



MBA DEPARTMENT

Concepts in Financial Services and Systems

1. **Financial System:** The 'Financial system' is a broader term which brings under its fold the financial markets and the financial institutions which support the system. The major assets traded in the financial system are money and monetary assets.
2. **Financial Assets:** A Financial Asset is one which is used for production or consumption or for further creation of assets. The basic product of any financial system is the financial asset.

Classification of Financial Assets: Financial Assets can be classified into:

a. Marketable assets b. Non-Marketable assets.

3. **Financial Intermediaries:** The term financial intermediary includes all kinds of organizations which intermediate and facilitate financial transactions of both individuals and corporate customers. Thus, it refers to all kinds of financial institutions and investing institutions which facilitate financial transactions in financial markets.

They may also be classified into two;

1. Capital Market intermediaries
2. Money market intermediaries

1. 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.

2. Money market intermediaries: They supply only short term funds to individuals and corporate customers. These consist of commercial banks, co-operative banks, etc.

4. **Financial Markets:** Generally, 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. However, financial markets can be referred to as those centers and arrangements which facilitate buying and selling of financial assets, claims and services. Some times we do find the existence of a specific place or location for a financial market as in the case of stock exchange. These markets got divided into 1. Organized Market 2 . Unorganized market.

5. **Organized market:** There are standardized rules and regulations governing their financial dealings. These markets are subject or strict supervision and control by the RBI or other regulatory bodies. A. Capital Market B. Money Market.
6. **Unorganized Market:** In this market there are a number of money lenders, indigenous bankers, traders etc. The regulations concerning their financial dealings are still inadequate and their financial instruments have not been standardized.
7. **Capital Market:** The capital market is market for financial assets which have a long or indefinite maturity. It deals with long term securities which have a maturity period of above one year. Ex: Equity shares, Preference shares, Bonds and Debentures etc. This market is controlled by SEBI (Securities Exchange Board of India).
8. **Money Market:** Money market is a market for dealing with financial assets and securities which have a maturity period of upto one year. It is a market purely short term funds. Ex: Call money market, Commercial bill market, Treasury bill market, Short term loan market.
9. **Primary Market / New Issue market:** It is a market for new issues or new financial claims. It deals with those securities which are issued to the public for the first time.
10. **Secondary market:** Secondary market is a market for secondary sale of securities. In other words the securities which have already passed through the new issue market are traded in this market. This market consists of all stock exchanges recognized by the Government of India.
11. **Foreign Exchange market:** The term foreign exchange market refers to the process of converting home currencies into foreign currencies and vice versa.
12. **Financial Instruments:** Financial Instruments refer to those documents which represent financial claims on assets. Financial asset refers to a claim to the repayment of certain sum of money at the end of a specified period together with interest of dividend. Ex: Bill of exchange, Promissory note, Treasury bill, Government Bonds, Share, Debentures etc.

13. **Leasing:** lease is a contract between the owner of an asset (the lessor) and its user (the lessee) for the right to use the asset during a specified period in return for a mutually agreed periodic payment (the lease rentals)

Lease agreements are basically of two types. They are (a) Financial lease and (b) Operating lease. The other variations in lease agreements are (c) Sale and lease back (d) Leveraged leasing and (e) Cross Border Leasing.

14. **Financial Lease:** Long-term, non-cancellable lease contracts are known as financial leases. A Financial Lease is like an installment loan. It is a legal commitment to pay for the entire cost of the equipment plus interest over a specified period of time. The lessee commits to a series of payment which in total exceed the cost of the equipment. The Risk of obsolescence is assumed by the lessee. Ex: Air crafts, and building, Heavy machinery are leased.
15. **Operating lease:** An Operating lease is also known as Service lease, or short term lease or True lease. An Operating lease is a rental agreement. The lessee is not committed to paying more than the original cost of equipment during contractual period. Ex: Computers, office equipments, automobiles, truck etc.
16. **Sale and Lease Back:** The owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of lease rentals. However, under this arrangement, the assets are not physically exchanged but it all happens in records only. This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected depreciation but appreciation, say land.
17. **Direct Leasing:** Under direct leasing, a firm acquires the right to use an asset from the manufacturer directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc.
18. **Sub-lease:** A transaction in which leased property is released by the original lessee to a third party, and the lease agreement between the two original parties remains in effect.
19. **Hire Purchase:** Hire purchase is a type of installment credit under which the hire purchaser, called the hirer, agrees to take the goods on hire at a stated rental, which is inclusive of the repayment of principal as well as interest, with an option to purchase. Under this transaction, the hire purchaser acquires the property (goods) immediately on signing the hire purchase

agreement but the ownership or title of the same is transferred only when the last installment is paid. The hire purchase system is regulated by the Hire Purchase Act 1972.

20. **Factoring:** factoring is an arrangement under which a financial institution (called factor) undertakes the task of collecting the book debts of its client in return for a service charge in the form of discount or rebate.
21. **Credit Rating:** According to CRISIL, "Credit rating is an unbiased and independent opinion as to issuer's capacity to meet its financial obligations. It does not constitute a recommendation to buy/sell or hold a particular security"
22. **Credit Card:** A Credit card is a card or mechanism which enables cardholders to purchase goods, travel and dine in a hotel without making immediate payments.
23. **Smart card:** It is a new generation card. Embedded in the smart card a microchip will store a monetary value. When a transaction is made using the card, the value is debited and the balance comes down automatically. Once the monetary value comes down to nil, the balance is to be restored all over again for the card to become operational.
24. **ATM Card:** (An Automatic Teller Machine) card is useful to a card holder as it helps him to withdraw cash from banks even when they are closed. This can be done by inserting the card in the ATM installed at various bank location.
25. **Mutual Fund :** 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'.
26. **Venture capital:** 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.
27. **Merchant banking :** it is an institution which covers a wide range of activities such as management of customer services, portfolio management, credit syndication, acceptance credit, counseling, insurance etc.
28. **Project counseling :** Project counseling includes preparation of project reports, deciding upon the financing pattern to finance the cost of the project an appraising project report with the financial institution and banks.
29. **Loan syndication :** loan syndication refers to assistance rendered by merchant banks to get mainly term loan projects. Such loans may be obtained from a single development, finance institution or a syndicate or consortium.

30. **Issue Management** : Management of issue involves marketing of corporate securities viz equity shares, preference shares and debentures or bonds by offering them to public. Merchant banks act as intermediary whose main job is to transfer capital from those who own it to those who need it. The issue function may be broadly divided into,
1. Pre issue management
 2. Post issue management.
31. **Portfolio management** : It refers to maintain proper combination of securities in a manner they give maximum return with minimum risk.
32. **Underwriting of public issue** : Underwriting is a guarantee given by the underwriters that in the event of under subscription the amount underwritten, would be subscribed by him.
33. **Merger** : A merger is a combination of two or more companies into a single company where one survives and others lose their corporate existence.
34. **Takeover** : A takeover is the purchase by one company acquiring controlling interest in the share capital of another company.
35. **Forfeiting** : it is a technique by which a forfeiter (financing agency) discounts an export bill and pays ready cash to the exporter who can concentrate on export front without bothering about collection of export bills.
36. **Custodial services** : 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 for a prescribed fee.
37. **Financial Innovation** : Financial innovation is the design, the development and the implementation of innovative financial instrument and process the formulation of creative solution to problems in finance.
38. **Depository** : A depository can be defined as, "an institution which transfers the ownership of securities in electronic mode on behalf of its members."
39. **Right Issue** : Sec.81 of the Companies Act specifies the conditions to be satisfied by a public company for issuing rights shares. Right shares are offered to the existing share holders in a particular proportion to their existing share ownership.
40. **Pension Fund** : A Fund established by private employers, governments or unions for the payment of retirement benefits is known as a Pension Fund.

41. **Blue Chip Shares** : Shares of well-known and established companies are called Blue Chip Shares. They must show consistent growth over the years.
42. **Defensive Shares** : These shares tend to fall less in a bare market when compared with other shares and they provide a safe return for the investor's money. In other words these shares are more stable than other shares.
43. **Growth Shares** : They represent the shares of the fast growing companies. They show increasing and higher than average earnings per share than the industry. They are good for long-term investment, although the current yield of shares can be insignificant, because of their higher P/E ratios.
44. **Commercial Paper** : A Commercial Paper is a short term negotiable money market instrument, with a fixed maturity of 3-6 months banking and non-banking companies can issue this for raising short term debts. It also carries an attractive rate of interest. Since its denomination is very high, it is suitable only to institutional investors.
45. **Treasury Bill** : A Treasury Bill is also a money market instrument issued by central govt. It is issued at a discount and redeemed at par. It is between 1 82-3 64 days.
46. **Deep Discount Bonds** : There will be no interest payment in the case of these bonds; hence they are sold at a large discount to their nominal value.
47. **Convertible Bonds** : A Convertible Bond is one which can be converted into equity share at a predetermined timing either fully or partially.
48. **Securitization** : Securitization refers to the process of liquidating the illiquid and long term assets like loans and receivables of financial institutions like banks by issuing marketable securities against them.
49. **Forward Contract** : A Forward Contract refers to an agreement between two parties to exchange an agreed quantity of an asset for cash at a certain date in future at a predetermined price specified in that agreement.
50. **Derivative** : Derivatives involve payment/ receipt of income generated by the underlying asset on a notional principle in other words derivatives are those which derive their value from an underlying asset. Ex: One takes an insurance against his house covering all risks. This insurance is called a derivative instrument on the house.