Contents

About the Author	ii
Preface	vii
Syllabus Mapping	X
Supplementary Material on the Companion Website	xiv
1. Financial System: An Overview	1
Introduction 1	
Concept of Finance, Savings and Investments 2	
Features 3	
Role of Finance in an Economy 3	
Different Financial Innovations and Developments in the Financial System 4	
Rudimentary Finance 4	
Direct Finance 5	
Indirect Finance 6	
Financial System in India 7	
Objectives 8	
Significance 8	
Functions of Financial System 8	
Structure or Components of Indian Financial System 10	
Regulatory Bodies 10	
Financial Institutions/Intermediaries 12	
Direct/Primary Instruments 15	
Indirect Instruments 17	
Derivatives Instruments 17	
Financial Markets 18	
Financial Services 20	
Financial System and Economic Development in India 21	
Evolution and Reforms in Financial System in India 22	
Phase I: Pre-1947 Scenario (Pre-Independence Era) 23	
Phase II: Pre-1951 Scenario (Post-Independence and Pre-Planned	
Economic Policy Era) 25	
Phase III: 1951 to the Mid-1980s Scenario (Planned Economic Policy Era) 2	6
Weakness in the Pre-1990s Scenario 31	
Phase IV: Mid-Eighties and Post 1990s Scenario (Economic Reforms Era) 3	2

ii

 \boldsymbol{x}

	Conclusion 36	
	Keywords 36	
	Summary 37	
	Review Questions 38	
2.	Money and Indian Banking System	40
	Introduction 40	
	Concept of Money 41	
	The Origin 41	
	Features of Money 42	
	Functions of Money 42	
	Alternative Measures to Money Supply in India 43	
	The Concept and Meaning 43	
	Different Components of Money Supply in India 44	
	Determinants of Money Supply 47	
	Money Supply and the Creation of Bank Credit 49	
	Commercial Banks 50	
	The Concept and Meaning 50	
	Evolution of Commercial Banks in India 50	
	Importance of Commercial Banks 51	
	Functions of Commercial Banks 52	
	Structure of Commercial Banking in India 54	
	What Distinguishes Commercial Banks from Central Banks 56	
	Credit Creation Process of Commercial Banks 57	
	Concept of Money Multiplier 61	
	High-Powered Money: Concept and Uses 62	
	The Concept 62	
	The Central Bank: The Reserve Bank of India (RBI) 63	
	Introduction 63	
	Evolution and History of RBI 64	
	Functions/Role of RBI 71	
	Direct and Indirect Instruments of the RBI 74	
	Monetary Policy in India 75	
	Introduction 75	
	Objectives of Monetary Policy 75	
	Instruments of Monetary and Credit Control under Monetary Policy 76	
	Main Features of Monetary Policy Since Independence in India 80	

Conclusion 86 Keywords 86 Summary 87 Review Questions 88 Case Study 89 3. Development Banks: An Overview 91 Introduction 91 Organizational Structure of Financial Institutions in India 92 All-India Financial Institutions (AIFIs) State Level/Regional Institutions 95 Other Institutions 96 Development Banks in India 96 The Concept and Meaning Historical Background 97 Features 98 Objectives 99 Role of Development Banks in Financial Sector 99 Distinction between Development Banks and Commercial Banks 100 The Concept of Universal Banks in India 101 Transformation of Development Banks into Commercial Banks 102 Major Financial Institutions and their Functions Major Development Banks and their Functions 103 Industrial Finance Corporation of India Limited (IFCI Ltd.) 103 Industrial Development Bank of India Limited (IDBI Ltd.) 106 Industrial Credit and Investment Corporation of India Limited (ICICI Bank Limited) 110 Major Specialized Financial Institutions, Re-Financing Institutions and State Level Institutions and their Functions 114 Export-Import Bank of India (EXIM Bank) 114 National Bank for Agriculture and Rural Development (NABARD) 117 Small Industries Development Bank of India (SIDBI) 121 State Financial Corporation (SFCs) 122 Conclusion 123 Keywords 124 Summary 124 Review Questions 125 Case Study 126

4. Other Financial Institutions: An Overview 127 Introduction 127 Insurance Industry 127 The Concept and Meaning 127 Basic Principles of Insurance 128 Insurance Sector and Economic Growth 130 Origin of Insurance Sector 132 Historical Background of Insurance Sector in India 133 Reforms of Insurance Sector in India 136 Benefits of Insurance 138 Types of Insurance in India 139 The Insurance Concerning Business Approach 139 The Insurance Concerning Risk Approach 140 Insurance Intermediaries 141 Life Insurance Business in India 142 The Concept 142 Features 143 Structure 143 Private Sector Life Insurance Companies in India: A Brief Description 144 Life Insurance Corporation of India (LICI) 152 Introduction 152 Objectives 152 Functions 153 Different Products 154 General Insurance Business in India 156 The Concept 156 Evolution of General Insurance Business and General Insurance Corporation of India (GICI) 156 Features 158 Present Structure 158 General Insurance Products 161 Regulatory Framework in Insurance Industry 162 Introduction 162 The Insurance Act 1938 163 General Insurance Business (Nationalization) Act 1972 165 Life Insurance Corporation Act 1956 165 Insurance Regulatory and Development Authority (IRDA) Act 1999 166

Mutual Funds & Unit Trust of India (UTI) 169 Introduction and Basic Concept of Mutual Funds 169 History of Mutual Funds Industry 169 Indian Scenario 172 Benefits of Mutual Funds 173 Risk Factors Associated with Mutual Funds 174 Mutual Fund Investors 174 Types of Mutual Fund Schemes 174 Constituents of Mutual Funds 176 Shortcomings in Operation of Mutual Funds 177 Regulatory Framework 178 Structure of the Indian Mutual Fund Industry 178 Leading Mutual Fund Companies in India 179 Unit Trust of India (UTI) and UTI Mutual Fund 181 Unit Trust of India (UTI) 181 The Unit Scheme 1964 (US-64) 182 UTI Mutual Fund (UTI Asset Management Company Private Limited): Changing Paradigm 185 Conclusion 189 Keywords 189 Summary 189 Review Questions 191 Case Study 192 194 5. Interest Rate Structure Introduction 194 Concept of Interest 195 Gross and Net Interest Rate 195 Nominal Interest Rate and Real Interest Rate 197 Differential Interest Rate (DRI) Scheme 197 Causes of Variation of Interest Rate 197 Relationship between Interest Rate and Economic Progress 199 Interest Rate Determination and Theories of Interest Rate 200 Classical or Real Theory of Interest 201 Loanable Fund Theory or Neo-Classical Theory of Interest 203 Liquidity Preference or Keynesian Theory 206 Determination of the Rate of Interest 208 Hicks-Hansen's General Equilibrium Theory 209

	The Term Structure of Interest Rates 210	
	Introduction 210	
	Yield Curves 211	
	Theories of the Term Structure of Interest Rate 213	
	Interest Rate Policy in India 218	
	Introduction 218	
	Interest Rate Policy of RBI 218	
	Recent Changes in Interest Rate Structure in India 224	
	Lending Interest Rates Structure (The Base Rate System) 224	
	Savings Bank Deposit Interest Rate (Deregulation Era) 231	
	Conclusion 231	
	Keywords 231	
	Summary 332	
	Review Questions 233	
	Case Study 233	
6.	Financial Markets: An Outline	235
	Introduction 235	
	The Concept and Meaning 235	
	Features 236	
	Functions 236	
	Structure 237	
	Capital-and Money Markets: Distinguishing Features 239	
	Primary and Secondary Markets: Distinguishing Features 239	
	Reforms in the Financial Markets in India 241	
	Introduction 241	
	Money Markets Reforms 241	
	Foreign Exchange Market Reforms 242	
	Securities Markets/Capital Markets Reforms 243	
	Conclusion 247	
	Keywords 247	
	Summary 248	
	Review Questions 248	
7.	Money Markets Operations: An Overview	250
	Introduction 250	
	The Concept and Meaning 251	
	Objectives 251	
	Features 251	

Functions 252 Structure of Money Markets in India 252 Shortcomings of Indian Money Market 253 Money Market Instruments in India 256 Call or Notice Money 256 Treasury Bills 258 Commercial Papers 261 Commercial Bills (CBs) 262 Certificates of Deposit (CDs) 264 Re-purchase Agreements (Repos) 266 SBI Discount and Finance House of India Limited (SBI DFHIL) 267 Securities Trading Corporation of India Limited (STCIL) 268 Money Market Mutual Funds (MMMFs) 269 Money Market Reforms and its Recent Trends in India 269 Conclusion 271 Keywords 272 Summary 272 Review Questions 273 Case Study 274 276 8. Primary Capital Markets: Organization and Operations Introduction 276 The Concept and Meaning of Primary Markets (i.e. New Issue Markets) 277 Functions 278 Changed Regulatory Framework Governing Public Offerings 278 Different Kinds of Issues of Securities 279 Public Issue 280 Rights Issue 290 Bonus Issue 294 Private Placement 295 Types of Private Placement Public Issue Mechanism 303 Pricing of Public Issues: The Fixed Price Method 303 Pricing of Public Issues: Book-Building Method 305 Stages of Pricing of Public Issues 307 Price Discovery: The Book-Building Process 308 Distinction between Fixed-Price and Book-Building Method 311 Book-Building Process and Activities of Intermediaries in Public Issue Management 311

	Allotment Process of Book-Building Issues 314	
	Basis of Allotment 317	
	Reservation on Competitive Basis 318	
	Application Supported by Blocked Amount (ASBA) Procedure 319	
	Shortcomings 320	
	Pricing of FPOs: Pure-Auction Method 320	
	IPO Grading in India 322	
	Green Shoe Option: A Price Stabilization Mechanism in Public Issues 327	
	Bird's Eye View of Indian Primary Capital Markets 333	
	Conclusion 336	
	Keywords 337	
	Summary 337	
	Review Questions 340	
	Case Study 342	
n	Secondary Capital Markets: Organization and Operations	346
7.	Introduction 346	340
	The Concept and Meaning of Secondary Markets (i.e. Stock Markets) 347	
	Features 348	
	Functions 348	
	Brief History of Indian Capital Market 349	
	Pre-Independence Period 349	
	Post-Independence Period (Before Liberalization and Globalization) 350	
	Post-Independence Period (After Liberalization and Globalization) 351	
	Listing of Securities at the Stock Exchanges 353	
	Meaning 353	
	Benefits 353	
	Legal Provisions 354	
	Mandatory Listing 354	
	Consequences of Non-Listing 354	
	Securities Contracts (Regulation) Act 1956 (SCRA) 355	
	Listing Criteria of Important Stock Exchanges 355	
	Listing Requirements: NSE 360	
	For Initial Public Offerings (IPOs) 360	
	For Securities of Existing Companies 362	
	Listing Procedure at NSE 363	
	Functionaries of Stock Exchanges 366	
	Stock Brokers 366	

```
Registration of Stock Brokers 366
  Sub-Brokers 369
  Jobbers 372
  Consultants/Portfolio Managers 372
  Institutional Investors 377
  Non-Resident Indians (NRIs) 379
  Depository 380
  Depository Participant (DP) 380
  Registrar and Transfer Agent (R&T Agents) 380
  Custodians 380
Stock Exchange Trading 381
  Introduction 381
  Open Outcry System (Erstwhile Trading System) 381
  Online Trading through Depository System (Current Trading System)
  Key Features of the Depository System in India 383
  Functions of Depository System 385
  Benefits 385
  Depository in India 387
National Securities Depository Limited (NSDL) 387
  Basic Idea 387
  Services Offered by NSDL 388
  Stock Market Trading through NSDL Depository System 388
  Key Milestones 390
Central Depository Services (India) Limited (CDSL) 391
  Opening Demat Account under Depository System 392
  Freezing of Demat Accounts 394
  De-materialization Process 395
  Re-materialization Process 397
  Trading and Settlement of Securities Under the Depository System 398
  Rolling Settlement Cycles 402
Financial Derivatives in Stock Market 403
  Introduction 403
  The Concept 403
  Functions 404
  Participants in Derivatives Market 404
  Types of Derivatives 404
Forwards and Futures Contracts: Distinguishing Features 408
```

Conclusion 408 Keywords 409 Summary 409 Review Questions 412 Case Study 413 10. Stock Exchanges: Stock Price Indices 416 Introduction 416 History of Indian Stock Exchanges 417 Pre-Independence Scenario 418 Post-Independence Scenario 419 Leading Stock Exchanges 419 Introduction 419 Bombay Stock Exchange Limited (BSE) 422 Introduction 422 The BSE Initiative 422 National Stock Exchange of India Ltd. (NSE) 424 Introduction 424 Corporate Structure 425 The NSE Initiative 426 Over the Counter Exchange of India (OTCEI) 429 Introduction 429 Corporate Structure 429 The OTCEI Initiative 429 Securities Traded on the OTCEI 430 Stock Market Indices 430 The Concept 430 Importance of Stock Index 431 Computation of Index Number 432 Determinants of a Stock Index 435 Leading Share Price Indices 436 BSE 30 Index: Sensex 437 Introduction 437 Objectives of Sensex 437 Calculation Methodology 438 Maintenance of BSE Indices and Base Market Capitalization Adjustment 440 Companies in the Sensex 441 History of Replacements in Sensex 442

Sensex: Historical Facts 445 Sensex Milestones 446 S&P CNX Nifty (Nifty) 448 Introduction 448 Calculation Methodology 448 Companies in the S&P CNX Nifty Index 450 History of Replacements in S&P CNX Nifty 453 Maintenance of Nifty Index and Base Market Capitalization Adjustment 455 Nifty: Historical Facts 456 Conclusion 457 Keywords 457 Summary 457 Review Questions 459 Case Study 460 461 11. Regulatory Framework: Investors' Protection Introduction 461 Investors' Protection: Meaning 462 Investors' Protection: The Need 462 Regulatory Framework 463 Market Regulators: A Brief Outline 464 Department of Economic Affairs (DEA) 464 Department of Company Affairs (DCA)/Ministry of Corporate Affairs 465 Reserve Bank of India (RBI) 466 Securities and Exchange Board of India (SEBI) 466 Certain Initiatives of the SEBI 466 Establishment of the Integrated Surveillance Department in SEBI 466 Supervision for Investors' Protection 468 Investigation for Investors' Protection 469 Regulatory Action for Investors' Protection 469 Redressal of Investors' Grievances 469 Stock Exchanges 470 Surveillance in Stock Exchanges 470 The Need 470 Surveillance Activities 471 Surveillance Actions 472 Grievances Concerning Stock Exchange Dealings and their Removal 472 Grievance Redressal Cell in Stock Exchanges: Bombay Stock Exchange (BSE) 472

	Grievance Redressal Cell in Stock Exchanges: National Stock	
	Exchange (NSE) 474	
	Complaints of Investors 474	
	Investor Protection Fund (IPF) 475	
	Insurance Development and Regulatory Authority (IRDA) 476	
	Legislations Governing the Securities Market: A Brief Outline 476	
	The Securities Contracts (Regulation) Act 1956 476	
	Securities Contracts (Regulation) Rules, 1957 477	
	The Companies Act 1956 477	
	Role of Company Law Board 477	
	The SEBI Act 1992 478	
	Historical Perspective of SEBI Regulations 478	
	Objectives of the SEBI 480	
	Powers and Functions of SEBI 481	
	Organization of SEBI 481	
	Management of the SEBI 482	
	SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 482	
	SEBI (Prohibition of Insider Trading) Regulations 1992 483	
	The Depositories Act 1996 484	
	SEBI (Investor Protection and Education Fund) Regulations 2009 485	
	Role of Judiciary: Investors' Protection 486	
	Regulatory Issues 486	
	SEBI's Actions: Appeals Filed Before SAT 488	
	Role of Press Media: Investors' Protection 488	
	Conclusion 489	
	Keywords 489	
	Summary 490	
	Review Questions 491	
	Case Study 492	
12.	Financial Services: Merchant Banking	495
	Introduction 495	
	The Concept and Meaning 495	
	Significance 496	
	Evolution in India 497	
	Characteristics of Financial Services 497	
	Types of Financial Services 498	
	Fee Based Services 498	

	Contents	xxvii
Fund Based Services 501		
Insurance Services 503		
Challenges to the Financial Services Sector 504		
Merchant Banking in Financial Services: Historical Background 505		
The Concept 507		
Importance of Merchant Banking in India 507		
Functions of Merchant Bankers in India 509		
Distinction Between Merchant and Commercial Banks 514		
Distinction Between Merchant and Investment Banks 515		
Capital Issue Management: SEBI Registered Merchant Bankers 516		
The Regulatory Framework for Merchant Bankers 517		
Conclusion 519		
Keywords 520		
Summary 520		
Review Questions 522		
Case Study 522		
13. Financial Services: Credit Rating		524
Introduction 524		324
The Concept and Meaning 525		
Historical Background 526		
Global Scenario 526		
Indian Scenario 527		
Objectives of Credit Rating 527		
Functions of Credit Rating Agencies 528		
Benefits 528		
Issuers 529		
Investors 529		
Financial Intermediaries 529		
Business Counter-parties 529		
Regulators 529		
Limitations 530		
The Rating Process 530		
The Rating Methodology 531		
Credit Rating Agencies in India: A Brief Profile 533		
Credit Rating Information Services of India Limited (CRISIL) 533		
Key Milestones from its Journey 534		
Credit Ratings Symbols 535		

```
Long-Term Instruments Ratings 535
  Fixed Deposits Ratings 536
  Short-Term Instruments 536
  Corporate Credit Rating Scale 537
Investment Credit Rating Agency of India Ltd. (ICRA) 537
  Key Milestones from its Journey 538
  Credit Ratings Symbols 540
     Medium-Term Rating Scale: All Public Deposit Programmes 540
  Short-Term Rating Scale: All Instruments with Original
    Maturity within One Year 541
Credit Analysis and Research Ltd. (CARE) 541
  Credit Ratings Symbols 542
  Long/Medium-Term Instruments (NCD/FD/CD/SO/CPS/RPS/L) 542
  Short-Term Instruments 542
Fitch Ratings India Pvt. Ltd. 543
  Credit Ratings Symbols 544
  Long-Term Credit Ratings 544
  Term Deposit Credit Ratings 545
Brickwork Ratings India Pvt. Ltd. 545
  Credit Rating Symbols 546
  Long-Term Debt Instruments 546
  Short-Term Debt Instruments 547
The Regulatory Framework for CRAs 547
  Registration of Credit Rating Agencies 547
  General Obligations of Credit Rating Agencies 548
  Procedure for Inspection and Investigation 548
  Procedure for Action in Case of Default 549
Conclusion 549
Keywords 549
Summary 549
Review Questions
                 550
Case Study 551
```

Index 553