Vidyasagar College of Arts and Science
Approved by UGC, Affiliated to Bharathiar University & Re-Accredited by NAAC
Udumalpet - 642122

NH83Udumalpet–PollachiRoad,Udumalpet–642122 Cell :
98430 24997, 97877 21960
e-mail :
vcasudt@yahoo.comwebsite:www.vi
dyasagarcollege.org

Course: B.Com Batch : 2023-26 Semester:VI

SUBJECT : FINANCIAL MARKET

SYLLABUS FINANCIAL MARKET

UNIT -I

Financial Markets - Structure of Financial Markets-Financial Investment - Money Market in India-Indian Capital Markets-Difference between Money Market and Capital Market-Classification and object of Indian Money Markets and structure of capital Markets.

UNIT -II

Markets for Corporate Securities - New Issue Markets - Functions Issue Mechanism-Merchant Banking - Role and Functions of Merchant Bankers in India-Underwriting

UNIT - III

Secondary Markets - Stock Exchange - Role of Secondary Markets-Trading in Stock Exchange - Various Speculative Transactions- Role of SEBI - Regulation of Stock Exchange.

UNIT IV

Banks as Financial Intermedieries- Commercial Bank Role in Financing- GIC-UTI-Mutual Funds-Invesment Companies.

UNIT - V

New Modes of Financing- Leasing as source of Finance - Forms of Leasing - Venture Capital-Dimension Functions - Venture Capital in India - Factoring - Types - Modus Operandi of Factoring - Factoring as Source of Finance - Securitisation of Assets - Mechanics of Securitisation-Utility of Securitisation - Securitisation in India

UNIT -I

Financial Investment – Easy Explanation

Financial investment means putting your money into assets with the aim of **earning income or profit in the future**.

Simple definition

Investment is the use of savings today to increase wealth in the future.

Examples (easy to remember)

- **Shares** – earn dividends & capital gain
- **Bonds / Debentures** – earn interest
- **Fixed Deposit (FD)** – safe, fixed return
- **Mutual Funds** – money invested through experts
- **Real Estate** – land, house, buildings
- **Gold** – long-term value

Objectives of financial investment

- To **earn income**
- To **increase wealth**
- To **protect money from inflation**
- To **achieve future goals** (education, business, retirement)

Types of investment

- **Financial investments** – shares, bonds, deposits
- **Real investments** – land, buildings, machinery

Risk & return

- **Low risk → Low return** (FD, bonds)
- **High risk → High return** (shares)

Financial Market Meaning

Financial investment refers to the allocation of funds into financial assets like shares, bonds and deposits with the objective of earning returns and increasing wealth.

Money Market

Money market is the part of the financial market where **short-term funds** are borrowed and lent for a period of **up to one year**.

Simple definition

Money market deals with short-term financial instruments and funds.

Features of money market

- Deals in short-term funds **(≤ 1 year)**
- High liquidity
- Low risk
- Helps in meeting short-term financial need**s**

Instruments of money market

- Treasury Bills (T-Bills)
- Commercial Paper
- Call & Notice Money
- Certificates of Deposit
- Repurchase Agreements (Repo)

Participants

- Central Bank (RBI)
- Commercial Banks
- Financial Institutions
- Companies
- Mutual Funds

Functions / Importance

- Maintains **liquidity** in the economy
- Helps banks manage **short-term shortages**
- Supports **monetary policy** of RBI
- Promotes **stable financial system**

Indian Capital Market – Easy Explanation

Indian Capital Market is the market that deals with **long-term funds** (more than one year). It helps companies and the government **raise capital** and helps investors **invest their savings**.

Simple definition

Indian capital market is a market for long-term financial securities like shares and debentures.

Structure of Indian Capital Market

- **Primary Market**
    - New issue of shares and debentures
    - Examples: IPO, FPO, Rights issue
- **Secondary Market**
    - Buying and selling of existing securities
    - Examples: **BSE** (Bombay Stock Exchange), **NSE** (National Stock Exchange)
- **Instruments**
- Equity Shares
- Preference Shares
- Debentures & Bonds
- Government Securities
- Mutual Funds
- **Participants**
- Companies
- Investors
- Banks & Financial Institutions
- Stock Exchanges
- Brokers
- **SEBI** (regulator)

Regulator

- **SEBI (Securities and Exchange Board of India)**
- Protects investors and ensures fair trading practices.

Functions / Importance

- Mobilizes **long-term savings**
- Provides **capital for industrial growth**

- Encourages **investment habit**
- Promotes **economic development**

Difference between Money Market and Capital Market

Basis	Money Market	Capital Market
Meaning	Deals in short-term funds	Deals in long-term funds
Time period	Up to 1 year	More than 1 year
Purpose	Meeting short-term needs	Raising long-term capital
Instruments	T-bills, CP, CD, Call money	Shares, Debentures, Bonds
Risk	Very low	Comparatively high
Return	Low	Higher
Liquidity	Very high	Less than money market
Examples	RBI, Banks	NSE, BSE

I. Classification of Indian Money Market

Indian money market is classified into **two types**:

1. Organized Money Market

- RBI
- Commercial Banks
- Co-operative Banks
- Financial Institutions
- Discount & Finance House of India (DFHI)

2. Unorganised Money Market

- Money lenders
- Indigenous bankers
- Chit funds
- Traders & landlords

II. Objectives of Indian Money Market

- To provide **short-term funds**

- To maintain **liquidity** in the economy
- To help **RBI in monetary control**
- To meet **short-term credit needs** of banks and institutions
- To promote **economic stability**

III. Structure of Capital Market

Capital market is divided into **two main segments**:

1. Primary Market (New Issue Market)

- Issue of **new shares and debentures**
- Methods:
    - IPO
    - FPO
    - Rights Issue
    - Private Placement

2. Secondary Market (Stock Market)

- Buying and selling of **existing securities**
- Major stock exchanges:
    - **BSE**
    - **NSE**

UNIT II

Markets for Corporate Securities

Markets for corporate securities are places where **companies raise long-term funds** by issuing securities to investors.

What are corporate securities?

They are financial instruments issued by companies, mainly:

- **Shares (Equity)**
- **Debentures / Bonds**
- **Preference shares**

Types of Markets for Corporate Securities

1. Primary Market (New Issue Market)

- Companies issue **new securities** to the public for the **first time**.
- Purpose: **Raise fresh capital** for business.
- Investors buy directly from the company.

Methods:

- IPO (Initial Public Offering)
- Rights issue
- Private placement

Example:
A company launches an IPO to collect money for expansion.

2. Secondary Market (Stock Market)

- Existing securities are **bought and sold among investors**.
- The company does **not** directly receive money.
- Provides **liquidity** (easy buying and selling).

Examples in India:

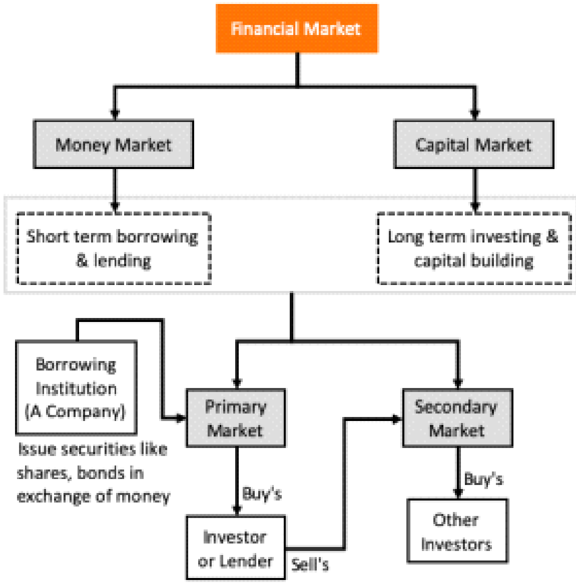
- BSE (Bombay Stock Exchange)
- NSE (National Stock Exchange)

Importance of Markets for Corporate Securities

- Helps companies raise **long-term finance**
- Gives investors **returns** (dividend, interest, capital gain)
- Ensures **liquidity** and **price discovery**
- Supports **economic growth**

New Issue Market (Primary Market)

The **New Issue Market** is the market where **companies issue new securities for the first time** to raise **fresh capital**.



Features

- Deals with **new shares, debentures and bonds**
- Money goes **directly to the company**
- Used for **business expansion and development**
- No prior trading history of securities

Methods of Issue

- Initial Public Offering (IPO)
- Rights Issue
- Private Placement
- Offer for Sale

Importance

- Helps companies raise **long-term funds**
- Promotes **industrial growth**
- Provides investment opportunities to the public

New Issue Market

Functions & Issue Mechanism

Functions of New Issue Market

- **Raising capital** for companies.
- **Mobilises savings** of the public.
- **Provides new investment opportunities**.
- **Promotes industrial and economic growth**.
- **Facilitates capital formation**.

Issue Mechanism (Methods of Issue)

- **Public Issue (IPO/FPO)**
  Securities offered to the public through prospectus.
- **Rights Issue**
  Shares offered to **existing shareholders** at a concessional price.
- **Private Placement**
  Securities sold directly to **selected investors** (banks, institutions).
- **Offer for Sale**
  Securities sold through **intermediaries** like stockbrokers.
- **Book Building**
  Price discovered based on **investor demand**.

Merchant Banking

Meaning

Merchant banking refers to **financial services provided to companies** for **issue management, finance, and advisory services**, especially in the **New Issue Market**.

Functions of Merchant Banking

- Issue management (IPO, Rights Issue)
- Preparation of prospectus
- Underwriting of securities
- Financial and project advisory
- Corporate restructuring & mergers
- Portfolio management

- Loan syndication

Importance

- Helps companies **raise capital smoothly**
- Protects **investor interests**
- Ensures **legal and SEBI compliance**
- Improves efficiency of capital markets

Examples of Merchant Bankers in India

- SBI Capital Markets
- ICICI Securities
- Axis Capital
- Kotak Investment Banking

Role and Functions of Merchant Bankers in India

Role of Merchant Bankers

- Act as **intermediaries** between companies and investors.
- Help companies **raise funds** through shares and debentures.
- Ensure **SEBI rules and regulations** are followed.
- Protect **investor interests**.
- Promote development of the **Indian capital market**.

Functions of Merchant Bankers

1. Issue Management

- Planning and managing **IPO, FPO, Rights Issue**
- Pricing of securities
- Marketing and allotment

2. Preparation of Prospectus

- Drafting prospectus and offer documents
- Disclosing financial and legal information

3. Underwriting

- Guaranteeing subscription of shares/debentures

4. Corporate Advisory Services

- Advice on mergers, acquisitions and takeovers
- Corporate restructuring

5. Project & Financial Advisory

- Project appraisal and feasibility studies
- Capital structure planning

6. Portfolio Management

- Managing investments on behalf of clients

7. Loan Syndication

- Arranging long-term loans from banks and institutions

Underwriting

Meaning

Underwriting is an agreement in which an **underwriter guarantees to buy the unsold portion of securities** if the public does not fully subscribe to an issue.

Functions of Underwriting

- **Guarantees full subscription** of shares/debentures.
- Builds **investor confidence** in new issues.
- Helps companies **raise capital smoothly**.
- Reduces risk for the **issuing company**.
- Supports development of the **primary market**.

Types of Underwriters

- **Merchant banks**
- **Commercial banks**
- **Financial institutions**
- **Stock broker**

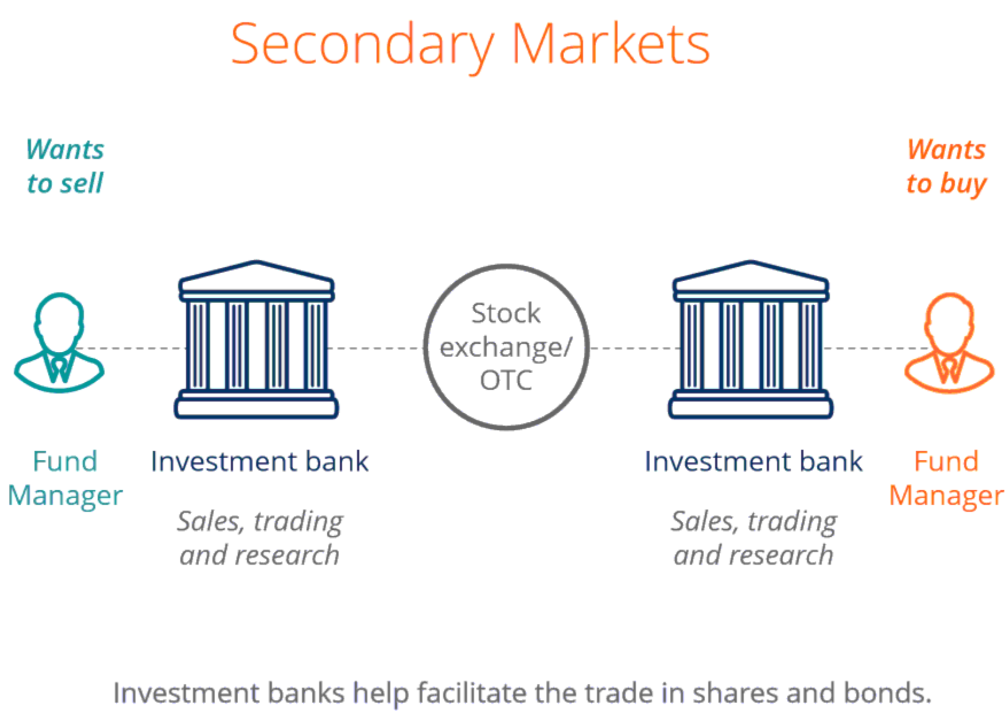
Importance of Underwriting

- Ensures success of **public issues**
- Facilitates growth of **capital market**
- Protects issuing companies from financial failure

.

UNIT III

Secondary Market



Secondary market is the market where **already issued securities** (shares, debentures, bonds) are **bought and sold between investors**.
The issuing company does **not** get money from these transactions.

Meaning

It is the market where investors trade existing securities with each other after they are first issued in the primary market.

Examples

- Stock exchanges like **BSE (Bombay Stock Exchange)**
- **NSE (National Stock Exchange)**
- Over-the-Counter (OTC) markets

Types of Secondary Market

- **Stock Exchange Market** – Organized, regulated market (BSE, NSE)
- **OTC Market** – Unorganized, direct dealing between buyers and sellers

Functions of Secondary Market

- Provides **liquidity** (easy buying & selling)
- Helps in **price discovery** of securities
- Encourages **investment** by reducing risk
- Enables **continuous valuation** of securities
- Supports **economic growth**

Importance

- Investors can convert securities into cash anytime
- Builds confidence among investors
- Helps companies raise funds indirectly by improving demand for shares

Difference from Primary Market (one line)

- **Primary market**: New securities issued
- **Secondary market**: Existing securities traded

If you want this in **2-mark, 3-mark, or exam-ready short notes**, tell me 👇

Stock exchange

Stock Exchange

Meaning

A **stock exchange** is an organized market where **securities like shares, debentures, and bonds are bought and sold** in a regulated manner.

Examples in India

- **BSE – Bombay Stock Exchange**
- **NSE – National Stock Exchange**

Functions of Stock Exchange

- **Provides liquidity** – Easy buying and selling of securities
- **Price discovery** – Determines fair market price of shares
- **Capital formation** – Encourages savings and investments
- **Safety & regulation** – Trading under SEBI rules
- **Economic growth** – Supports industrial development

Features

- Regulated by **SEBI**
- Only **listed securities** are traded
- Uses **online trading system**
- Transparent and systematic market

Importance

- Builds investor confidence
- Helps companies raise funds indirectly
- Promotes savings and investments

Major Roles / Functions

- **Provides Liquidity**
  Investors can easily convert shares and securities into cash anytime.
- **Price Discovery**
  Market forces of demand and supply determine the fair price of securities.
- **Encourages Investment**
  Easy exit option increases confidence of investors.
- **Promotes Capital Formation**
  Active trading motivates savings and long-term investments.
- **Continuous Valuation**
  Helps investors know the current value of their investments.
- **Supports Primary Market**
  A strong secondary market increases demand for new issues.
- **Economic Growth**
  Helps smooth flow of funds and development of the economy.

Trading in Stock Exchange

Meaning

Trading in a stock exchange refers to the **buying and selling of existing securities** such as shares, debentures, and bonds through a regulated platform like **BSE or NSE**.

Participants

- Investors
- Stock brokers
- Stock exchange
- Clearing corporation
- Depository (NSDL / CDSL)

Process of Trading (Simple Steps)

- **Open Demat & Trading Account**
- **Place Order** (Buy/Sell shares)
- **Order Matching** on exchange
- **Trade Confirmation**
- **Clearing & Settlement** (T+1 in India)
- **Transfer of shares & money**

Types of Trading

- **Delivery-based trading** – Shares held in Demat
- **Intraday trading** – Buy & sell on same day

Importance

- Provides liquidity
- Helps price discovery
- Ensures safe & transparent transactions

Various Speculative Transactions

Speculative transactions are stock-exchange dealings made to **earn profit from price fluctuations**, not for long-term investment.

Main Types

- **Bull**
  Buys securities expecting **price to rise**, then sells at a profit.

- **Bear**
  Sells securities expecting **price to fall**, then buys later at a lower price.
- **Stag**
  Applies for **new issue shares** and sells them on listing for quick profit.
- **Lame Duck**
  A speculator who **fails to meet obligations** due to losses.
- **Arbitrageur**
  Buys securities in one market and sells in another where the price is higher.
- **Scalper**
  Makes many **small, quick trades** to earn minor profits.

1. Secondary Markets

- **Definition:** Secondary markets are financial markets where existing securities (like shares, debentures, bonds) are bought and sold among investors.
- **Purpose:** They provide **liquidity** to investors, enabling them to sell their securities and get cash.
- **Examples:** NSE (National Stock Exchange), BSE (Bombay Stock Exchange).

2. Stock Exchange

- **Definition:** A stock exchange is a **regulated marketplace** where buyers and sellers trade securities.
- **Functions:**
  - Facilitates buying/selling of shares.
  - Helps companies raise capital through listed shares.
  - Ensures **fair and transparent trading**.
- **Examples in India:** NSE, BSE.

3. Role of Secondary Markets

- Provides **liquidity** to investors.
- Helps in **price discovery** – determining the value of securities based on demand and supply.
- Reduces risk by allowing **easy transfer of securities**.
- Encourages **investment culture** among the public.

4. Trading in Stock Exchange

- **Methods of Trading:**
  - **Floor Trading:** Traditional method on trading floor (less common now).
  - **Electronic Trading:** Online trading platforms (most common today).
- **Process:**
  1. Investor places an order (buy/sell).
  2. Order is matched with a seller/buyer.
  3. Transaction is completed and recorded.

4. **Participants:** Investors, brokers, market makers, and regulators.

5. Various Speculative Transactions

- **Speculation:** Buying/selling securities with the aim of making short-term profits based on price fluctuations.
- **Types of Speculative Transactions:**
  - **Day Trading:** Buying and selling on the same day.
  - **Swing Trading:** Holding securities for a few days to weeks to profit from price swings.
  - **Options and Futures Trading:** Contracts to buy/sell at a future date at a fixed price.

6. Role of SEBI (Securities and Exchange Board of India)

- **Definition:** SEBI is the regulatory authority for securities markets in India.
- **Functions:**
  - Regulates **stock exchanges and brokers**.
  - Protects **investors' interests**.
  - Prevents **malpractices like insider trading**.
  - Promotes **development of capital markets**.

If you want, I can make a **super short, easy-to-remember version** of all this for quick exam revision. It will fit in one small page. Do you want me to do that?

Regulation of stock exchange

Here's a clear explanation:

Regulation of Stock Exchange

Definition:
Regulation of a stock exchange means **monitoring and controlling the activities** of the exchange and its participants to ensure **fair, transparent, and orderly trading**.

Regulatory Authorities:

- **SEBI (Securities and Exchange Board of India)** – Main regulator in India.
- **Stock Exchanges themselves** – Have their own rules and compliance systems.

Objectives of Regulation:

- Protect **investors' interests**.
- Ensure **fair trading practices**.
- Prevent **malpractices** like insider trading, price rigging, or fraud.
- Maintain **financial stability** of the market.

Methods of Regulation:

- **Registration & Licensing:** Brokers, sub-brokers, and other intermediaries must be registered.
- **Monitoring Trading Activities:** Exchanges track transactions to detect irregularities.
- **Disclosures & Reporting:** Companies must provide timely financial information.
- **Imposing Penalties:** Violators of rules can face fines, suspension, or cancellation of licenses.
- **Audit & Inspection:** Periodic checks to ensure compliance.

Key Role:

- SEBI ensures that the **stock exchange operates efficiently** and **investors' money is safe**.

UNIT IV

Banks as Intermediaries

Banks act as financial intermediaries by connecting people who save money (surplus units) with people who need money (deficit units).

How banks work as intermediaries

Accepting deposits

Banks collect money from individuals, businesses, and institutions in the form of savings accounts, current accounts, and fixed deposits.Depositors earn interest on their savings**.**

Providing loans and advances

Banks lend this deposited money to borrowers such as individuals, businesses, and governments**.**

Borrowers pay interest on the loans.

Earning income

The difference between the interest paid to depositors and the interest charged to borrowers is the bank's main source of income (called the interest margin).

Importance of banks as intermediaries

Mobilize savings: Encourage people to save and bring idle money into the economy.

Promote investment: Provide funds for business expansion, education, housing, and agriculture.

Reduce risk: Spread risk by lending to many borrowers instead of one.

Ensure liquidity: Allow depositors to withdraw money when needed.

Support economic growth: Smooth flow of funds boosts production, employment, and development.

Simple example

A person deposits ₹10,000 in a bank.

The bank lends this money to a small business owner.

Both benefit: the depositor earns interest, and the borrower gets funds to run the business.

In short, banks act as a bridge between savers and borrowers, making them essential intermediaries in the financial system.

Investment Companies – Short Notes

Investment companies are financial institutions that collect money from investors and invest it in a diversified portfolio of securities such as shares, bonds, and other financial assets.

Meaning

An investment company pools savings from many investors and invests them on their behalf to earn returns in the form of income and capital appreciation.

Functions of Investment Companies

Mobilization of savings – Collect funds from small and large investors.

Investment of funds – Invest in shares, debentures, bonds, and other securities.

Risk diversification – Spread investments across many securities to reduce risk**.**

Professional management – Managed by experts who analyze and select investments.

Liquidity – Investors can easily buy or sell units/shares.

Types of Investment Companies

Open-ended investment companies

Issue shares continuously.

Investors can buy or redeem shares anytime.

Example: Mutual funds**.**

Close-ended investment companies

Issue a fixed number of shares.

Shares are traded on stock exchanges.

Unit trusts

Funds are divided into units held by investors.

Income is shared proportionately.

Advantages

Suitable for small investors

Reduced risk through diversification

Access to professional fund management

High liquidity

Encourages capital market development

Disadvantages

Management fees reduce returns

No direct control over investment decisions

Market risk still exists

Conclusion

Investment companies play a vital role as financial intermediaries, channeling savings into productive investments and supporting economic growth.

UNIT V

Modes of Financing

Modes of financing refer to the different ways by which a business raises funds to meet its financial needs. A company can arrange finance from **owners**, **outsiders**, and **financial institutions**.

1. Equity Financing

- Funds raised by issuing **equity shares**.
- Owners get voting rights.
- No fixed interest or repayment obligation.

2. Debt Financing

- Borrowed funds with **fixed interest**.
- Includes loans from banks, debentures, bonds, etc.
- Must be repaid within a specific period.

3. Internal Financing

- Funds generated **within the business**.
- Examples: retained earnings, depreciation funds, sale of assets.
- No cost of capital and no dilution of control.

4. Short-Term Financing

- Finance obtained for **less than 1 year**.
- Used for working capital needs.
- Sources: trade credit, bank overdraft, cash credit, commercial paper.

5. Long-Term Financing

- Finance for **more than 5 years**.
- Used for purchase of fixed assets and expansion.
- Sources: shares, debentures, term loans, venture capital.

6. Lease Financing

- Business uses assets by paying **rent** instead of buying.
- Useful for machinery, vehicles, equipment.

7. Venture Capital / Private Equity

- Funds provided by investors to **new, innovative, or risky businesses**.
- Investors get ownership and long-term returns.

8. Government & Institutional Financing

- Loans from institutions like **IDBI, IFCI, LIC, GIC, SIDBI**, etc.
- Used for industrial and large-scale development.

Leasing as a Source of Finance

Leasing is a method of obtaining the right to use an asset (like machines, vehicles, equipment, computers) **without owning it**. The business (lessee) pays a **periodic rent** to the owner (lessor) for using the asset.

Definition

Leasing is a contractual arrangement where the **lessor** (owner) allows the **lessee** (user) to use an asset for a fixed period in return for **regular lease rentals**.

Features

- Ownership stays with **lessor**.
- Lessee only gets the **right to use** the asset.
- Payments are made as **lease rentals**.
- Useful when a business cannot afford to buy expensive assets.

Types of Leasing

1. Operating Lease

- Short-term.
- Asset is returned to lessor after lease period.
- Maintenance done by lessor.

2. Financial Lease

- Long-term and non-cancellable.
- Lessee bears maintenance and risks.
- Lease rentals cover the full cost of the asset.

Advantages

- No need for huge upfront investment.
- Improves cash flow and liquidity.
- Easy and quick to obtain.
- Useful for assets that become outdated quickly.
- Lease rentals are tax deductible (for businesses).

Disadvantages

- Total lease cost may be higher than buying.
- Lessee does not get ownership.
- Restrictions may be imposed in the lease contract.

Forms of Leasing

Leasing has several forms depending on the nature, duration, and responsibilities of the parties involved. The main forms are:

1. Operating Lease

- Short-term lease.
- Lessee uses the asset for a limited period.
- Maintenance and repairs are done by the **lessor**.
- Asset is returned after the lease period.

2. Financial Lease (Capital Lease)

- Long-term, non-cancellable lease.
- Lessee bears maintenance, insurance, and risks.
- Lease rentals cover the full cost of the asset.
- Used for machinery and equipment.

3. Sale and Leaseback

- The company **sells its asset** to a leasing company and then **takes it back on lease**.
- Helps generate immediate cash while still using the asset.

4. Leveraged Lease

- Asset is financed by **multiple parties**.
- Lessor borrows a major portion of the cost from lenders.
- Used for large, expensive assets like aircraft, ships, heavy machinery.

5. Direct Lease

- Lessor buys the asset and leases it directly to the lessee.
- Common in equipment leasing.

6. Open-End and Closed-End Lease

Open-End Lease

- Lessee may have to pay for difference between asset value and residual value.

Closed-End Lease

- Lessee returns the asset without any additional obligation.

7. Domestic and International Lease

Domestic Lease

- Both lessor and lessee are from the same country.

International Lease

- Parties are from different countries (used for global equipment and aircraft).

Venture Capital

Venture Capital (VC) is a form of financing provided by **specialized investors** to **new, innovative, high-risk start-up companies** that have strong growth potential but lack access to traditional bank loans.

Definition

Venture capital is **equity or equity-linked financing** given to early-stage and high-potential businesses in return for **ownership (shares)** and future profits.

Features

- Funds provided to **new or growing start-ups**.
- High risk, but potential for high returns.
- Venture capitalists get **equity** and become part-owners.
- They offer not only funds but also **management guidance** and **technical support**.

Stages of Venture Capital Financing

- **Seed Capital** – For research, product development, and idea testing.
- **Start-up Finance** – For launching the product commercially.
- **Early / Expansion Finance** – For business growth, marketing, capacity expansion.
- **Later Stage / Mezzanine Finance** – For scaling up operations before IPO.

Advantages

- Helps start-ups grow quickly.
- Provides expert advice and networking support.

- No fixed interest or repayment like loans.
- Encourages innovation and new technology.

Disadvantages

- Founders may lose some control due to shared ownership.
- Investors expect high returns and involvement in decisions

Examples of Venture Capital Firms in India

- **Sequoia Capital**
- **Accel Partners**
- **Tiger Global**
- **IDBI Venture Capital Fund**

Dimensions of Finance Function

The finance function in a business has **two main dimensions**:

1. Investment Decision (Capital Budgeting)

This dimension deals with **how the firm uses its funds**.
It includes decisions related to:

- Purchasing fixed assets (machinery, buildings).
- Selecting profitable projects.
- Allocation of funds among different investment options.

Goal: Choose investments that give maximum returns with minimum risk.

2. Financing Decision

This dimension deals with **how the firm raises funds**.
It includes decisions about:

- Sources of finance (equity, debt, loans, retained earnings).
- Optimal capital structure (mix of debt and equity).
- Cost of capital.

Goal: Raise funds at minimum cost while maintaining financial stability.

3. Dividend Decision

This dimension decides **how much profit should be distributed** to shareholders and how much should be retained in the business.

It includes:

- Dividend payout ratio
- Retained earnings policy

Goal: Balance shareholder satisfaction and future growth.

4. Liquidity Decision (Working Capital Management)

This dimension ensures the firm has **enough cash** for day-to-day operations.

It includes:

- Managing cash, inventories, receivables, payables
- Maintaining adequate working capital

Goal: Ensure smooth business operations and avoid liquidity problems.

Venture Capital in India

Venture Capital (VC) in India refers to **equity financing provided to new, innovative and high-growth start-up companies**. It supports entrepreneurs who have potential but lack access to traditional bank finance.

Development of Venture Capital in India

- VC activity in India started in the **mid-1980s** with support from financial institutions like **IDBI, ICICI, and IFCI**.
- The Government of India and SEBI introduced policies to promote VC funds and start-up growth.
- After 2000, India saw rapid growth in VC due to the rise of **IT, e-commerce, fintech, biotech**, and other technology sectors.
- Today, India is one of the **top start-up ecosystems** in the world.

Major Venture Capital Institutions in India

- **IDBI Venture Capital Fund**
- **ICICI Venture**
- **IFCI Venture Capital Funds Ltd.**
- **SIDBI Venture Capital Ltd. (SVCL)**
- **Risk Capital Technology Finance Corporation (RCTFC)**
- **Private VC firms** like Sequoia Capital, Accel, Tiger Global, Matrix Partners, Nexus Venture Partners.

Sectors Receiving Venture Capital in India

- Information Technology (IT)
- E-commerce
- Fintech
- Healthcare & Biotechnology
- EdTech
- Renewable Energy
- Consumer services

Advantages of Venture Capital in India

- Promotes innovation and entrepreneurship
- Provides not just funds but also management guidance
- Helps start-ups scale quickly
- Encourages technological development

Challenges of Venture Capital in India

- High risk due to start-up failures
- Long gestation period for returns
- Limited exit options in some industries.

Factoring

Factoring is a financial service where a business **sells its accounts receivable (debts owed by customers) to a financial institution (called a factor)** to get **immediate cash** instead of waiting for customer payments.

It is mainly used for **short-term finance** and working capital management.

Definition

Factoring is an arrangement in which a **factor** (financial institution or bank) buys the **receivables of a business** at a discount and collects payments from the debtors.

Features

- Business sells **accounts receivable** to the factor.
- Factor provides **immediate cash** (usually 70–90% of invoice value).
- Factor takes responsibility for **collection** of debts.
- Service includes **finance, credit protection, and debt collection**.

Types of Factoring

- **Recourse Factoring** – Business is responsible if the customer fails to pay.
- **Non-Recourse Factoring** – Factor bears the risk of customer default.
- **Maturity Factoring** – Payment made to business after a fixed period.
- **Advance Factoring** – Immediate cash is given against receivables.

Advantages

- Improves cash flow and liquidity.
- Reduces the burden of **debt collection**.
- Helps in **credit management**.
- Suitable for businesses with **large accounts receivable**.

Disadvantages

- Factor charges **service fees** or discount, reducing profit.
- Business may lose **direct relationship with customers**.
- Only suitable for businesses with **good-quality receivables**.

Types of Factoring

Factoring can be classified based on **risk, payment timing, and services offered**:

1. Recourse Factoring

- The **business bears the risk** if the customer fails to pay.
- Factor can claim the money back from the business.
- Lower fees because risk is with the business.

2. Non-Recourse Factoring

- The **factor bears the risk** of customer default.
- Business is protected if customers fail to pay.
- Higher fees due to higher risk for the factor.

3. Advance Factoring

- Factor provides **immediate cash** (advance) against receivables.
- Helps business maintain liquidity.

4. Maturity Factoring

- Factor pays the business **only after customers pay**.
- No advance is given.

5. Domestic Factoring

- Both business and its customers are **in the same country**.

6. Export Factoring (International Factoring)

- Used for **foreign trade**.
- Factor manages receivables and collections from international buyers.
- Helps reduce **foreign exchange and credit risks**.

Meaning of the terms

- **Recourse** – business bears default risk.
- **Non-recourse** – factor bears default risk.
- **Advance** – immediate cash given.
- **Maturity** – payment after customer pays.
- **Domestic** – within the country.
- **Export** – for international trade.

Modus Operandi of Factoring

Factoring works as a **financial service for managing receivables**. The process involves a series of steps between the business (seller), factor (financial institution), and customers (debtors).

Step-by-Step Process

- **Agreement Between Business and Factor**
    - The business enters into a **factoring agreement** with the factor.
    - Terms include **advance percentage, fees, type of factoring (recourse/non-recourse), and services provided**.
- **Sale of Receivables**
    - The business **sells its accounts receivable** (invoices) to the factor.
    - These receivables can be **domestic or export invoices**.
- **Advance Payment by Factor**
    - Factor provides **immediate cash**, usually **70–90% of invoice value**, to the business.

    - This improves the business's **liquidity and working capital**.
- **Collection from Customers**
    - Factor takes responsibility for **collecting payments** from the debtors.
    - Ensures timely payment and credit management.
- **Settlement of Remaining Amount**
    - Once the customer pays, the factor **remits the balance** to the business, after deducting **factoring fees and charges**.
- **Risk Bearing (if non-recourse)**
    - In **non-recourse factoring**, the factor bears the **risk of customer default**.
    - In **recourse factoring**, the business is liable if the customer fails to pay.

Factoring as a Source of Finance

Factoring is a financial service where a business **sells its accounts receivable (debts owed by customers) to a factor (financial institution)** to get **immediate cash**. It is an important **short-term source of finance** for working capital management.

Definition

Factoring is an arrangement in which a factor **buys the receivables of a business** at a discount and **collects payments** from the debtors.

Features

- Provides **immediate liquidity** to the business.
- Factor takes care of **credit management and debt collection**.
- Can be **recourse** (business bears default risk) or **non-recourse** (factor bears risk).
- Mainly used for **short-term finance** and **working capital**.

Advantages

- Converts receivables into **ready cash**.
- Reduces the burden of **debt collection**.
- Helps in **maintaining liquidity** for day-to-day operations.
- Can protect against **bad debts** (if non-recourse).

Disadvantages

- Factor charges **fees/discount**, reducing profits.
- May reduce **direct control over customers**.

- Only suitable for businesses with **reliable receivables**.

Securitisation of Assets

Securitisation is a financial technique where a company **converts its illiquid assets (like loans, receivables, or mortgages) into marketable securities** that can be sold to investors to raise funds.

It is mainly used for **long-term finance** and improving liquidity.

Definition

Securitisation is the process of **pooling financial assets** and **issuing securities backed by these assets** to investors.

- The company gets **immediate cash**.
- Investors receive **returns from the cash flows** generated by these assets.

Process / Modus Operandi

- **Asset Pooling** – Company identifies assets like loans, receivables, or mortgages.
- **Special Purpose Vehicle (SPV)** – Assets are transferred to an SPV, which issues securities.
- **Issuance of Securities** – SPV sells these securities to investors.
- **Cash Flow Management** – Payments from underlying assets are passed to investors.
- **Fund Utilisation** – Company uses cash for growth, debt repayment, or working capital.

Advantages

- Converts **illiquid assets into liquid funds**.
- Reduces **financial risk** and improves balance sheet.
- Provides **long-term financing** without increasing debt.
- Investors earn **steady returns** from underlying assets.

Disadvantages

- Complex and costly process.
- Requires regulatory compliance and legal framework.
- Risk depends on the **quality of underlying assets**.

Mechanics of Securitisation

Securitisation involves a **structured process** where financial assets are transformed into marketable securities. The process can be broken down into key steps:

1. Asset Identification

- The company identifies **financial assets** such as:
    - Loans
    - Mortgages
    - Receivables (accounts receivable)
- Only assets with **predictable cash flows** are suitable.

2. Creation of Special Purpose Vehicle (SPV)

- Assets are **transferred to an SPV**, a separate legal entity.
- SPV isolates the assets from the company's balance sheet.

3. Pooling of Assets

- Similar assets are **pooled together** to create a large, homogeneous portfolio.
- Pooling helps **diversify risk** and improves attractiveness to investors.

4. Issuance of Securities

- SPV issues **securities backed by the pooled assets** to investors.
- Types of securities can be:
- Asset-backed securities (ABS)
- Mortgage-backed securities (MBS)

5. Sale to Investors

- Investors purchase the securities and provide **funds to the SPV**.
- The company receives **immediate cash** from the SPV.

6. Cash Flow Distribution

- Payments from the underlying assets (loan EMIs, receivables, interest) are collected by the SPV.
- SPV distributes these **cash flows as returns to investors**.

7. Credit Enhancement (Optional)

- To reduce risk for investors, measures such as:
- Reserve funds
- Third-party guarantees
- Subordination of lower-priority securities
- Are often included.

Utility of Securitisation

Securitisation is a process of converting **illiquid financial assets into marketable securities**. Its utility lies in helping both businesses and investors in various ways.

1. Provides Immediate Liquidity

- Converts assets like loans, receivables, and mortgages into **cash**.
- Helps businesses meet **working capital needs** or fund new projects.

2. Risk Transfer

- Transfers the **credit risk** of underlying assets from the company to investors.
- Reduces the impact of **default risk** on the company's balance sheet.

3. Diversification of Funding

- Offers an **alternative source of finance** apart from bank loans and equity.
- Companies can **raise long-term funds** without increasing debt.

4. Balance Sheet Management

- Assets transferred to SPV are **off the company's balance sheet**.
- Improves financial ratios and **reduces leverage**.

5. Investment Opportunities for Investors

- Provides investors with **fixed-income securities** backed by cash flows of assets.
- Attractive for institutional investors looking for **predictable returns**.

6. Encourages Lending and Credit Expansion

- By securitising loans, banks and financial institutions **free capital**.
- This allows them to **lend more**, promoting economic growth.

Securitisation in India

Securitisation in India refers to the process where financial institutions **convert illiquid assets like loans or receivables into marketable securities** to raise funds.

It helps banks, financial institutions, and companies to **improve liquidity** and manage credit efficiently.

Development in India

- Introduced in India in **early 2000s**.
- **Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002** played a key role.

- Encouraged **banks, NBFCs, and other institutions** to securitise loans and improve capital efficiency.
- SEBI and RBI provide **regulatory guidelines** for securitisation and asset-backed securities (ABS).

Institutions Involved

- **Banks** – use securitisation to manage non-performing assets (NPAs).
- **Non-Banking Financial Companies (NBFCs)** – issue asset-backed securities.
- **Investors** – institutional investors like mutual funds, insurance companies, and pension funds invest in ABS.

Sectors Using Securitisation in India

- Housing loans and mortgages
- Vehicle loans
- Credit card receivables
- SME loans and trade receivables

Benefits

- Provides **immediate liquidity** to banks and companies.
- Improves **asset-liability management**.
- Encourages **credit expansion** and economic growth.
- Reduces risk of default if structured properly.

Material Prepared by

Dr.B.Divya Keerthika

Assistant Professor

Department of Commerce with Professional Accounting

Vidyasagar College of Arts and Science

Udumalpet

Reference Books

- Financial Markets and Securities: E.Gordon K.Natarajan
- Net sources .