Department of Business Administration (BBA)

Government Arts College (Autonomous), Coimbatore -641018

SEMESTER-V ; Core Paper IX - Financial Services ; Subject Code : 18BBA51C

UNIT –I

Financial Services: Meaning - Classification - Scope - Modern Activities - Sources, Causes for Financial Innovation - New Financial Products and Services.

UNIT – II

Merchant Banking : Definition - Merchant Banking and Commercial Banks -Services of Merchant Banks - Merchant Banker's Code of Conduct Regulatory Framework - Operational Guidelines for Merchant Bankers.

UNIT III

Hire Purchase: Feature ~ Hire Purchase and Installment Sale - Hire Purchase and Leasing-Bank Credit for Hire Purchase Business. Leasing: Definition - Types of Lease - Difference between Financial and Operating Lease - Advantages and Disadvantages of Leasing. Securitization: Definition - Features - Parties Involved Mechanics of Securitization - Benefits of Securitization.

UNIT IV

Venture Capital: Meaning – Definition - Features - Stages of Venture Capital Financing - Importance of Venture Capital - Methods of Venture Financing. Discounting - Factoring - Meaning ~ Modus Operandi - Functions - Types of Factoring - Benefits. Discounting Vs Factoring.

UNIT-V

Credit Rating: Definition - Meaning - Functions - Benefits of Credit Rating- Credit Rating Agency of India CRISIL ,ICRA , CARE. Derivatives: Meaning – Definition - Kinds - Importance.

Text Books:

E.Gordan & K.Natarajan -Financial Markets and Services, 2005, Himalaya Publishing House.

Punithavathy Pandian - Financial Services and Markets, 2009, Vikas Publishing House Ltd.

Reference Books:

M.Y.Khan - Financial Services, 2013, Mc Graw Hill Publications.

S.Gurusamy - Financial Services, 2015, Vijay Nichole Imprints Pvt Ltd.

Unit I

Subject Name	Subject Code	Semester	Prepared By
Financial Services	**18BBA51C**	**V**	**Dr.K.Karthikai, Assistant Professor in BBA**

Meaning of financial services

All types of activities which are of financial nature is brought under the term Financial Services. In a broad sense means mobilizing and allocating savings. It includes all activities transformation of savings into investment. This Financial Services can also be called financial intermediation. Financial intermediation is the process by which mobilize from a large number of savers and make them available to all those who are in need of it and particularly to corporate customers.

Classification of financial services industry.

Intermediaries in India are classified into two :

1. Capital market intermediaries and

2. Money market intermediaries.

Capital market intermediaries consist of term lending institutions and investing institutions which provide long term funds.

Money market consists of commercial banks, cooperative banks and other agencies which supply only short term funds.

Scope of Financial Services

Financial Services maybe e classified into traditional activities and modern activities. **Traditional activities**- it may be a fund based activities and non-fund based activities. **Fund based activities** include underwriting of or investment in shares, debentures, Bonds etc. of new issues, dealing in secondary market activities, participating in money market instruments, involving in equipment leasing, hire purchase, venture capital, seed capital etc. and dealing in foreign exchange market activities.

Non fund based activities include managing capital issues, making arrangements for placement of capital and debt instruments with investment institutions, arrangement of funds from Financial institutions for the client project cost or his working capital requirements, assisting in the process of getting government and other clearances.

Modern activities

Besides the traditional services the financial intermediaries render in numerable services in recent times. Some of the modern services provided by them include rendering project advisory services write some preparation of project report still raising of funds for starting the project with necessary government approval, planning for merger and acquisitions, guiding corporate customers in capital restructuring, acting as trustees to debenture holders, recommending suitable changes in management structure, structuring the financial collaboration and joint ventures, rehabilitating and reconstructing Sick companies, hedging of risks, managing portfolio of large public sector companies, undertaking risk Management Services, advising the client on selecting the best source of funds, guiding clients in minimization of cost of debt and determination of optimum debt equity mix undertaking services relating to capital market like clearing services, registration and transfers, safe custody of securities, collection of income on securities and promoting credit rating agencies.

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 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 among themselves and this 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**: The recent economic liberalisation 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 has 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.

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 briefly discussed below:

(i) **Merchant Banking**: A merchant banker is a financial intermediary who helps to transfer capital from those who possess it to those who need it. Merchant banking includes a wide range of activities such as management of customer's securities, portfolio management, project counselling 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 them.

(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

(iv) **Mutual Funds**: A mutual fund refers to a fund 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 minimising risk. The fund provides investment avenues for small investors who cannot participate in the equities of big companies. It ensures low risks, 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) **Forfaiting**: Forfaiting is a technique by which a forfaitor (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.

(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 yet 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 Services**: 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 so 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 risks due to price fluctuations by the investments manager.

(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 :(a) Forward Contracts (b) Options (c) Futures (d) Swaps.

(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 a financing institution/bank of one country with another institution/bank/agent to support the export of goods and services so 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.