Financial Instrument

A financial instrument consists of a combination of the characteristics such as yield, price and credit risk, liquidity quantum and maturity structure etc. The process of financial innovation involves creating new instruments and techniques by unpacking and re-bundling of the same characteristics in different fashion to suit the ever changing needs of the issuers and the investors.

Commercial paper (Not longer than 1 year)

This is short-term fund raising mechanism that has become popular , in the recent past. The salient features are:

It is a promissory note negotiable by endorsement and delivery will be effected at a discount.

To give a boost to the money market and reducing the dependence of highly rated corporate borrowers on bank finance for meeting their working capital requirement, corporate borrowers were permitted to arrange short terms borrowing by issue of commercial papers w.e.f. 1st Jan, 1990. It is being regulated by the RBI. The interest rates on such an instrument is determined by the market forces. The companies which are allowed to issue 'Commercial paper' must have a net worth of Rs. 10 crores, maximum permissible bank finance not less then Rs. 25 crore and are listed on the stock exchange. In India, the cost of a C.P will include the following components:

1) discount
2) rating charges
3) stamp duty
4) issuing
5) issuing paying agent (IPA) charges

A commercial paper is a short term insurance promissory note issued by a company negotiable by endorsement and delivery, issued a such a discount on face value as may be determined by the company.

Zero Interest Convertible Debentures /Bonds

These instruments have been introduced in the Capital Market very recently. The Debentures / Bonds are convertible into equity shares after a period of time and no interest is payable till such conversion. Since the conversion takes place normally after the project bears fruit, the company would be in a better position to service the equity as no interest is payable on the instrument. From the investor's angle, interest is only notional and is adjusted at the time of conversion in the premium fixation. This gain is to be looked only on the sale of shares and would be a long-term capital gain , with the usual exemption available. More importantly, the interest income, which in this case is notional, of course, would not be subject to tax. The conventional interest bearing debentures which are also being offered to public is not discussed here.

Deep Discount Bond(Zero interest bonds)

These Bonds are sold at a large discount to its nominal value as there will be no interest payments. In some cases, the maturity periods of these bonds can extend as far as 25 years with an option to the investors to withdraw at the end of each term , say 3 or 5 years from the date of allotment. These bonds have been recently offered by IDBI to individuals, partnership firms and companies etc., as an unsecured instrument. The scheme would be attractive when the interest rates in the market are stagnant.

Option Bonds

These are cumulative and non- cumulative bonds where in the interest are accumulated and is payable on maturity or the interest fs paid periodically, as the case may be. In certain cases, redemption premium is also offered to attract the investors. These bonds have also been recently issued by IDBI.

Partly Convertible Debentures with buy back arrangements: In a recent issue made Kotak Mahindra Finance Limited , the company has offered to its investors, a novel scheme of partly convertible debentures. The salient features are that a part of the debenture money will be converted into equity (with premium), after stipulated period. The balance money i.e. the non-convertible portion is redeemed at par in three annual installments at the end of 7th , 8th and 9th years from the date of allotment of the Debentures The company , in this case, made an arrangement with a Bank to buy back the non- convertible portion of the Debentures (KHOKHA) at a discount. It appears that the market has responded to this offer, in good numbers.

Non-Convertible Debentures with Equity warrants: The issue was recently made by ITC Agrotech Limited, where in debentures are to be redeemed in full at the usual premium of 5% in three annual installments at the end of 7th , 8th and 9th year from the date of allotment. One detachable share warrant was also attached with each debenture. The holder thereof shall have the option to exchange the warrant for one equity share at its face value at the end of 12 months from the date of allotment of debentures, on surrender of the warrant along with the payment for the equity share, at face value.

Cumulative Convertible Preference Shares (CCPs): The government has issued guidelines for the companies proposing to issue CCPs. pre salient features are :

The entire issue of CCP would be convertible into equity shares between the end of 3 years and 5 years, as may be decided by the company.

The conversion of CCP into equity would be deemed as being one resulting from the process of redemption of the preference shares out of the proceeds of the fresh issue made for the purpose of redemption. The rate of preference dividend payable on CCP would be 10%. The preference share would have voting rights as applicable to preference shares under the companies Act, 1956. The face value of the aforesaid shares will ordinarily be Rs.100 each. It appears that this scheme was riot found favorable by the investors.

Stocinvest: A new instrument called stock invests has been introduced as per the scheme prepared by the SBI and approved by the RBI. The investor who has an account for a deposit with the SBI can request the bank, in writing, to issue a statement expressing that it is guaranteed for payment at par on all branches. The investor while applying for the public issue will enclose the stock invest forms duly filled in along with an application form and send them to the collecting bank, as he normally does under the existing system. Stockinvest is not alternative, but an additional facility available to the investor in case he so opts. The issuing company on the basis of allotment to the applicant would encash the stockinvest instrument in respect of those applicants who are successful allottees. The unsuccessful applicants stockinvest instruments would be returned to the investor without encashing them. The scheme is aimed at avoiding blocking of funds of the investors and any complaint about non-payment delay in respect of share application money from the investing public.

Non-Convertible Debentures on Private Placement basis.

The investment institutions like UTI, LIC, GIC and mutual funds and some banks agree to subscribe to the Non-Convertible Debentures issued by the companies to meet their long-term working capital requirements. The procedure is very simple and the investing institutions after satisfying the eligible criteria as per the government guidelines subscribe to the debentures issued by the company However in view of the recent relaxation on ceiling of interest rates, the investing institutions have the freedom to charge interest at a higher rate above 14% depending upon the company's standing.

Unsecured Short-term Deposit: The investment institutions like UTI place unsecured short-term deposits sought by the companies to meet their short-term working capita requirements. The interest rate would be the prevailing working capital interest rate normally, and is repayable within 12 months. Formalities are simple and the lead-time for placement of deposit is very short since this is an unsecured deposit.

Index-Linked Gills (Fully secured or Govt security): Currently, the dated Securities issued by the Central Government offer a coupon rate varying between 10 to 11.5% p.a. (recently hiked to 12 % p.a. on new issues), depending upon the term of maturity. Given an average annual inflation rate of 10% p.a. The inflation-adjusted rate of return real rate of return earned on these securities is just marginally positive and can be negative in those periods, where the inflation rate exceeds the coupon rate. To protect the institutional investment (a significant part of which gets canalized into Government securities) from the purchasing power risk or inflation risk, we can consider the introduction of "Index-Linked Gilts". These index-linked gilts are inflation -proof over their terms of maturity.

The Government can issue index-linked gilts along with the following lines

The base for index-linking can be the Consumer Price Index (CPI). Each intervening coupon payment and the maturity proceeds are to be increased in the ratio of the CPI value.

Index-Linked Gilts were introduced in 1981 and have been growing in importance over the last ten years. Given the fact that an index-linked gilt-edged stock is a low income -high capital gains stock, the stock has also attracted considerable amount of investment from individual investors in the higher brackets.

Variable Rate Instrument: These are the debt instruments with a coupon rate of interest which is not fixed but which varies in accordance with some predetermined formula. For Example, the instrument may provide for the coupon being determined at six- monthly intervals at a margin above the six-month inter -bank rate.

One of the popular types of variable -rates instruments is the "drop-Lock" loan. Under this financing arrangement, the borrower borrows funds at some margin over the at the prevailing bank interest rate from the financial institutions. The interest payable from time to time varies according to the money-market conditions. However, if the short-term interest rates arc declining, then at some predetermined level the loan "Locks" into a conventional debentures. To illustrate, if the interest rate have been continuously declining from a level of say 16% p.a. is the predetermined level, the loan gets converted into a conventional bond carrying a coupon rate of 15% p.a. for the remaining term of maturity once the market declines to 16% or less. From the borrowers point of view the financing arrangement has the advantage of not being committed to a fixed interest loan at rates which are temporarily very high.

Another type of variable rate loan is one where the coupon rises in steps until it reaches a market level after several years. This arrangement enables the borrower to ease his cash flow in the early years; the lender is compensated by offering a higher than average yield to maturity.

Money market:

The money market is a market for short term financial assets which can be reconverted into cash in a very low cost. It provides a place where short term surpluses can be transferred to the borrowers for short term. Short term can be taken as one year from the date of acquisition. The instruments of money markets are government bonds, commercial paper, certificate of deposits, treasury bills, repose etc. Short term financial assets arc near substitute of money.

The major players in the money market are RBI, UTI, GIC, LIC and other financial institutions.

Call money market or inter bank call money market is a segment of money market where scheduled commercial banks are permitted to borrow and lend on call (overnight) or a short notice (up to 14 days) to manage the day to day surpluses or deficits in their cash flows.

The RBI appointed a working group under the chairmanship of Shri N.Vaghul in September, 1986 for an in-depth study in the Indian money market and to make recommendations on the steps required to be taken for the development of a healthy and active money market. In the recommendations of the committee, the objectives of Indian money market was outlined, and those are as follows;

1. It should provide an equilibrating mechanism for evening out short term surpluses and deficits.

2. It should provide a focal point for intervention by RBI for influencing liquidity in the economy.

3. It should provide a reasonable access to users of short term money to meet their requirements at a realistic price.

To achieve these objectives, the committee adopts a four pronged strategy;

1. Selective increase in the number of participants to broaden the base of the market.

2. Activating the existing instruments and developing new ones so as to have a diversified mix of instruments.

3. Orderly moving away from the administered rate of interest to market determined interest rate.

4. Creation of an active secondary market through establishing new instruments.

Money Market Instruments

Call/ Notice money: The core of the Indian money market structure is the inter-bank call money market which is centralized primarily in Mumbai, but with sub-markets in Delhi, Calcutta, Chennai and Ahemdabad. Moreover current and expected interest rates on call money are the basic rates to which other money markets and to some extent the Government securities market are anchored. The activities in the call money are confined generally to inter-bank business predominantly an overnight basis, although a small amount of business, known as notice money was also transacted side by side with call money with a maximum period of 14 days. The participants in the market are commercial banks, cooperative banks and primary dealers who can borrow and lend funds. Large mutual funds promoted by commercial banks, private sector mutual funds all day India financial institutions can participate in the market as lenders only. Corporate entities having bulk lendable resources of minimum of Rs.5 cores per transactions have been permitted to lend in call money through all Primary Dealers provided they do not have any short-term borrowings from banks. Brokers are not permitted in the market. Interest rate in the market is market driven and is highly sensitive to the forces of demand and supply. Within one fortnight, rates are known to have a 0.50% to 1% intra day variations. Hence, the participants in the markets are exposed to a high degree of interest rate risk.

Inter bank term money: This market which was exclusively for commercial banks and co-operative banks has been opened up for select All India Development Financial Institutions in October, 1993.

The DFIs are permitted to borrow from the market for a maturity period of 3 to 6 months within the limits stipulated by RBI for each institution. The interest rates are market driven. Lenders in the market cannot prematurely recall these funds and as such this instrument is not liquid. The market is predominantly 90 days market.

Inter-bank participation certificates (IBPC): The IBPCs are short-term instruments to even-out the short-term liquidity within the banking system. The IBPC can be issued by scheduled commercial bank and can be subscribed to buy any commercial bank. The IBPC is issued against an underlying advance, classified standard and the aggregate amount of participation should be covered by the outstanding balance in account. The participation can be issued in two types, viz. with and without risk to the lender. While the participation without it can be issued for a period not exceeding 90 days, participation is now with risk for a period between 91 days and 180 days. The interest rate on IBPC is freely determined in the market. The certificates are neither transferable nor prematurely redeemable by the issuing bank. In the case of the bank issuing IBPC with risk, the aggregate amount of participation would be reduced from the aggregate advance outstanding. The participating bank would the aggregate amount of such participation as part of its advances. In cases where risk have materialized, the issuing bank and participating bank should share the recoveries proportionately. However in without risk sharing management, the issuing bank will show the same under advances to banks. In case of any loss, the issuing bank should compensate fully the participating bank.

The scheme is beneficial both to the issuing and participating banks. The issuing bank can secure funds against advances without actually diluting its asset-mix. To the lender, its provides an opportunity to deploy the short-term surplus funds in a secured and profitable manner.

Inter corporate deposit: The inter corporate market operates outside the purview of the regulatory framework. It provides an opportunity for the corporate to park their short-term surplus funds at market- determined rates. The market is predominantly a 90 days market. The market, which witnessed the flurry of activities, has received a serious jolt in the wake of series of defaults in 1995-96.

Treasury Bills (TBs): Among money market instruments TB's provide a temporary out-let for short-term surplus and also provide financial instruments of varying short-term maturities to facilitate a dynamic asset-liabilities management. The TB's are short-term promissory notes issued by government of India at a discount for 14 to 364 days.
More relevant to the money market is the introduction of 14 days, 28 days, 91 days and 364 days TB's on auction basis. In order to provide investors with instruments of varying short-term maturities. Government of India introduced the auction of 14 days TB's since June 1997.

The salient features of 14 days Treasury Bills

1) Sold for a minimum amount of Rs. 1,00,000 and in multiples of Rs. 1,00,000.

2) Not transferable.

3) Discount rates are set at quarterly intervals; the effect yield is equivalent to the interest rate on Ways and Means Advances chargeable to Central Government.

4) Re-discounted at 50 basis points higher than the discount rate. On re-discounting, the TBs are extinguished.

TBs are issued at discount and their yield can be calculated with the help of the following formula:

$$Y = \frac{F - P}{P} \times \frac{365}{\text{No. of days}} \times 100$$

For e.g. if a treasury bill of 14 days of face value Rs. 1,00,00 issued at Rs.99,625. Compute the yield.

$$\text{Yield} = \frac{1,00,000 - 99,625}{99,625} \times \frac{365}{14} \times 100 \qquad = 9.81\%$$

The treasury bills are extremely important among money market instruments, both for the issuer and the investor. Through these instruments, Government can raise funds for short-term to meet the temporary mismatches in cash flows and mop up excess liquidity in the system. The PDs have assumed the role of market makers in treasury bills and they regularly provides two-way quotes. This has added to the liquidity and deepened the secondary market of this instrument. Thus treasury bills have emerged as an effective instrument for dynamic asset-liabilities management.

Commercial Bills: Bill financing is the core component of meeting working capital needs of corporate in developed countries. Such a mode of financing facilitates an efficient payment system. The commercial bill is instrument drawn by a sale of goods on a buyer of goods. RBI has pioneered its efforts in developing bill culture in India, keeping in mind the distinct advantage of commerce bills, like, self liquidating in nature, recourse to two parties, knowing exact date of transactions, transparency of transactions etc.

Derivative. usance promissory naotes: The DUPNs are sold to investors in movement lots and maturities. (15 days to 90 days)on the basis of genuine trade bills, discounted by the discounting bank. The discounting bank should comply with the following conditions;

1. Bank which originally discounts the bill will only draw DUPN.
2. Continue to hold unencumbered usance bills till the date of maturity of DUPN.
3. Matured bill will be substituted by fresh eligible bills.
4. The transactions underlying DUPN will be bonafide commercial transactions.
5. The usance of the bill should not exceed 120 days and the unmatured period of such bills for drawing DUPN should not exceed 90 days.

Certificate of Deposits/Fixed Deposit (CDs): The CDs are negotiable term-deposits accepted by commercial banks from bulk depositors at market related rates. The CDs can be issued by scheduled commercials banks at a discount to face value for a period from 3 months to one year. The CDs can be issued for minimum amount of Rs. 5 lakhs to a single investor. CDs above Rs. 5 lakhs should be in multiples of Rs. 1 lakh. There is, however, no limit on the total quantum of funds raised through CDs. The discount on CDs is deregulated and is market determined. Banks are prohibited from granting loans against CDs as buyback of their own CDs.
As stated earlier, CDs are issued at discount to face value. The discount is offered either front end or rear end. In the case of front end discount, the effective rate of discount is higher than the quoted rate, while in cases of rear end discount, the CDs on maturity yield the quoted rate. This can be explained as under:

CDs issued at front end discount

Amount of issue - Rs. 100

Period 6 months Rate of discount - 20 %

Discount = 100 x 20/100 x 6/12 =Rs.10.00

Hence CD will be issued for Rs. 100 - 10 = Rs.90.00. The effective rate to the bank will, however, be calculated on the basis of the following for

$$ED = \{1 + D/(100xM)\}^{M} - 1 \times 100$$

Where M = 12/No. of months or 365/No. of days

Repurchase Options (Repo.) and Ready Forward (RF) Contracts :

Under this transaction the borrower places with lender certain acceptable securities against fund received and agrees to reverse these transactions on a pre-determined future date at agreed interest cost. No fixed period has been prescribed for this transaction. However, the repo-transactions are for minimum period of 14 days and maximum period of 1 year. The interest on such transactions is market determined and built in the structure of the Repo. The transactions can be undertaken by commercial banks financial institutions, brokers, DFHI. At present Repo transactions have been prohibited in all securities except treasury bills.

The borrower has advantage of raising funds against the securities without altering its assets mix while lenders finds a safe avenue giving attractive returns. Moreover, the funds management for both borrower and lender is approved as the date of reversal of transaction is known in advance.

The RBI intervenes in the market as and when required by conducting repos (ready forward purchases) though its two subsidiaries, namely Securities Trading Corporation of India (STCI) and Discount and Finance House of India (DFHI).

Repo or ready-forward deal is a sale of RBI approved securities (or Repo securities) by a bank to another bank , or STCI or DFHI, with a commitment to repurchase the same at an agreed future date.

Foreign Currency Convertible Bonds (FCCBS)

FCCBS is a bond issued by an Indian company and subscribed for by non-residents in foreign currency and convertible into ordinary/ equity shares of the issuer company in any manner whether in whole or in part or on the basis of any equity related warrants attached to debt instruments.

Advantages of FCCBs

1) The convertible bond gives the investor the flexibility to convert the bond into equity at a price or redeem the bond at the end of a specified period, normally three years if the price of the share has not met his expectations.

2) Companies prefer bonds as it leads to delayed dilution of equity and allows company to avoid any current dilution in earnings per share that a further issuance of equity would cause.

3) FCCBs are currently marketable as investors enjoy option of conversion into equity if resulting to capital appreciation. Further investor is assured of minimum fixed interest earnings.

Disadvantages of FCCBs

1) Exchange risk is more in FCCBs as Interest on bonds would be payable in foreign currency. Thus companies with low debt equity ratios, large foreign earnings potential only opt for FCCBs.

2) FCCBs means creation of more debt and a fore out go in terms of interest which is in foreign exchange

3) In the case of convertible bonds, the interest rate is low , say around 3-4% but there is exchange risk on the interest rate as well as re-payments if the bonds are not converted into equity shares. The only major advantage would be that where the company has a high rate of growth in earnings and the conversion takes place subsequently, the price at which shares can be issued can be higher than the current market price.

Global Depository Receipts (GDRs) and American Depository Receipts/Eqt sh. issue out side India :

Global Depositary Receipts (GRDs): It is a negotiable certificate denominated in US dollars which represents a Non - US Company's publicly traded local currency equity.
GDRS are created when the local currency shares of an Indian company are delivered to the depository's local custodian bank against which the depository bank issues depository receipts in US$.

These GDRS may be freely traded in the overseas market like any other dollar denomination security, either on a foreign stock exchange or in the over the counter market of among qualified institutional buyers. By issue of GDRs Indian companies are able to tap global equity market to raise foreign currency funds by way of equity. It has distinct advantage over debt as there is no replacement of the principal and service costs are lower.

Rule 144A of SEC of USA permits companies from outside USA to offer their GDRs to QIBs.

(i) American Depository Receipts (ADRs): These are depository receipts issued by a company in the USA and are governed by the provisions of Securities and Exchange Commission of USA. As the regulations are sever. Indian Companies tap the American market through private debt placements of GDRs listed in London Luxemberg Stock Exchanges.

Apart from legal impediments, ADRs are costlier then GDRs. Legal fees are considerably high for US listing. Registration fees in USA is also substantial. Hence ADRs are less popular than GDR.s.

(ii) Debt securitisation: It id the method of recycling of funds. It is specially beneficial to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this assets pool, market securities can be issued. Through SPV route.

Bridge finance: It includes all loans taken by a company normally from commercial banks for short period, pending disbursement of loans sanctioned by financial institutions.

Euro convertible bonds: A Euro convertible bond is a bond issued by an Indian issuer company which gives the holders of the bond an option to convert the bond into a predetermined number of shares after a specified time. It carries a fixed rate of interest. The interest will be paid in dollars and the redemption opted by the holder will also be payable by the issuer company in dollars. If the issuer company desires, it can issue the bonds carrying call provision. Here the issuer company can exercise the option of calling the bond and redeeming those when the prices of the shares has risen appreciably This option forces the shareholders to convert the shares when the prices are rising and comes near to redemption price and by this conversion the company does not have to pay the redemption amount. On the reverse side the holder can go for redemption also before the company exercises the option.

Brokers: Brokers are the authorized members of a stock exchange who buy or sell securities, as agents of their clients on the floor of the exchange. But now the trading is done on line and the broker need not go to the floor of the exchange. But for this buying and selling broker charges commission. Brokers also appoint sub-brokers who are the authorized assistants of brokers, and buy and sell securities on behalf of the broker of the stock exchange.

SEBI: Security and exchange board of India was established on 12th of April, 1988 to promote and regulate the stock markets in India. The advancement in the capital market activities and the growing complexities in the market related problems have necessitated the emergence of such an institution. Hence SEBI was given the legal status as a supervisory body in 1992. It regulates and promotes the securities market by:

a) Providing fair dealing in the issue of securities and ensuring a market place where funds can be raised at a relatively low cost.

b) Providing a degree of protection to the investors and safeguard their rights and interests so that there is a steady flow of savings into the market.

c) Regulating and developing a code of conduct and fair practices by intermediaries in the capital market like brokers and merchant bankers with a view to making them competitive and professional.

National Stock Exchange: The NSE was set up in June, 1994. It has shown impressive performance since its inception. In January 1997 there were 541 companies listed on NSE and about 600 other securities were permitted for trading. Since November, 1995 the trading volume of NSE is higher than BSE.

A company can be listed on NSE on the condition that it should have a minimum paid up capital of Rs.10 crores and a market capitalisation of Rs.25 crores, and it should have a track record of profitability of at least three years. The trading system is all computerized in NSE.

OTCEI: Over the counter exchange of India is an exchange, granted the recognition under Securities Contract (Regulation) Act by the Government of India. It was promoted by UTI, ICICI and others. It provides the facility of screen based trading. The members of this exchange are called the market makers and they always give two way quotations. A company can get the benefit of listing by offering even 10% of its issued capital to the public. This is not a popular exchange as very few companies are listed in this exchange and trading volume is also low. But this exchange possesses the distinction of initialising the screen based trading.

Warrants(Deferrer Equity Issue): A warrant entitles the purchaser of warrant to buy a fixed number of ordinary shares at a particular price during a specified time period. Warrants are used by large profit making companies as a part of financing package. Warrant has to be listed and traded in the stock exchange. The exercise price of a warrant is the price at which the holder can purchase the equity shares of the company. Exercise ratio is the number of shares that can be purchased against one warrant of the company. The expiration date is the date on which the option to buy the equity shares expire. If a warrant can be sold separate from the debentures, it is called a detachable warrant, otherwise it is called non-detachable.

Theoretical value of warrant = (Share price - Exercise price) x Exercise ratio Market value of warrant is the value at which the warrant is traded in the market. Now a buyer of warrant has to pay the market value of warrant to the seller and the exercise price to the company, and that will be the cost of the warrant.

It is also considered as deferred equity financing as the company can sell its equity shares in future by setting a higher exercise price than the prevailing price of the share at the time of issue of warrant.

However its success depends upon the future market price of the share. Because if it does not rise to the expected level, the warrant holder may not exercise the warrant.

Stock Dividend (Bonus Shares): The issue of bonus shares represents the distribution of shares in addition to the dividends and known as stock dividend. This increases the number of outstanding shares in the share capital of the company. The shares are distributed proportionately and the shareholder retains the proportionate ownership over the company. However it is also known as capitalisation of profits and

hence it also decreases the balance of reserves and surplus of the company. Normally issue of bonus does not increase the wealth of the shareholders as the total; wealth of the shareholders remains same before and after the bonus and it is a mere accounting entry. The bonus issue has certain advantages as compared with the dividends.

1) It is an indicator of higher future earnings, as the directors declare dividend when the anticipate that future earning will offset the requirement of earnings for additional shares outstanding.
2) It has a higher psychological value than dividend.
3) It does not involve cash outlay and the company can conserve cash for future investments.

Share split: Share split is a mechanism to increase the number of outstanding shares by way of proportional reduction in the par value of shares. So it does not effect the wealth of the shareholders. For example if the company has 1,00,000 outstanding shares Rs.10, it can split each share into 10 shares of Re.1 and can increase the number of outstanding shares to 10,00,000. Generally it is done by a company whose shares are quoted at a very higher price. As the share split reduces the market price per share, more number of small investors can trade in shares and increasing the marketability and liquidity of the shares. Some companies like HLL, Satyam, Infosys has gone for share split in the recent past. A company can also go for **reverse split** in case the market price per share is in decreasing trend to increase the market price per share.

Venture capital: Venture capital is an important source of financing of small scale enterprises. It is a source of long term finance but the major problem is that a venture capitalist has a great deal of involvement in the management of client's enterprises. The main attributes of this type of financing is

1) Equity participation
2) Long term investment
3) Participation in management

The financing can take any or more of the following modes:

1) Equity financing
2) Conditional loan
3) Income note
4) Participating debentures.

13 EXPLANATION OF SOME ADDITIONAL TERMS ON FINANCIAL MANAGEMENT

Debt trap: A company which is highly levered can not borrow further loan or can borrow ion a very restrictive terms. Heavy indebtedness leads to the pressure of the creditors and a lot of constraints on the management's functioning. During the period of low profitability this type of company can not pay the interest charges and as a result their pressure on the company and control over the company gets tightened. In such situation the company has to borrow on a very unfavorable terms and the company is said to have fallen in debt trap.

Financial planning: Financial planning is the systematic approach of attaining effective management performance. It can be said to be a detailed planning which helps the financial manager to regulate the flow of funds and most effectively utilizing those. Financial forecasting is the basis of financial planning. It involves the following steps.

1) Analysing the past performance of the company and analysing the strength and weakness of the company.
2) Analysing the operating characteristics like, product, market, competition, and growth objective.
3) Determining the investment needs and corporate strategy.
4) Analysing the financial alternatives.
5) Forecasting the financial revenues and expenses and decide about dividend policies.
6) It also involves the planning about long term growth and consistency in profit making.

Arbitrage: The simultaneous purchase and sale transactions in a security or commodity , undertaken in different markets to profit from price differences. For example , an arbitrageur may find that the share of The Tata Iron and Steel company is trading at a lower price , at the National stock exchange compared to exchange at Bombay. Hence , he may simultaneously purchase TISCO stock in NSE, at say Rs.250 , and sell in Bombay at a higher price , say Rs.250, and sell in Bombay at a higher price , say Rs.256 , making a profit of Rs.6 per share less expenses. The arbitrage opportunity can also be there in currency trading or any other trading.

Over capitalisation: Capitalisation refers to the process of determining quantum of long term funds that an enterprise would require to run its business. Overcapitalisation implies that the company possesses an excess capital in relation to its activity level and requirements. So here the company possesses more capital than what is required. So here the return on capital is bound to fall. The reasons for this may be;

1) Purchase of assets at a higherprice.
2) Excess amount paid for acquisition of goodwill
3) Depreciation not provided due to losses.
4) Company not being able to fully utilize the assets.
5) Company in possession of funds in excess of requirements.

Under capitalisation(Loss of reputation): This is a situation where the firm does not have sufficient amount of funds to carry on its activities. The concern may not be having sufficient working capital for use and may not have sufficient fund for investment in capital assets. The current ratio may be very poor and liquidity is in danger. The assets may be all leased. So here we can not acquire required inventories and may not even incur expenditure on repairs, research and all. So the only remedy for this type of situation is issue of share capital and acquiring long term loans.

Bank rate: It is the rate of interest charged by the reserve bank of India on its financial accommodation extended to commercial banks and other financial institutions. The accommodation by RBI is provided in the form of bill rediscounting and advances against specified assets of the commercial banks and financial institutions. This bank rate keeps changing to serve the purpose of credit creation or credit control. If the RBI wants that more credit shall be extended to the public, it reduces the bank rate and vice versa.

Basis point: A basis point is $1/100^{th}$ of 1 percent or one basis point = 0.0001

Bull and bear: A bull is a person who expects the share prices in general to move up and he is likely to take a long position in the stock market. A long position is where the investors purchase the shares. A bear is a person who expects the share prices in general to decline and he is likely to indulge in short sales. A short sale is a position where the investor sells the shares without holding those in anticipation that the prices will come down and he will create a long position in the same shares to cancel the short position created earlier to earn the difference.

Bellwether stock: It is a share listed in a stock exchange which very often reflects the state of the stock market. So this type of stock is always monitored by the technical analysts who forecasts about the movement of share market by tracking the bellwether stock.

Bought out deal: This is a deal of sale of securities between the issuing company and the investing institution like mutual funds. This is used as an alternative to the public issue. The buyer enters into such a deal to earn a profit by off loading those later in the market, however there is always a risk of fall in the share prices. For the mutual funds this is an avenue for investment. The issuing company saves the time and cost of public issue. Bought out deals are common in the issues over OTCEI. IT is very helpful for those companies who are in need of fund but their gestation period is a little bigger. So before going for primary market, they can go for bought out deals.

Bridge loan: A temporary accommodation provided to the borrower by the financers for a temporary shortage of funds, e.g. at the time of public issue.

Corner: It is the acquisition of substantial holding in a particular stock through purchases in the market. The investor can influence the prices of the stock in the market due to this and it can impose onerous terms on short sellers.

Correction: It is a reaction in the stock prices that reverses an excessive rise or decline posted earlier.

Cyclical stock: These are the shares of the company whose prices usually move up during the period of vigorous economic activity, and decline as the economy slackens. The performance of these company's share in the capital market is directly related to the general economic activity. Shares of the company dealing in steel, rubber or chemicals come under this. In India RIL, TISCO, HLL etc are considered as cyclical stocks.

Gilt edged securities: A term used for securities having highest degree of reliability. Government securities are gilt edged securities.

Castle in the air/Greater fool theory: A theory according to which an overvalued share is purchased by the investors on the conviction that they will find a greater fool who will buy the stocks from them at higher prices.

Libor: This is an average of the interest rates at which leading international banks are prepared to offer term euro dollar deposit (loans) to each other. It is an acronym used for London Inter Bank Offered Rate. It is used as a reference rate in quoting interest rate on other loans.

Mibor: This is the weighted average of the interest rates at which certain banks/institutions in Mumbai belonging to a representative panel are prepared to lend call money. It is also used as a reference rate in quoting interest rate in India. An acronym for Mumbai Inter Bank Offered Rate. **MIBID** or Mnmhai Inter Bank Bid Rate is the weighted average of the interest rates at which certain banks/institutions in Mumbai belonging to a representative panel are prepared to borrow call money.

Coupon rate: It is the rate of annual interest on the pre value of debentures or bonds that an issue promises to pay. In India, till a few years ago, coupon rates were subjected to a calling stipulated by the controller of capital issues. With the removal of the calling, issuer has fixed their coupon rates by talking into consideration, market perceptions and exceptions. The rate may be fixed or it may be floating in relation to some benchmark.

Book building: Book building is a process used for marketing a public offer of equity shares of a company and is a common practice in most developed countries. Book building is the process of collection of bids from investors, which is based on an indicative price range. The issue price is fixed after the bid closing date. Some of the companies offered there shares through book building in the recent past are HCL Ltd., Cinevista communications Ltd., Mukta Arts Ltd. etc. But in India 25 per cent of the issue has to be sold at a fixed price and 75 per cent is through book building. Otherwise the company is to split the 25 percent on offer to the public (small investors) into a fixed price portion of 10 percent and a reservation in the book built portion amounting to 15 per cent of the issue size. The rest of the book built portion is open to any investor.

Advantages of book building:

1) The book building process allows for price and demand discovery. Also , the cost of the public issue are much reduced and the time taken for the completion of the entire process is much less than that in the normal public issue.

2) Unlike in book-building, IPOs are usually marketed at a fixed price. Here the demand cannot be anticipated by the merchant banker and only after the issue is closed do we know whether the issue has achieved the minimum levels of subscription.

In book building, the demand for the share is known before the issue closes. In fact, if there is not much demand, the issue may be deferred.

Private placement of shares: Private placement involves the sale of shares (or other securities) by a company to few selected investors, particularly the institutional investors like the Unit Trust of India, the Life Insurance Corporation of India etc.

Advantages of private placement of shares

1) It is helpful to issue small amount of funds.
2) It is less expensive. In the case of public issue of securities, issue costs are very high which can be avoided through private placement.
3) It take less time to raise funds through private placement. Public issues involve a number of requirements to be fulfilled and this requires a lot of time to raise capital.

Mutual Fund: It is an organization that mobilizes the surpluses of savers and invests the same in different securities. Thus, an individual who own a share in a mutual fund has a proportionate claim on the portfolio of investment vehicles held by the fund. In financial nomenclature, the term mutual fund refers to the 'Open-end' type of Investment Company which has no limit on the number of shares that it can issue. The Unit Trust of India's, Units 1964 scheme is a prime example. However, in common parlance , the term mutual fund refers to both the open-end and closed-end types of investment companies.

Managing an open-end fund however, involves some distinct challenges. The portfolio manager must estimate the maximum possible demand for redemption and accordingly retain some liquid assets. Moreover, daily calculation of the NAV requires a sophisticated information system.

Post-shipment Credit: Funds lent by banks in rupees or dollar denominated credit to exporters after the shipment of goods. This is useful to exporters who may otherwise suffer a long collection period. Post -shipment finance can be in the form of purchase or discounting of export bills, advance against foreign bills presented for collection, advance against cash incentives, etc. Post-shipment and pre-shipment finance entail disbursement of credit and hence are fund-based. In addition, banks assist exporters through non fund-based facilities such as issuance of letters of guarantee and letters of credit.

Pre-shipment Credit: Funds lent by banks in rupees or foreign currency to exporters, prior to the shipment of goods. Pre-shipment finance can be in the form of packing credit, advance against cash incentives and others. Packing credit is offered to an exporter for purposes of packing and shipment and also manufacture of goods. Such credit may be in the form of a loan, cash credit or overdraft facility.

STRIPS: An acronym for Separate Trading or Registered Interest and Principal of Securities. This technique enables an intermediary such as a brokerage firm or a bank to strip the coupons from the principal of the bond, so that the two can be traded separately. For example, a three- year debenture with coupons payable semi-annually will have seven distinct cash flows viz., coupon payments at the end of every six months till maturity and the principal payment at maturity. Accordingly, the coupons can be sold to investors as fixed deposits falling due at the end of 6,12, 18,24,30 and 36 months and the principal is sold on a discounted basis, similar to a Zero coupon bond. The advantages to investors arise from the flexibility it offers to suit cash flow needs and maturity requirements. In India, GE Capital and ABN Amro have teamed up to use the technique for the first time, for the former's debenture issue.

Unsystematic Risk: A risk that is unique to a firm or industry. The returns on an asset can be affected by occurrences such as a labour strike, changes in consumer preferences, or even wrong management decisions. The adverse impact of any such occurrence would be confined to one or a few firms. Therefore,

These unsystematic variations occur independently of broad price movements in the market. By having a diversified portfolio, it is possible to neutralize unsystematic risk, which is also therefore termed, 'Diversifiable Risk'. Generally, firms which are less vulnerable to macroeconomic changes, as e.g., those manufacturing consumer non-durables (e.g. Hindustan Lever and Colgate) would have less systematic risk and a higher degree of unsystematic risk.

STOCK MARKETS

Stock markets are the markets where the shares and securities are priced and traded. So in essence they ensure the liquidity of the shares and securities. They are said to reflect the strength of country's economy. However there are a lot of economic and non economic factors which influence the movement in the stock markets, viz. money supply, inflation, credit/deposit ratio and fiscal deficit apart from political instability. Further corporate performance, industrial growth and overall economic condition of the country also influence the stock markets.

Primary / Secondary Markets:

Primary markets are the markets where new issues of common stock, bond and preferred stock are sold by companies, government and local authorities to acquire new capital. The proceeds raised in this market is the new capital fund to be used by the concern for its business. In the secondary market the outstanding issues are permitted to be traded. In the secondary market, those shares and securities are bought and sold which are already issued by the company. So the securities traded here are between the present and potential owners. The proceeds from the sale in this market goes to the existing owner of the securities. So this market actually ensures the liquidity of the securities. There are two broad segments of secondary markets:

1. Organised stock exchanges
2. Over he counter stock exchanges

Perfect Capital Market: The efficiency of capital market depends on the efficiency in flow of information. Now this efficiency in flow of information depends on the level of information disclosure and the speed with which the information is processed by the market and incorporated in the share prices. So a perfect capital market is a market where the information is processed fast and incorporated in the share prices at the earliest. However the following are the attributes of a perfect capital market.

1. No entry barriers.
2. Large number of buyers and sellers.
3. Divisibility of financial assets.
4. Absence of transaction costs/ Minimisation of transaction costs.
5. No tax differences between class of investors, i.e. on dividends and capital gains, all investors are taxable at the same rate.
6. No government restrictions in trading.

Generally tax differences and transaction costs are barriers of the efficient capital market. Further the information also are not available to all at all times and a few or some investors avail the benefit of a particular information. So this can also be taken as a barrier to efficient capital market.

Listing of securities: Listing means admission of securities for the dealing in the recognised stock exchange. It is only after listing, a security can be bought or sold in that stock exchange. The prices at which the securities are bought and sold on a recognised stock exchange is known as official quotation.

Scripless trading: This is trading in DEMAT form. This is done through depository participants. Depository participant is an intermediary between the investors and the depository. According to SEBI guidelines, financial institutions, banks, custodians, stock brokers, etc. can become depository participant. Dalmia securities ltd. Ortem securities Ltd. HDFC are the names of some of depository participants. The benefits of this system are enumerated below;

1) It eliminates bad delivery and a lot of paperwork.
2) It eliminates problems of odd-lot.
3) It facilitates stock lending.
4) It helps in quick settlement
5) It reduces the risk of forgery, theft and loss of physical shares.
6) It reduces transaction costs due to elimination of stamping.
7) It enhances the image of the company and reduces the time and cost of secretarial department.

Insider Trading:

Insider trading denotes dealing in company's securities on the basis of confidential information relating to the company, which is not published and not known to the public. This is used to make profit or avoid loss in the transactions in securities of the company. Insider is a person who has the knowledge of facts not available to the general public.

Insider information implies information about the company's affairs that is obtained by insiders before the public obtains it. The information generally is price sensitive information and is likely to have an impact on the company's securities price in the market.
Insider trading generally means trading in the shares of a company by the persons who are in the management of then company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company , which they posses but not available to others.

Insiders include directors, officers and employees of a company and related companies, persons with professional or business relationship with a company (e.g. auditors solicitors, bankers and brokers), large beneficial shareholders, government officials and stock exchange employees etc.) An outsider may be held to be an insider by virtue of engaging himself in this practice on the strength of inside information coming to his knowledge obtained by him either directly by the reason of his being connected with the company , or indirectly from any one who is connected with the company.
The SEBI has passed the regulations called the Securities and Exchange Board of India (Insider Trading) Regulations 1992 prohibiting the insider trading. That can be studied in SEBI Act.

Maximum permission bank finance (MPBF):

Maximum permissible limit for bank finance as recommended and suggested by study groups of RBI was 75% of working capital gap shown as below:

Current assets	**100**
Less: Non - interest bearing current	**(40)**
Liabilities Working capital gap	**60**
Financing from long term sources 25% of either CA or working capital gap	**(15)**
MPBF	**45**

The RBI vide its credit policy (beginning of 1997) scrapped the concept of MPBF. These salient features of new credit system were:

1) For borrowers with requirements of upto Rs. 25 lakhs credit limit will be computed after detailed discussions with the borrower, without going into detailed evaluation.

2) For borrowers with requirements above Rs. 25 lakh but upto Rs. 5 crore, credit limit can be offered upto 20% of the projected gross sales of the borrower.

3) For large borrowers not falling in the above categories, the cash budget systems may be used to identify the working capital needs.

Stock market indexes:

Indexes are used to reflect the overall movement of stock prices. Generally all the securities in a stock market tend to move up or down together. But this does not happen always. So stock index movement

will give us an idea whether the market in overall has moved up or down on a particular day. It is used to represent the changes in the values of securities between a base time period and another time period.

BSE Sensex is a weighted average of prices of 30 select stocks and S&P CNX Nifty of 51 select stocks, where the weight is the market capitalization of individual stocks. Hence the shares with highest market capitalization influences the stock most. In both sensex and Nifty, HLL and RIL are such types of stock.

Book building:

Book building is a process of issuing shares by action and there by fixing best issue price in a public issue. As the share issued is based on the basis of auction, the highest bidders will get the allotment. The Book Runners appointed by the company keep note of prices offered by prospective investors and the number of shares each wise to take. The final issue price is determined with reference to the prices quoted by the investors.

Advantages of Book Building:

The book building process allows for price and demand discovery. Also , the cost of the public issue are much reduced and the time taken for the completion of the entire process is much less than that in the normal public issue.

Unlike in book-building, IPOs are usually marketed at a fixed price.

In book building, the demand for the share is known before the issue closes. In fact, if there is not much demand, the issue may be deferred.

Green Shoe Option:

Green Shoe Option is an option an issuing shares in excess of issue size. Any company making initial public offer of equity share through book building mechanism can avail of this option. The maximum permissible over allotment is 15% of the total issue size. For this, the company appoints a Stabilizing Agent. The Stabilizing Agent is a merchant banker acting as lead book runner. The SA borrows the shares to be over allotted from the promoters. The shares thus borrowed are then allotted to applicants on a pro-date basis. Within 30 days from the date, the trading on the shares is permitted in the stock exchange, the SA purchases the shares from the market and returns them to the promoters. The number of issued shares after the period then comes down to the issue size. The demand created by purchase of shares by the SA is expected to resist a decline in the price of the shares. The following conditions are also there no understand.

The shares borrowed from the promoters must be dematerialized from.

The money received from the applicants against the shares over allotted are to be kept in a special GSO Bank account. The shares borrowed from the promoters must be held in a special GSO Demat Account. On allotment of shares to applicants, the GSO Demat Account is debited.

The Balance in the GSO Bank Account is used for the purpose of buying shares from the market. The shares brought from the market by the SA during the stabilization period, is credited to the GSO Demat Account.

The shares bought from the market and lying in the GSO Demat Account is returned to the promoters immediately, in any case not later than 2 working days after the close of the stabilization period.

But if S A cannot buy shares to the extent of shares over allotted, the number of issued shares will exceed the issue size.

DEPOSITORIES :

Depository system:

Depository system is the system, which envisages the idea of keeping the securities in dematerialized.

forms, and it ensures to safeguard the interest of the investors. The structure of depository system as envisaged in the Depositories Act, 1996 has depository, depository participants, Issuer Company and investors as its constituents.

Depository: Depository is an organization where the securities are held in electronic form through the medium of depository participants and which provides various other services.

In India, National Securities Depository Limited (NSDL) promoted by IDBI, UTI & NSE has been set up as first depository. Recently, SEBI has granted certificate of registration to another Depository i.e. Central Depository Services Limited which is promoted by B.S.E. & BOI.

Services offered by NSDL
NSDL offers the following services through its agents i.e., depository participants

Dematerialisation i.e. converting physical certificates to electronic form;

Rematerialisation i.e. converting shares in electronic form back to physical form;

Effects settlement of securities traded;

Receipts of corporate benefits in electronic form.

Depository participant:

Depository participant is an intermediary between the investors and the depository. According to SEBI guidelines, financial institutions, banks, custodians, stock brokers, etc.

can become depository participant. Dalmia Securities Ltd. HDFC are the names of some of depository participants. The benefits of this system are enumerated below;

1) It eliminates bad delivery and a lot of paperwork.
2) It eliminates problems of Odd-lot.
3) It facilitates stock lending.

It helps in quick settlement.
It reduces the risk of forgery, theft and loss of physical shares. It reduces transaction costs 1due to elimination of stamping.1
It enhances the image of the company and reduces the time and cost of secretarial department.

The various functions rendered by Depository are:

Enable dematerialization and rematerialisation of eligible securities.
Provide for disbursement of corporate benefits to the beneficial owners.
Efficient settlement of securities traded on the exchanges.
Facilitate pledging /hypothecation of eligible securities.

Repurchase Options (Repo.) and Ready forward (RF) contracts :

Under this transaction the borrower places with lender certain acceptable securities against fund received and agrees to reverse transactions on a pre-determined future date at agreed interest cost. No fixed period has been prescribed for this transaction. However, the Repo-transactions are for minimum period of 14 days and maximum period of 1 year. The interest on such transactions is market determined and built in the structure of the Repo. The transactions can be undertaken by commercial banks financial institutions, brokers, DFHI. At present Repo transactions have been prohibited in all securities except treasury bills.

The borrower has advantage of raising funds against the securities without altering its assets mix while lenders find a safe avenue giving attractive returns. Moreover, the funds management for both borrower and lender is approved as the date of reversal of tra01nsaction is known in advance.

The RBI intervenes in the market as and when required by conducting Repos (ready forward purchases) though its two subsidiaries, namely Securities Trading Corporation of India (STCI) and Discount and Finance House of India (DFHI).

Repo or ready-forward deal is a sale of RBI approved securities (or Repo securities) by a bank to another bank, or STCI or DFHI, with a commitment to repurchase the same at an agreed future date.

Foreign Direct Investments (FDI):

In the industrial policy of 1991, The Financial Minister Manmohan Singh introduced an Automatic Route system of not requiring approval from Government of India for FDI. Initially the automatic route was limited to certain number of industries and was subjected to an investment ceiling also. But the scope of Automatic Route has been expanded and the requirement of RBI's approval has been waived.

The Ministry of Industry has with the passage of time expanded the list of industries eligible for automatic approval of foreign investments. In certain cases, the upper level of foreign ownership has been raised to 74% and further in certain cases to 100%.

Automatic Route is not available to those foreign investors who already have a financial or technical collaboration in the same or allied field or where more than 24% foreign investment is made is a company which is engaged in manufacture of an item reserved for small scale industry.

Foreign investments are on a repatriation basis. Dividends declared on foreign investments can be remitted freely.

Non-resident can sell shares on Stock Exchange without prior approval of RBI. They can approach a bank for repatriation of the sale proceeds if they hold the shares on repatriation basis and if they have necessary certificate issued by Income Tax authorities.

Foreign Institutional Investor (FII):

Portfolio investments are investments in secondary market e.g. purchase of shares, debentures and other.

securities from stock exchanges. The Foreign Institutional Investors (FII) includes Asset Management Companies, Mutual Funds etc.

The FIIs intending to make portfolio investments in India are required to obtain registration from the SEBI. FIIs are required to apply to SEBI for this. A copy of the application form it sent by SEBI to RBI along with their 'No objection' so as to enable RBI to grant necessary permission under FEMA will enable to FII to buy/sell security on Stock Exchanges and open foreign currency and Indian Rupee accounts with a designated bank branch.

No permission from RBI is needed so long as a FII purchases and sells on a recognized stock exchange. They can invest in listed and unlisted securities including shares, debt instruments, Government Securities and Treasury Bills.

External Commercial Borrowings (ECB)

External Commercial Borrowings are funds borrowed in India from external sources like international banks, international capital markets, and international financial institutions.

The foreigners lend more when interest in India exceeds foreign interest rate and they withdraw their money once the situation reverse. Even the borrowers will lead repayments if they believe that the Rupee is expected to decline. So there is always a risk for flight of capital out of India.

Expired and Un-expired cost (Revenue & Fixed Assets Cost):

Cost and expense are not essentially the same. Cost generally is incurred to acquire an asset. But it is divided into two; a) expired cost, b) un-expired cost. Expired cost is one which has already helped to produce revenues and it can be said revenue expenditure. Un-expired cost is one which will help to produce revenues. So fixed assets are un-expired costs.

Debt Trap:

A company which is highly levered can not borrow further loan or can borrow ion a very restrictive terms. Heavy indebtedness leads to the pressure of the creditors and a lot of constraints on the management's functioning. During the period of low profitability this type of company can not pay the interest charges and as a result their pressure on the company and control over the company gets tightened. In such situation the company has to borrow on a very unfavorable terms and the company is said to have fallen in debt trap.

Financial Planning:

Financial planning is the systematic approach of attaining effective management performance. It can be said to be a detailed planning which helps the financial manager to regulate the flow of funds and most effectively utilizing those. Financial forecasting is the basis of financial planning. It involves the following steps.

Analysing the past performance of the company and analysing the strength and weakness of the company Analysing the operating characteristics like, product, market, competition, and growth objective. Determining the investment needs and corporate strategy. Analysing the financial alternatives. Forecasting the financial revenues and expenses and decide about dividend policies. It also involves the planning about long term growth and consistency in profit making.

Over Capitalisation:

Capitalisation refers to the process of determining quantum of long term funds that an enterprise would require to run its business. Overcapitalisation implies that the company possesses an excess capital in relation to its activity level and requirements. So here the company possesses more capital than what is required. So here the return on capital is bound to fall. The reasons for this may be ;

Purchase of assets at a higher price.
Excess amount paid for acquisition of goodwill
Depreciation not provided due to losses.
Company not being able to fully utilize the assets.
Company in possession of funds in excess of requirements.

Under Capitalisation:

This is a situation where the firm does not have sufficient amount of funds to carry on its activities. The concern may not be having sufficient working capital for use and may not have sufficient fund for investment in capital assets. The current ratio may be very poor and liquidity is in danger. The assets may be all leased. So here we can not acquire required inventories and may not even incur expenditure on repairs, research and all. So the only remedy for this type of situation is issue of share capital and acquiring long term loans.

Bank Rate:

It is the rate of interest charged by the reserve bank of India on its financial accommodation extended to commercial banks and other financial institutions. The accommodation by RBI is provided in the form of bill rediscounting and advances against specified assets of the commercial banks and financial institutions. This bank rate keep changing to serve the purpose of credit creation or credit control. If the RBI wants that more credit shall be extended to the public, it reduces the bank rate and vice versa.

Basis Point:

A basis point is l/100th of 1 percent or one basis point=0.0001

Bellwether Stock:

It is a share listed in a stock exchange which very often reflects the state of the stock market. So this type of stock is always monitored by the technical analysts who forecasts about the movement of share market by tracking the bellwether stock.

Seed capital assistance:

The Seed capital assistance scheme is designed by IDBI for professionally or technically qualified entrepreneurs and/or persons possessing relevant experience, skills and entrepreneurial traits. All the projects eligible for financial assistance from IDBI, directly or indirectly through refinance are eligible under the scheme. The project cost should not exceed Rs.2 crores and the maximum assistance under the project will be restricted to 50% of the required promoter's contribution or Rs. 15 lacs whichever is lower.

The Seed Capital Assistance is interest free but carries a service charge of one percent per annum for the first five years and 10% p.a. thereafter. However, IDBI will have the option to charge interest at such rate as may be determined by IDBI on the loan if the financial position and profitability of the company so permits during the currency of the loan. The repayment schedule is fixed depending upon the repaying capacity of the unit with an initial moratorium up to five years.

For projects with a project cost exceeding Rs.2 crores, seed capital may be obtained from the Risk Capital and Technology Corporation Ltd.(RCTC) For small projects costing up to Rs. 5 lacs, assistance under the National Equity Fund of the SIDBI may be availed.

Stock lending scheme:

In the stock lending, a holder of the shares lends the shares by transferring the title of the shares to the borrower in some consideration and after the specified time he gets his shares back from the borrower. So in this, the legal title of a security is temporarily transferred from a lender to a borrower. The lender retains all the benefits of ownership (like dividends, rights, bonus), other than the voting rights.

The borrower is entitled to utilize the securities as required but is liable to the lender for all benefits (e.g. dividends, interest or rights). The stock lending began as a means to cover short sales (selling shares without possessing them).

Advantages of stock lending: It is used by the lenders to maximise yields on their portfolio. Borrowers use the securities lending programme to avoid settlement failures. Securities lending provides income opportunities for security-holders and creates liquidity to facilitate trading strategies for borrowers.

Securities lending gives borrowers access to lender portfolios, which provide the flexibility necessary when borrowing is for financing inventories. From the point of view of the markets, stock lending and borrowing, facilitates timely settlement, increases the settlements, reduces market volatility and improves liquidity.

The borrower has to deposit the collateral securities, which could be cash, bank guarantees, government securities or certificates with the approved intermediary. In case the borrower fails to return the securities, he will be declared a defaulter and the approved intermediary will liquidate the collateral deposited with it. The approved intermediary is liable for making good the loss caused to the lender. The borrower cannot discharge his liabilities of returning the equivalent securities through payment in cash or kind.

National Securities Clearing Corporation Ltd (NSCCL), Stock Holding Corporation of India Ltd (SHCIL), Deutsche Bank and Reliance Capital are some of the approved intermediaries.

NSCCL proposes to offer a number of schemes, including the automated lending and borrowing mechanism (ALBM), automatic borrowing for settlement failures and case by case borrowing.

Private placement of shares:

Private placement involves the sale of shares (or other securities) by a company to few selected investors, particularly the institutional investors like the Unit Trust of India, the Life Insurance Corporation of India etc. Advantages of private placement of shares It is helpful to issue small amount of funds. It is less expensive. In the case of public issue of securities, issue costs are very high which can be avoided through private placement. It takes less time to raise funds through private placement. Public issues involve a number of requirements to be fulfilled and this requires a lot of time to raise capital.

Open Market Operations (OMO):

The purchase or sale of securities, by the central bank of a country to expand or contract the reserves with the banking system. Open market Operations serve as an instrument of public debt management and also of monetary control, besides the cash reserve ratio and statutory liquidity ratio. Through OMO, the Reserve Bank of India (RBI) is able to absorb liquidity from, or inject the same into, the banking system. Since it is envisaged that OMO will become the dominant tool of monetary control in India, the government and RBI have initiated a series of measures to deepen and widen the market for government securities. These actions, which will enhance the effectiveness of OMO, are as follows:
A shift to market rates of interest on Government Securities. The promotion of new institutions viz., Discount and finance house of India and Securities trading corporation of India. Permitting banks to trade in Government Securities, in order to promote the retail market segment.

Post-shipment Credit:

Funds lent by banks in rupees or dollar denominated credit to exporters after the shipment of goods. This is useful to exporters who may otherwise suffer a long collection period. Post -shipment finance can be in the form of purchase or discounting of export bills, advance against foreign bills presented for collection, advance against cash incentives, etc. Post-shipment and pre-shipment finance entail disbursement of credit and hence are fund-based. In addition, banks assist exporters through non fund-based facilities such as issuance of letters of guarantee and letters of credit.

Pre-shipment Credit:

Funds lent by banks in rupees or foreign currency to exporters, prior to the shipment of goods. Pre-shipment finance can be in the form of packing credit, advance against cash incentives and others. Packing credit is offered to an exporter for purposes of packing and shipment and also manufacture of goods. Such credit may be in the form of a loan, cash credit or overdraft facility.
The emergence of a ready and receptive set of intermediaries that aid in the issuance of new securities by functioning as transient holders. Further, the link between PDs and investors will be forged by Satellite Dealers. The system of flotation and trading of Treasury Bills and Gilts will be streamlined by new developments that are planned, viz. screen-based dealing and dematerialisation of Gilts. The importance of the future role of PDs can be grasped from the fact that the ultimate aim of the Reserve Bank of India is to completely withdraw its own support to the primary issues of the Government. Making a market by offering two-way quotes which imparts liquidity to secondary market transactions.

Private Equity Fund (PEF):

A fund belonging to private investors that typically invests in the equity of upcoming companies by a negotiated deal. The investment is medium term, the period ranging between three and five years, and is usually in unlisted companies. The success of a PEF depends on both the quality of the portfolio as well as the profit upon exit. Thus, a fund has to be very selective about its investments and must also plan its exit properly. The investments may be liquidated in future either through a public issue, a direct placement or under a prior agreement with the promoter for buying back the shares. Since the commitment of PEFs is for an appreciable length of time, promoters of many companies welcome their participation. Others, however, are uneasy with the idea since PEFs take a close interest in the activities and performance of the companies funded by them which may include setting financial targets jointly and then tightly monitoring the progress.

STRIPS:

An acronym for Separate Trading or Registered Interest and Principal of Securities. This technique enables an intermediary such as a brokerage firm or a bank to strip the coupons from the principal of the bond, so that the two can be traded separately. For example, a three- year debenture with coupons payable semi-annually will have seven distinct cash flows viz., coupon payments at the end of every six months till maturity and the principal payment at maturity. Accordingly, the coupons can be sold to investors as fixed deposits falling due at the end of 6,12, 18,24,30 and 36 months and the principal is sold on a discounted basis, similar to a Zero coupon bond. The advantages to investors arise from the flexibility it offers to suit cash flow needs and maturity requirements. In India, GE Capital and ABN Amro have teamed up to use the technique for the first time, for the former's debenture issue.

Treasury Stock :

The equity shares repurchased by the issuing company. Companies in the U.S. undertake treasury stock operations for a variety of reasons- the shares could be used for acquisitions, stock option plans or other purposes, In India , however the Companies Act 1956, vide Section 77, has explicitly forbidden treasury stock operations. By an ordinance (promulgated in October 1998, companies have been allowed to buy back their shares up to 25% of their paid up capital and free reserves; the same ordinance also permits companies to issue sweat equity. As a sequel, the Securities and Exchange Board of India has announced the related regulations.

Ways and Means Advances (WMA):

The short-term loans granted by the Reserve Bank of India (RBI) to state governments, to enable the latter to over come a temporary mismatch in cash flows. Such assistance is intended to help them to tide over temporary difficulties caused by an unexpected shortfall in receipts. The RBI is empowered to grant ways and means advances to the central and state governments for a term of three months. The amounts of advance varies from state to state, and is a multiple of the balance maintained by a state government with RBI. A state government may seek financial accommodation on the strength of the central government securities it holds. This is termed "special" WMA. Over the years, the total limits for ways and means advances under clean and secured basis have been progressively increased, keeping in view the higher volume of cash flows and transactions, versus the imperatives of monetary policy; the latter aspect impels the RBI to closely monitor the utilization of this credit facility and also charge penal interest on overdrafts. Further, in extraordinary circumstances, e.g., a natural calamity, the RBI may allow an additional special ways and means advance.

Winner's Curse:

The event of being a successful bidder in an auction (e.g. for TREASURY BILLS) as a consequence of having bid a very high price. However, securities so acquired fetch a lower price when sold, thus resulting in a loss to the bidder. Therefore, fear of the Winner's Curse prompts bidders to quote somewhat lower prices at auctions. Thus, this type of behavior is detrimental to the fund-raising operations of a Government.

Contract Note: (Purchase from Broker share then give by Broker)

It is given by the stock broker to the buyer/seller of shares, embodying an agreement reached between them to buy or sell so many shares of such and such companies at a stated price, which usually includes the brokers commission. The broker sends the note after executing the customers order as an agreement of delivery. The contract note must be carefully preserved, as it is documentary evidence to the income tax authorities in computation of short term or long term capital gains or losses.

Coupon :

A slip attached to a loan instrument, a bond or a debenture, entitling the holder to receive interest on presentation to the company or a bank. A bond may have a detachable coupon sheet containing a dated detachable coupons. The interest rate applying to the coupon is called coupon rate.

Pecking Order Theory of Capital Structure:

The peeking theory suggests that preference for financing sources for all firms follows a general sequence. In general, a finance manager prefers internal sources to external. Because the internal source in form of retained earnings adds least worry from him. Coming to the external sources, a finance manager prefers issue of debts to issue of equity. Which is consider the last resort when the company runs out of its debts capacity. The debt is preferred because of asymmetric information, which means that the managers know more of the companies' prospects, risks and values then the outside investors.

The way asymmetric information effect choise between debt and equity financing is explained below.

An optimistic manager makes think that considering the companies prospectus, its share are currently under priced. He will therefore prefer debt issue.

Curvilinear Break-even-Analysis: Under marginal costing approach, the main assumption is that selling price and variable cost per unit will remain constant at any level of activity. The basic assumption is that of cost-volume-profit relationship is linear.

In practical business scene, increased sales volume may be obtained by offering price concessions to customers. The costs behave variedly due to economies to scale. This effect of the decreasing price per unit with increase in demand and the increasing cost per unit due to diminishing returns is to have a profit figure that increases upto a point and then decreases until it is converted into a loss. The break-even chart, therefore, becomes curvilinear instead of linear model. In the curvilinear model, the optimum production level is where the total revenue line exceeds the total cost line by the largest amount.

Financial Intermediation: It involves financial institutions acquiring funds from the public by issuing their own instruments and then using the funds to buy primary securities. It is a sort of indirect financing in which savers deposit funds with financial institutions rather than directly buying bonds and the financial institutions, in turn, lend to the ultimate borrowers. Financial intermediaries are in a better position than individuals to bear and spread the risks of primary security ownership. Because of their large size, intermediaries can diversify their portfolios and minimize the risk involved in holding any security. The employ skilled portfolio managers, posses expertise in evaluation of borrower credit characteristics and take advantage of economies in large scale buying and selling.

Financial intermediaries are firms that provide services and products that customers may not be able to get more efficiently by themselves in financial market. A good example of a financial intermediary is a mutual fund, which pools the financial resources of a number of people and invests in a basket of securities.

Shareholder Value Analysis: SVA is an approach to Financial Management developed in 1980s, which focuses on the creation of economic value for shareholders, as measured by share price performance and flow of funds. SVA is used of a way of linking management strategy and decision to the creation of value for shareholders. The factors. Called 'value drivers' are identified which will influence the shareholders' value. They may be growth in sales, improvement in profit margin, capital investment decisions, capital structures decisions, etc. The management is required to pay attention to such value drives while taking investment and finance decisions. SVA helps the management to concentrate on activities, which create value to the shareholders rather than on short-term profitability.

Social Cost-Benefit Analysis of industrial projects*:* This refers to the moral responsibility of both PSU and private sector enterprises to undertake socially desirable projects - that is, the social contribution aspect needs to be kept in view. Industrial capital investment projects are normally subjected to rigorous feasibility analysis and cost benefit study from the point of view of the investors. Such projects, especially large ones often have a ripple effect on other sections of society, local environment, use of scarce national resources etc. Conventional cost-benefit analysis ignores or does not take into account or ignores the societal effect of such projects.

Social Cost Benefit (SCB) is recommended and resorted to in such cases to bring under the scanner the social costs and benefits. SCB sometimes changes the very outlook of a project as it brings elements of study which are unconventional yet very very relevant. In a study of a famous transportation project in the UK from a normal commercial angle, the project was to run an annual deficit of more than 2 million pounds. The evaluation was adjusted for a realistic fare structure which the users placed on the services provided which changed the picture completely and the project got justified. Large public sector/service projects especially in under-developed countries which would get rejected on simple commercial considerations will find justification if the social costs and benefits are considered.

SCB is also important for private corporations who have a moral responsibility to undertake socially desirable projects, use scarce natural resources in the best interests of society, generate employment and revenues to the national exchequer.

Indicators of the social contribution include

1. Employment potential criterion;
2. Capital output ratio - that is the output per unit of capital;
3. Value added per unit of capital;
4. Foreign exchange benefit ratio.