
- Preparation of a complete action plan and budget for total expenses of the issue
- Drafting of documents like prospectus, letter of offer and getting approval from concerned agencies.
- Assisting in advertisement campaigns, holding the press, brokers' and investors' conferences etc. for grooming the issue
- Advise the company for the issue period and days of opening and closing the issue
- Monitoring the collection of funds in public issue.
- Coordination with underwriters, brokers and bankers to the issue and stock exchange etc
- Strict compliance of post issue activities

**iv) Corporate counselling**

Although the functions discussed up till now are also covered under corporate counselling but here other dimensions will be deliberated Corporate counselling is to rejuvenate the corporate units which are otherwise having signals to low productivity, low efficiency and low profitability. The merchant bankers can play a substantial role in reviving the sick units They make mergers and acquisition exercise smooth, They can advise on improvement in the systems operating in managing the show of a corporate unit Some of the specific assignments for the merchant banker are

- Rejuvenating old line and ailing/sick unit or appraising their technology and process, ssessing their requirements and restructuring their capital base
- Evolving rehabilitation programmes/packages which can be acceptable to the financial institutions and banks
- Assisting in obtaining approvals from Board for Industrial and Financial Reconstruction (BIFR) and other authorities under the Sick Industrial Companies (special provisions) Act1985 (SICA)

- Monitoring implementation of schemes of rehabilitation
- Advice on financial restructuring involving redeployment of corporate assets to refocus companies line of business
- Advice on rearranging the portfolio of business assets through acquisition etc
- Assisting in valuing the assets and liabilities
- Identifying potential buyers for disposal of assets if required. Identify the candidates for take over
- Advice on tactics in approaching potential acquisition
- Assisting in deciding the mode of acquisition whether friendly or unfriendly or hostile.
- Designing the transaction to reap the maximum tax advantages Acting as an agent for leveraged buyout (LBO) involving heavy use of borrowed funds to purchase a company or division of a company.
- Facilitating Management Buy outs (MBO) i e selling a part of business to their own managers by a company
- Clearly spelling out organisation goals
- Evolving corporate strategies to achieve the laid down goals
- Designing or restructuring the organisational pattern and size.
- Evolving Management Information System

Corporate advisory services should offer real value addition to the client Highly specialised in nature, these services should be clearly distinguished from the gamut of other financial services offered by NBFCs such as underwriting or fund-based activities of leasing and hire purchase In India corporate advisory has a good potential. The Indian industry is going through an unprecedented churning, bracing itself for global com-petition The Indian corporate sector has been on a restructuring spree. Groups have been shedding companies. Companies in turn, have been dropping divisions as they struggle to become fit to survive in the new milieu Free pricing of issues and the opportunity to tap the international market through the Euro-issue route has greatly enhanced the need for expert advisory services. In areas of restructuring, strategic alliances and corporate planning is now advising foreign companies in their plans for development of infrastructure in India Merchant bankers have a great role to play.

Strategic product consolidation is another recent phenomenon Units in which the company does not plan to become a market leader are spun off to others A good corporate advisor is always on the alert to seize such opportunities The process of acquisition cannot be done overnight It requires a patient search for the right company which can be acquired, the proper evaluation of the financial impact of the acquisition, a sound strategy in blending the business acquired within the fold of the group, followed by negotiation and execution of the agreement Occasionally, advisory services are required in cases of splits within the family group In such cases, there is a need to split the company into different units amongst the disputing family members At the same time, the shareholders interest is to be kept in mind by the corporate advisor

**v) Portfolio management**

Merchant bankers as a body of professionally qualified persons also undertake assignments of managing an individual investor's portfolio Portfolio management is being practised as an investment management counselling in which the investor is advised to seek financial assets like government securities, commercial papers, debentures, shares, warrants etc that would grow in value and/or provide income. The investors whether local or foreigner with substantial amount for investment in securities seek portfolio management services of authorised merchant bankers The functioning of portfolio manager can be regulated or unregulated Portfolio manager may use totally his discretion or may act only after getting signal from investor for each transaction of sale or purchase. A diverse range of services which may be rendered by merchant banker include

- Advising what and when to sell and buy.
- Arranging sale or purchase of securities
- Communicating changes in investment market to the client investor
- Compliance of regulations of different regulating bodies for sale of purchase of portfolio
- Collection of returns and reinvest as per directions of clients
- Evaluating the portfolio at regular intervals or at direction of investors
- Advising on tax matters pertaining to income from and investment in portfolio
- Safe custody of securities.

**vi) Stock broking and dealership**

The merchant bankers who have requisite professional knowledge and experience may also act as share broker on a stock exchange and even as dealer for Over The Counter trading To venture into this area it is normally desired that the merchant banker has reasonable network Their actions and activities are regulated by rules and regulations of the concerned stock exchange They are at liberty to appoint sub brokers and sub dealers to ensure wider net work of their operations. They can be broker for inland as well as foreign stock exchanges In India the merchant bankers who desire to act as brokers are regulated by SEBI (Stock Broker and Sub-brokers) Rules 1992

**vii) Joint venture abroad**

Depending on economic and political considerations many countries may permit joint ventures by local businessmen abroad. Here again merchant bankers can play a decisive role They facilitate meeting of foreign partner, get sanctions under various provisions, make techno economic surveys, legal documentations under local as well as foreign legal provisions etc

**viii) Debenture trusteeship**

The merchant bankers can get themselves registered to act as trustee These trustees are to protect the interests of debenture holders as per the terms laid down in trust deed They are, as trustees, to undertake redressal of grievances of debenture holders. They are to ensure that refund monies are paid and debenture certificates are dispatched in accordance with the Companies Act Debenture trustees are expected to observe high standards of integrity and fairness in discharging their functions They can call for periodical reports from the body corporate. They charge fee for such services

**B. Fund based Functions**

**(i) Bill discunting**

Bill discounting is a service against which merchant banker has to arrange funds against the bills which have been discounted This service is undertaken by merchant bankers generally if bill market is big as well as mature. Otherwise bill discounting is undertaken by banks only Depending on their credibility they may also undertake the assignment of bill acceptance These bills accepted and or discounted can be foreign and merchant bankers can specify what types of bills they entertain They charge commission for these services

**(ii) Venture capital**

Venture capital is the organized financing of relatively new enterprises to achieve substantial capital gains Such new companies are chosen because of their potential for considerable growth due to advance technology, new products or services or other valuable innovations A high risk is implied in the term and is implicit in this type of investment Since certain ingredients necessary for success of such projects are missing in the begging but are added later on. Merchant bankers undertake to arrange and if necessary, to provide such venture capital since traditional sources of finance like banks, financial institutions or public issue etc may not be available. Since expected returns on projects involving venture capital is high, these are normally provided on soft terms Such scheme is also popular as seed capital or risk capital scheme Merchant bankers deeply study such proposals before releasing the money At opportune time such investment can be disinvested to keep the cycle of venture capital more on.

**(iii) Bought out deals**

When a promoter envisages that if public issue made to raise capital will not clinch, he may approach merchant bankers (bought out dealer or sponsor) and places the shares of company initially with him which are offered to public at a later stage, this route is known as bought out deal Many a time a syndicate of merchant bankers jointly sponsor a bought out deal to spread the risk involved In contract to venture capital, there is no role to be played by non traditional technology Such bought shares by sponsor can be disposed off at an opportune time on 'over the counter' or other stock exchanges

**(iv) Lease financing and hire purchase**

Depending on the funds available, merchant bankers can also enter the field of lease or hire purchase financing Lease is an agreement where by the lessor (merchant banker in our case) conveys to the lessee (the user), in return for rent, the right to use an asset for an agreed period of time On the other hand in hire purchase the user at the end of the agreed period has an option to purchase the asset which he has used till date The merchant bankers can advise the client to go in for leasing or hire purchase system of financing an asset A comparative study may be communicated to the prospective client showing benefits of these alternatives The client can also depend on merchant banker for acquiring the needed asset and complying with all formalities

**(v) Factoring**

Factoring is a novel financing innovation It is a mixed service having financial as well as non financial aspects On one hand it involves management and collection of books debts which arise in process of credit sale. The merchant bankers can take up this assignment and are required to perform activities like sales ledger administration, credit collection, credit protection, evolving credit policy, arranging letter of credit etc. On the other hand there is involvement of finance Against factored debts the merchant banker may provide advance with a certain margin. The released funds can be used by client to manage its liquidity and working capital Merchant bankers are entitled to service charges for factoring services

The merchant banker's role is thus to .

- Maintain the books of accounts pertaining to credit sales
- Make a systematic analysis of relevant information for credit monitoring and control
- Provide full or partial protection against bad debts and accepting the risk of non realization
- Provide financial assistance to the client
- Provide information about prospective buyers
- Provide financial counseling and assisting managing the liquidity

**vi) Underwriting**

It refers to a contract by means of which merchant banker gives an assurance to the issuing company that the former would subscribe to the securities offered in the event of non-subscription by the persons to whom it was offered The liability of merchant banker arises if the issue is not fully subscribed and this liability is restricted to the commitment extended by him The merchant bankers undertaking underwriting make efforts on their own to induce the prospective investors to subscribe to the concerned issue

Such assignment is accepted after evaluating viz

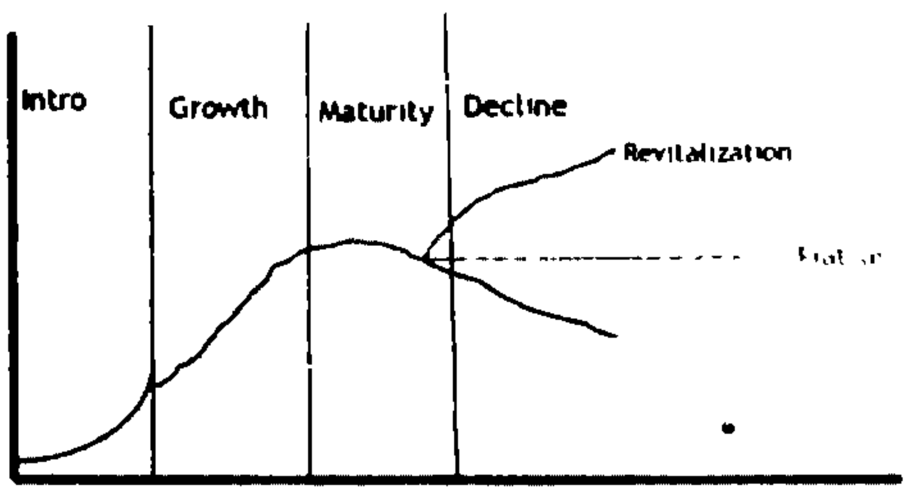
- Company's standing and its past record
- Competence of the management.
- Purpose of the issue
- Potentials of the project being financed
- Offer price and terms of the issue
- Business environment

The financial involvement of merchant banker in underwriting arises in case of development To get their blocked funds released, the merchant bankers have stock exchange as exit route They get underwriting commission

These are some of the prominent activities being undertaken by merchant bankers world over The practices may differ from country to country depending on maturity of financial sector of their economy The multifarious activities of the corporate sector and spectacular growth of industry gives new dimensions to merchant banking activities In the phase of globalisation of economies merchant bankers are facing new challenges The changing international financing environment has rather pushed merchant bankers to operate at international level creating more opportunities to serve the world business community in diverse ways

### 3. THE PRODUCT LIFE CYCLE

Products often go through a *life cycle* Initially, a product is introduced



Since the product is not well known and is usually expensive (e g , as microwave ovens were in the late 1970s), sales are usually limited Eventually, however, many products reach a *growth* phase—

sales increase dramatically More firms enter with their models of the product Frequently, unfortunately, the product will reach a ~~*maturity* stage where little growth will be seen~~ For example, in the United States, almost every household has at least one color TV set Some products may also reach a *decline* stage, usually because the product category is being replaced by something better For example, typewriters experienced declining sales as more consumers switched to computers or other word processing equipment The product life cycle is tied to the phenomenon of diffusion of innovation When a new product comes out, it is likely to first be adopted by consumers who are more innovative than others— they are willing to pay a premium price for the new product and take a risk on unproven technology It is important to be on the good side of innovators since many other later adopters will tend to rely for advice on the innovators who are thought to be more knowledgeable about new products for advice At later phases of the PLC, the firm may need to modify its market strategy For example, facing a saturated market for baking soda in its traditional use, Arm & Hammer launched a major campaign to get consumers to use the product to deodorize refrigerators Deodorizing powders to be used before vacuuming were also created

**Product Introduction/ Development Stage**

This is the first stage in product life cycle Before a new product is introduced in the market place, it should be created first The processes involve in this stage include generation of idea, designing of the new product, engineering of its details, and the whole manufacturing process This is also the phase where the product is named and given a complete brand identity that will differentiate it from the others, particularly the competitors Once all the tasks necessary to develop the product is complete, market promotion will follow and the product will be introduced to the consumers Product development is a continuous process that is essential in maintaining the product's quality and value to consumers This means that companies need to continuously develop or innovate their products to out ride new and existing competitors

**Product Growth Stage**

This is a period where rapid sales and revenue growth is realised However, growth can only be achieved when more and more consumers will recognize the value and benefits of a certain product In most cases, growth takes several years to happen, and in some instances, the product just eventually died without achieving any rise in demand at all Hence, it is important that while the product is still in the development and introduction stages, a sound marketing plan should be put in place and a market and primary demand should be established

**Product Maturity and Saturation Stage**

In the maturity stage, the product reaches its full market potential and business becomes more profitable During the early part of this stage, one of the most likely market scenarios that every business should prepare for is fierce competition As business move to snatch competitor's customers, marketing pressures will become relatively high This will be characterised by extensive promotions and competitive advertising, which are aimed at persuading customer to switch and encouraging distributors to continue sell the product In the middle and late phases of the maturity stage, the rate of growth will start to slow down and new competitors will attempt to take control of the market In most cases, many businesses falls and lose money in these stages as they focus more on increasing advertising spending in hope of maintaining their grip of the market

**Product Decline Stage**

The decline stage is the final course of the product life cycle This unwanted phase will take place if companies have failed to revitalize and extend the life cycle of their products during the maturity stage's early part Once already in this phase, it is very likely that the product may never again recover or experience any growth, eventually dying down and be forgotten

**PART – B**

**4 Benefits Of Credit Rating:**

The following are the benefits of credit rating .

1 Low Cost Information Credit rating is a source of low cost information to investors The collection, processing and analysis of relevant information is done by a specialised agency which a group of investors can trust

2 Quick Investment Decision In the present day complex world ratings enable investors to take quickest possible decisions based on associated ratings

3. Sources of Additional Certification Credit rating agency provides additional certification to the issue of debt/ financial instrument A highly rated firm can enter the market with great confidence Indian experience shows that individual companies that use credit rating, benefit a great deal by getting larger amount of money from a wider audience at a lower cost

4. Increase the Investors Population A sound credit rating system gives an alternative method to name recognition as a determining factor in making investment and helps increase the population of those investing in debt obligations of the company

5 Forewarns Risks Credit rating acts as a guide to companies which get a lower rating It forewarns the management of the perception of risk in the market and prompts to take steps on their operating and marketing risks and thereby changes the perception in the market

6 Encourages Financial Discipline Rating also encourage discipline among corporate borrowers to improve their financial structure and performance to obtain better rating for their debt obligations

7 Merchant Bankers Job Made Easy Merchant bankers and brokers will be relieved of the responsibility of guiding investors as to the risk of a particular investment Merchant bankers and brokers, in the absence of objective information, go on the basis of name recognition in guiding their clients With the advent of credit rating, what they would be required to do is to bring to the attention of their clients the ratings of debt obligations

8 Investors Protection Hiring of credit agency implies that the management of the company is ready to show its operations for independent scrutiny So, the investors who are not provided with confidential information can have overall assessment based on ratings A credible and objective rating agency can provide increased disclosure, better accounting standard and improved investor protection.

9 Foreign Collaborations made Easy The foreign collaborators always ask for credit rating while negotiating with an Indian company Credit rating enables to identify instantly the relative credit standing of the company The importance of credit rating is being increasingly recognized in the Euro-markets

10 Benefits the Industry as a Whole Relatively small and unknown companies use ratings to instill confidence in investors Higher rate companies get larger amount of money at a lower cost Thus the industry as a whole can benefit from ratings by direct mobilization of savings from individuals rather than from intermediary lending institutions

## 5 DIFFERENCE BETWEEN FORWARD CONTRACT AND FUTURE CONTRACTS

Fundamentally, forward and futures contracts have the same function both types of contracts allow people to buy or sell a specific type of asset at a specific time at a given price

However, it is in the specific details that these contracts differ First of all, futures contracts are exchangetraded and, therefore, are standardized contracts Forward contracts, on the other hand, are private agreements between two parties and are not as rigid in their stated terms and conditions Because forward contracts are private agreements, there is always a chance that a party may default on its side of the agreement Futures contracts have clearing houses that guarantee the transactions, which drastically lowers the probability of default to almost never

Secondly, the specific details concerning settlement and delivery are quite distinct For forward contracts, settlement of the contract occurs at the end of the contract Futures contracts are marked-to-market daily, which means that daily changes are settled day by day until the end of the contract Furthermore, settlement for futures contracts can occur over a range of dates Forward contracts, on the other hand, only possess one settlement date

Lastly, because futures contracts are quite frequently employed by speculators, who bet on the direction in which an asset's price will move, they are usually closed out prior to maturity and delivery usually never happens On the other hand, forward contracts are mostly used by hedgers that want to eliminate the volatility of an asset's price, and delivery of the asset or cash settlement will usually take place

## 6 Bases Of Market Segmentation:

Different variables are used to segment the consumer markets They can be broadly put into four categories

### Demographic Segmentation:

Demos means people and graphein means to measure or to study In Demography means study of people or population In Demographic segmentation, the market is segmented on the basis of demographic variables such as age, sex, family size, family life cycle, income, occupation, education etc Demographic variables or characteristics are the most popular bases for segmenting the market

**(a) Age:** Age is an important factor for segmenting the market This is because demand and brand choice of people change with age On the basis of age, a market can be divided into four- Children, Teenagers, Adults and Grown-ups For consumers of different age groups, different types of products are produced Johnson and Johnson cater to the needs of children below 6 years by presenting baby powders, baby soaps, oils etc

**(b) Sex:** Sex based segmentation means grouping customers into males and females. The wants, tastes, preferences, interests, choices etc, of men are different from that of women. For instance, women are more fond of cosmetics and other fancy articles. Marketers use gender differences for marketing garments, personal care products, bikes, cosmetics and magazines

**(c) Family Life Cycle:** It refers to the important stages in the life of an ordinary family. Broadly

divided into the following stages

Stage 1. Childhood

Stage 2 Bachelorhood (unmarried)

Stage 3. Honeymooners- Young married couple.

Stage 4 Parenthood- (a) Couple with children. (b) Couple with grown up children.

Stage 5 Post- parenthood- Older married couple with children living away from Parents (due to job or marriage of sons and daughters)

Stage 6 Dissolution- One of the partners is dead

Wants, tastes, interests, buying habits etc vary over different life cycles stages.

**(d)Religion:** Religious differences have important effect on marketing The male folk among the muslims have a demand for striped lungis and the woman folk for pardhas

**(e) Income:** Income segmentation is used for automobiles, clothing, cosmetics, travel, financial services etc For example, BMW (car manufacturer concentrates on high income segment)

**(f) Occupation:** Market segmentation is done also on the basis of occupation of consumers For instance, doctors may demand Surgical equipment, lawyers may demand coat etc

**(g) Family Size:** A marketer launches different sizes of products in the market according to size of the family For example, shampoos and oil are available in 100 ml 200ml 500ml etc

**(h) Education:** On the basis of education, market for books may be divided as high school, plus two, graduate and post graduate

**Geographic Segmentation:**

The marketer divides the market into different geographical units Generally international companies segment markets geographically The theory behind this strategy is that people who live in same area have some similar need and wants and that need and wants differ from those of people living in other areas

**(a) Area:** This type of segmentation divides the market into different geographical units such as country, state, region, district, area etc Some manufacturers split up their sales territories either state-wise or district-wise Markets may also be divided into urban and rural markets

**(b) Climate:** Different types of climate prevail in different places On the basis of climate, areas can be classified as hot, cold, humid and rainy region Climate determines the demand for certain goods

**(c) Population Density:** The size and density of population affects the demand for consumer goods. In those areas where size and density of population is high, there will be good demand for consumer goods

**Behavioural Segmentation:**

Behavioural segmentation is based on buyer behaviour i e the way people behave during and after purchase

**(a) Attitude** Customers can be segmented on the basis of attitude such as enthusiastic, positive,

indifferent, negative, hostile etc Fashionable and latest products are used by enthusiastic consumers Liquor, cigarette etc are used by negative consumers

**(b) Product Segmentation:** The market segmentation is done on the basis of product characteristics that are capable of satisfying certain special needs of customers

(1) Prestige products, e g , Automobiles, clothing, Home furnishing

(2) Maturity products, e g , Cigarettes, Blades etc

(3) Status products, e g , Most luxuries

(4) Anxiety products, e g , Medicines, soaps etc

(5) Functional products, e g , Fruits, vegetables etc

**(c) Occasion Segmentation:** According to the occasions, buyers develop a need, purchase a product or use a product There can be two types of situations- regular and special For example, for regular use, women purchase cotton or polyester sarees or churidars For attending marriage or reception(special occasion) they buy silk sarees

**(d) Benefit Segmentation:** Benefit segmentation implies satisfying one benefit group The benefit may be classified into Generic or Primary and Secondary or Evolved

| Product | Generic or primary Utilities | Secondary or Evolved Utilities |
|---|---|---|
| Tooth paste | Cleaning Breath | freshing, brightness |

**(e) Volume Segmentation:** The market is segmented on the basis of volume or quality of purchase The buyers are grouped into categories like bulk buyers, moderate buyers, and small buyers Heavy buyers are often small percentage of the market but account for a high percentage of total consumption Marketers prefer to attract one heavy buyer rather than several small buyers

**(f) Loyalty Segmentation:** Consumers have varying degree of loyalty to specific brands On the basis of brand loyalty, buyers can be divided into the following five groups (1) Hard-core loyals (2) Softcore loyals (3) Shifting loyals (4) Switchers (5) Consumer innovators

**Psychographic Segmentation:**

It refers to grouping of people into homogeneous segments on the basis of psychological make up namely personality and life style

**(a) Life Style:** A person's life style is the pattern of living as expressed in the person's activities, interests and opinions They express their life styles through the products they use For example, the life style of a college student is different from that of an ordinary worker Car, clothing, cosmetics, furniture, liquor, cigarettes etc are segmented by using life style

**(b) Personality:** Personality reflects a person's traits, attitude and habits It is in this background that a person is classified as active or passive, rational or impulsive, creative or conventional, introvert or extrovert For example, Raymond's advertisement says "Raymonds The Complete Man"

**(c) Social Class:** On the basis of Social class, consumers may be grouped into lower class, middle class and upper class Social class is determined by income, occupation and education

**PART –C**

7 a **Process Of Personal Selling**

Selling is the sequence of steps involved in the conversion of human desire into demand for a product or service Personal selling process involves the following stages

**1. Prospecting** It is the work of collecting the names and addresses of persons who are likely to buy the firm's product of services While collecting the details, 'suspects' must be separated from 'prospects' to avoid waste of time

**2. Pre approach** Pre approach is to get more detailed facts about a specific individual to have effective sales appeal on him or her It is closer look of prospects like habits, financial status, social esteem, family background, material status, tastes and preferences etc

**3. Approach:** Approach means the meeting of the prospect in person by the salesmen It is a face to face contact with the prospect to understand him better

**4. Presentation and demonstration**: A good sales presentation is one that not only gives all the benefits that the prospect gets but also proves to the latter that he or she will better off after the product is bought and used An effective sales presentation demands the sales person use skills like presentation and explanation

**5. Managing objections** This is the most important stage of personal selling For every action of salesman there is prospect's pro action or reaction, ie, approval or disapproval An efficient sales man has the ability to identify the reasons for raising objections by the prospects and the ways to overcome these objections

**6. Sale** If all the above stages have been concluded successfully, then the next stage is ultimate sale of the product

b **MARKETING MIX**

In the words of Philip Kotler, "Marketing Mix is the set of controllable variables and their levels that the firm uses to influence the target market " Marketing mix is a combination of various elements, namely, Product, Price, Place (replaced by Physical Distribution) and Promotion

The various important elements of marketing mix are briefly discussed as follows,

**Product:**

It is the thing possessing utility It is the bundle of value the marketer offers to potential customers Today manufacturers are realizing that customer expects more than just the basic product Therefore the product must satisfy the consumers needs The manufacturer first understands the consumer needs and then decides the type, shape, design ,brand, package etc of the goods to be produced The product is a marketer's primary vehicle for delivering customer satisfaction

**Price:**

it is the amount of money asked in exchange for product. It must be reasonable so as to enable the consumer to pay for the product While fixing the price of a product, the management considers certain factors such as cost, ability of the consumers, competition, discount, allowances, margin of profit etc

**Place (Physical Distribution):**

It is the delivery of products at the right time and at the right place It is the combination of decision regarding channel of distribution (wholesalers, retailers etc ), transportation, warehousing and inventory control

**Promotion:**

It consist of all activities aimed at inducing and motivating customers to buy the product. The selection of alternatives determine the success of marketing efforts Some firms use advertising, some others personal selling or sales promotion Thus promotion includes advertising public relations, personal selling and sales promotion Recently Packaging and People are two more elements of marketing mix that have been emerged These are discussed as follows

**Packaging:**

Packaging is the art, science and technology of preparing goods for transport, sale and exchange A well designed pack is invaluable in building brand loyalty with the customer Packaging must be such that a customer is impressed at the very moment he or she sees the product

**People :**

It consists mainly of the people to whom goods are sold(consumer) and the people through whom goods are sold(sales people, wholesalers, retailers etc ) people include competitors also This factor will be the reoson as well as resources for success in marketing

## c IMPORTANCE OF MARKETING

Marketing is important not only for organizations but for individuals, society and economy as a whole Financial success often depends on marketing ability Finance, operations, and other business functions will not really matter if there isn't sufficient demand for products and services so the company can make a profit. There must be top line for there to be a bottom line. Many companies have now created a Chief Marketing Officer, or CMO, position to put marketing on a equal footing with other C-level executives, such as the Chief Executive Officer (CEO) and Chief Financial Officer (CFO). Also marketing steps its foot in every walk of life. Some of its importance can be discussed as follows

**Importance Of Marketing To Companies:**

Sound marketing is critical to the success of the organisation in the following ways:

- Helps in income generation.
- Helps in planning and decision-making
- Helps in distribution.
- Helps in exchanging information.
- Helps to adapt to changing environment
- Expands global presence.
- Helps to earn goodwill.

**Importance Of Marketing To Consumers:**

- Provides quality products
- Provides variety of products
- Improves knowledge of consumers
- Helps in selection
- Consumer satisfaction.

**Importance Of Marketing To Society:**

- Marketing bridges the gap between firm and society
- Provides employment
- Raises standard of living
- Creates utilities.
- Reduces costs
- Solves social problems
- Makes life easier
- Enriches society

**Importance Of Marketing To Economy:**

- It stimulates research and innovation Saves the economy from depression
- Increase in national income
- Economic growth
- Ploughing back of resources

**d MERCHANT BANKING**

Despite the fact that merchant banking is emerging as one of the prominent segment of financial service sector, it is difficult to define what merchant banking is The reason is very obvious as its limits have never been adequately and strictly defined and it caters to wide variety of financial activities Dictionary of Banking and Finance explains merchant bank as an organisation that underwrites securities for corporations, advises such clients on mergers and is involved in the ownership of commercial ventures Securities and Exchange Board of India (Merchant Bankers) Rules 1992 defines merchant bankers as "any person who is engaged in the business of issue management either by making arrangement regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory services in relation to such issue management The Guidelines for Merchant Bankers (issued by Ministry of Finance, Deptt of Economic Affairs, Stock Exchange Division on 9-4-1990) instead of defining merchant banking stated that these guidelines shall apply to those presently engaged in merchant banking activity including as managers to issue and undertakes authorised activities These activities interalia include underwriting, portfolio management etc Thus to defines merchant bankers a definite better approach is to include those agencies as merchant bankers which do what a merchant banker does

To understand nature of merchant banking well, a contrast may be involved, between commercial banking and merchant banking Although the terms 'Merchant' and 'Commercial' have similar connotations yet commercial banking and merchant banking are different Commercial bankers are basically a financing agency where as merchant banks provide basically financial (not financing) services Commercial bankers are comparatively retail banking activity where as merchant banking is a whole sale banking (even if it provides financing services also) A merchant banking firm does not undertake commercial banking where as its, reverse is possible Commercial banking involves collections of savings and putting it, to optimum use as per plans and guidelines where as merchant banking refers to just an agency facilitating transfer capital from those who own to those who can use it without handling the amount of its own. Merchant bankers is more of an intermediary In the same context a merchant bank can be distinguished from a development bank since the latter is more involved in fund raising and lending Like commercial banks, development banks may also have separate merchant banking division

## f ISSUES MANAGEMENT

The new issue market / activity was regulated by the Controller of Capital Issues (CCI) under the provisions of the Capital Issues (Control) Act, 1947 and the exemption orders and rules made under it With the repeal of the Act and the consequent abolition of the office of the CCI in 1992, the protection of the interest of the investors in securities market and promotion of the development and regulation of the market/ activity became the responsibility of the SEBI. To tone up the operations of the new issues in the country, it has put in place rigorous measures These cover both the major intermediaries as well as the activities

So, we will discuss here, various intermediaries, their regulation and SEBI guidelines related to them

### Merchant Bankers

In modern times, importance of merchant banker is very much, because it the key intermediary between the company and issue of capital Main activities of the merchant bankers are – determining the composition of the capital structure, drafting of prospectus and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfer, listing of securities, arrangement of underwriting / sub-underwriting, placing of issues, selection of brokers, bankers to the issue, publicity and advertising agents, printers and so on

Due to overwhelming importance of merchant banker, it is now mandatory that merchant banker(s) functioning as lead manager(s) should manage all public issues In case of rights issue not exceeding Rs 50 lakh, such appointments may not be necessary The salient features of the SEBI framework, related to merchant bankers are discussed as under

**Registration :** Merchant bankers require compulsory registration with the SEBI to carry out their activities Previously there were four categories of merchant bankers, depending upon the activities Now, since Dec 1997, there is only one category of registered merchant banker and they perform all activities

**Grant of Certificate :** The SEBI grants a certificate of registration to applicant if it fulfills all the conditions like (i) it is a body corporate and is not a NBFC (ii) it has got necessary infrastructure to support the business activity (iii) it has appointed at least two qualified and experienced (in merchant banking) persons (iv) its registration is in the general interest of investors

**Capital Adequacy Requirement :** A merchant banker must have adequate capital to support its business Hence SEBI grants recognition to only those merchant bankers who have paid up capital and free reserves of minimum Rs 1 crore

**Fee:** A merchant banker has to pay a registration fee of Rs 5 lakh and renewal fees of Rs 2 5 lakh every three years from the fourth year from the date of registration

**Code of Conduct :** Every merchant banker has to abide by the code of conduct, so as to maintain highest standards of integrity and fairness, quality of services, due diligence and professional judgment in all his dealings with the clients and other people A merchant banker has always to endeavor to (a) render the best possible advice to the clients regarding clients needs and requirements, and his own professional skill and (b) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner

**Restriction on Business :** No merchant banker, other than a bank/public financial institution is permitted to carry on business other than that in the securities market w e.f Dec 1997 However a merchant banker who is registered with RBI as a primary dealer/satellite dealer may carry on such business as may be permitted by RBI w.e f Nov 1999

**Maximum number of lead managers :** The maximum number of lead managers is related to the size of the issue For an issue of size less than Rs 50 crores, two lead managers are appointed For size groups of 50 to 100 crores and 100 to 200 crores, the maximum permissible lead managers are three and four respectively A company can appoint five and five or more (as approved by SEBI) lead managers in case of issue sizes between Rs 200 to 400 crores and above Rs 400 crores respectively

**Responsibilities of Lead Managers :** Every lead manager has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosure, allotment and refund A statement specifying these is to be furnished to the SEBI at least one month before the opening of the issue for subscription It is necessary for a lead manager to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs 25 lakh whichever is less

**Due diligence certificate :** The lead manager is responsible for the verification of the contents of a prospectus / letter of offer in respect of an issue and the reasonableness of the views expressed in them. He has to submit to the SEBI at least two weeks before the opening of the issue for subscription a due diligence certificate

g **Underwriters**

Another important intermediary in the new issue/ primary market is the underwriters to issue of capital who agree to take up securities which are not fully subscribed. They make a commitment to get the issue subscribed either by others or by themselves Though underwriting is not mandatory after April 1995, its organization is an important element of primary market. Underwriters are appointed by the issuing companies in consultation with the lead managers / merchant bankers to the issues

**Registration :** To act as underwriter, a certificate of registration must be obtained from SEBI On application registration is granted to eligible body corporate with adequate infrastructure to support the business and with net worth not less than Rs 20 lakhs

**Fee :** Underwriters had to pay Rs 5 lakh as registration fee and Rs 2 lakh as renewal fee every three years from the fourth year from the date of initial registration Failure to pay renewal fee leads to cancellation of certificate of registration

PART – D

8.a **Capital Market :** The capital market is a market for financial assets which have a long or indefinite maturity Generally, it deals with long term securities which have a maturity period of above one year Capital market may be further divided into three namely

(i) Industrial securities market

(ii) Government securities market and

(iii) Long term loans market I

b **MEANING OF FINANCIAL SERVICES**

The Indian Financial services industry has undergone a metamorphosis since 1990 During the late seventies and eighties, the Indian financial service industry was dominated by commercial banks and other financial institutions which cater to the requirements of the Indian industry Infact the capital market played a secondary role only The economic liberalization has brought in a complete transformation in the Indian financial services industry Prior to the economic liberalization, the Indian financial service sector was characterized by so many factors which retarded the growth of this sector c LEASING

Leasing, as a financing concept, is an arrangement between two parties, the leasing company or lessor and the user or lessee, whereby the former arranges to buy capital equipment for the use of the latter for an agreed period of time in return for the payment of rent The rentals are predetermined and payable at fixed intervals of time, according to the mutual convenience of both the parties However, the lessor remains the owner of the equipment over the primary period.

d MERCHANT BANKING

To understand nature of merchant banking well, a contrast may be involved, between commercial banking and merchant banking Although the terms 'Merchant' and 'Commercial' have similar connotations yet commercial banking and merchant banking are different Commercial bankers are basically a financing agency where as merchant banks provide basically financial (not financing) services. Commercial bankers are comparatively retail banking activity where as merchant banking is a whole sale banking (even if it provides financing services also) A merchant banking firm does not undertake commercial banking where as its, reverse is possible. Commercial banking involves collections of savings and putting it, to optimum use as per plans and guidelines where as merchant banking refers to just an agency facilitating transfer capital from those who own to those who can use it without handling the amount of its own Merchant bankers is more of an intermediary In the same context a merchant bank can be distinguished from a development bank since the latter is more involved in fund raising and lending Like commercial banks, development banks may also have separate merchant banking division

e **Money Market**

Money market is a market for dealing with financial assets and securities which have a maturity period of upto one year In other words, it is a market for purely short term funds The money market may be subdivided into four They are

(i) Call money market

(ii) Commercial bills market

(iii) Treasury bills market

(iv) Short term loan market

## f. INDUSTRIAL GOODS

Industrial products are used as input or raw material to produce consumer goods for example, tools, machinery, etc

**Features of Industrial Product are:**

**1. Number of Buyers:**

Numbers of buyers of industrial products are limited as compared to consumer products

**2. Channel of Distribution:**

Shorter channel of distribution is used for sale of industrial products as there are limited buyers

**3. Geographical Concentration:**

Generally the demand for industrial products is not scattered but is concentrated at a fixed geographical location

**4. Derived Demand:**

Industrial products are demanded to produce consumer products that is why it is called derived demand, as demand of sugarcane depends upon the demand of sugar in the country

**5. Technical Consideration:**

Industrial products are produced as a result of complex process so there is more technical consideration of these products

**6. Reciprocal Buying:**

Some industries buy product from a company with intention of selling the finished goods to the same company For example the Maruti Co may buy tyres from MRF Company and tyre Company may in turn buy car from Maruti Co

**7. Leasing:**

Nowadays instead of buying industrialists prefer to take fixed assets on lease, because of high prices of these products

## g BRANDING

Branding means giving a name to the product by which it could become known and familiar among the public. When a brand name is registered and legalised, it becomes a *Trade mark* All trade marks are brands but all brands are not trade marks. Brand , brand name, brand mark, trade mark, copy right are collectively known as the language of branding.

## h SALES PROMOTION

Sales promotion is another major component of promotion mix The phrase sales promotion has a distinct meaning. It stands for all those activities that supplement, co-ordinate and make more effective the efforts of personal selling and advertising It collectively comprises of the tools used to promote sales in a given territory and time It consists of short term incentives designed to achieve a specific marketing goal in the immediate future