Investment Banking Notes (Session 1-10)

An investment bank is a financial services company or corporate division that engages in advisory-based financial transactions on behalf of individuals, corporations, and governments. Traditionally associated with corporate finance, such a bank might assist in raising financial capital by underwriting or acting as the client's agent in the issuance of securities. An investment bank may also assist companies involved in mergers and acquisitions (M&A) and provide ancillary services such as market making, trading of derivatives and equity securities, and FICC services (fixed income instruments, currencies, and commodities). Most investment banks maintain prime brokerage and asset management departments in conjunction with their investment research businesses. As an industry, it is broken up into the Bulge Bracket (upper tier), Middle Market (mid-level businesses), and boutique market (specialized businesses).

Unlike commercial banks and retail banks, investment banks do not take deposits. From the passage of Glass–Steagall Act in 1933 until its repeal in 1999 by the Gramm–Leach–Bliley Act, the United States maintained a separation between investment banking and commercial banks. Other industrialized countries, including G7 countries, have historically not maintained such a separation. As part of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd–Frank Act of 2010), the Volcker Rule asserts some institutional separation of investment banking services from commercial banking.

All investment banking activity is classed as either "sell side" or "buy side". The "sell side" involves trading securities for cash or for other securities (e.g. facilitating transactions, market-making), or the promotion of securities (e.g. underwriting, research, etc.). The "buy side" involves the provision of advice to institutions that buy investment services. Private equity funds, mutual funds, life insurance companies, unit trusts, and hedge funds are the most common types of buy-side entities.

An investment bank can also be split into private and public functions with a screen separating the two to prevent information from crossing. The private areas of the bank deal with private insider information that may not be publicly disclosed, while the public areas, such as stock analysis, deal with public information. An advisor who provides investment banking services in the United States must be a licensed broker-dealer and subject to U.S. Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) regulation.

The Dutch East India Company was the first company to issue bonds and shares of stock to the general public. It was also the first publicly traded company, being the first company to be listed on an official stock exchange. The Dutch also helped lay the foundations of the modern practice of investment banking.

Investment banking has changed over the years, beginning as a partnership firm focused on underwriting security issuance, i.e. initial public offerings (IPOs) and secondary market offerings, brokerage, and mergers and acquisitions, and evolving into a "full-service" range including securities research, proprietary trading, and investment management. In the 21st century, the SEC filings of the major independent investment banks such as Goldman Sachs and Morgan Stanley reflect three product segments:

Investment banking (mergers and acquisitions, advisory services, and securities underwriting), asset management (sponsored investment funds), and trading and principal investments (broker-dealer

activities, including proprietary trading ("dealer" transactions) and brokerage trading ("broker" transactions)).

In the United States, commercial banking and investment banking were separated by the Glass–Steagall Act, which was repealed in 1999. The repeal led to more "universal banks" offering an even greater range of services. Many large commercial banks have therefore developed investment banking divisions through acquisitions and hiring. Notable large banks with significant investment banks include JPMorgan Chase, Bank of America, Citigroup, Credit Suisse, Deutsche Bank, UBS, and Barclays.

After the financial crisis of 2007–08 and the subsequent passage of the Dodd-Frank Act of 2010, regulations have limited certain investment banking operations, notably with the Volcker Rule's restrictions on proprietary trading.

The traditional service of underwriting security issues has declined as a percentage of revenue. As far back as 1960, 70% of Merrill Lynch's revenue was derived from transaction commissions while "traditional investment banking" services accounted for 5%. However, Merrill Lynch was a relatively "retail-focused" firm with a large brokerage network.

Core investment banking activities

Investment banking is split into front office, middle office, and back office activities. While large service investment banks offer all lines of business, both "sell side" and "buy side", smaller sell-side investment firms such as boutique investment banks and small broker-dealers focus on investment banking and sales/trading/research, respectively.

Investment banks offer services to both corporations issuing securities and investors buying securities. For corporations, investment bankers offer information on when and how to place their securities on the open market, an activity very important to an investment bank's reputation. Therefore, investment bankers play a very important role in issuing new security offerings.

Front office

Front office is generally described as a revenue-generating role. There are two main areas within front office: investment banking and markets

Investment banking involves advising organizations on mergers and acquisitions, as well as a wide array of capital raising strategies.

Markets is divided into "sales and trading" (including "structuring"), and "research".

Corporate finance

Corporate finance is the aspect of investment banks which involves helping customers raise funds in capital markets and giving advice on mergers and acquisitions (M&A); this may involve subscribing investors to a security issuance, coordinating with bidders, or negotiating with a merger target. A pitch book of financial information is generated to market the bank to a potential M&A client; if the pitch is successful, the bank arranges the deal for the client.

The investment banking division (IBD) is generally divided into industry coverage and product coverage groups. Industry coverage groups focus on a specific industry — such as healthcare, public finance (governments), FIG (financial institutions group), industrials, TMT (technology, media, and telecommunications), P&E (power & energy), consumer/retail, food & beverage, corporate defense and governance — and maintain relationships with corporations within the industry to bring in business for the bank. Product coverage groups focus on financial products — such as mergers and acquisitions, leveraged finance, public finance, asset finance and leasing, structured finance, restructuring, equity, and debt issuance.

Sales and trading

On behalf of the bank and its clients, a large investment bank's primary function is buying and selling products. In market making, traders will buy and sell financial products with the goal of making money on each trade. Sales is the term for the investment bank's sales force, whose primary job is to call on institutional and high-net-worth investors to suggest trading ideas (on a caveat emptor basis) and take orders. Sales desks then communicate their clients' orders to the appropriate trading rooms, which can price and execute trades, or structure new products that fit a specific need. Structuring has been a relatively recent activity as derivatives have come into play, with highly technical and numerate employees working on creating complex structured products which typically offer much greater margins and returns than underlying cash securities. In 2010, investment banks came under pressure as a result of selling complex derivatives contracts to local municipalities in Europe and the US. Strategists advise external as well as internal clients on the strategies that can be adopted in various markets. Ranging from derivatives to specific industries, strategists place companies and industries in a quantitative framework with full consideration of the macroeconomic scene. This strategy often affects the way the firm will operate in the market, the direction it would like to take in terms of its proprietary and flow positions, the suggestions salespersons give to clients, as well as the way structurers create new products. Banks also undertake risk through proprietary trading, performed by a special set of traders who do not interface with clients and through "principal risk"—risk undertaken by a trader after he buys or sells a product to a client and does not hedge his total exposure. Banks seek to maximize profitability for a given amount of risk on their balance sheet. Note here that the FRTB framework has underscored the distinction between the "Trading book" and the "Banking book," i.e. assets intended for active trading—as opposed to assets expected to be held to maturity—and market risk capital requirements will differ accordingly. The necessity for numerical ability in sales and trading has created jobs for physics, computer science, mathematics, and engineering Ph.D.'s who act as quantitative analysts.

Research

The securities research division reviews companies and writes reports about their prospects, often with "buy", "hold", or "sell" ratings. Investment banks typically have sell-side analysts which cover various industries. Their sponsored funds or proprietary trading offices will also have buy-side research. Research also covers credit risk, fixed income, macroeconomics, and quantitative analysis, all of which are used internally and externally to advice clients; alongside "Equity", these may be separate "groups". The research group(s) typically provides a key service in terms of advisory and strategy.

While the research division may or may not generate revenue (based on policies at different banks), its resources are used to assist traders in trading, the sales force in suggesting ideas to customers, and

investment bankers by covering their clients.[citation needed] Research also serves outside clients with investment advice (such as institutional investors and high-net-worth individuals) in the hopes that these clients will execute suggested trade ideas through the sales and trading division of the bank, and thereby generate revenue for the firm.

With MiFID II requiring sell-side research teams in banks to charge for research, the business model for research is increasingly becoming revenue-generating. External rankings of researchers are becoming increasingly important, and banks have started the process of monetizing research publications, client interaction times, meetings with clients etc.

There is a potential conflict of interest between the investment bank and its analysis, in that published analysis can impact the performance of a security (in the secondary markets or an initial public offering) or influence the relationship between the banker and its corporate clients, thereby affecting the bank's profitability.

Middle office

This area of the bank includes treasury management, internal controls (such as Risk), and internal corporate strategy.

Corporate treasury is responsible for an investment bank's funding, capital structure management, and liquidity risk monitoring.

Internal control tracks and analyzes the capital flows of the firm, the finance division is the principal adviser to senior management on essential areas such as controlling the firm's global risk exposure and the profitability and structure of the firm's various businesses via dedicated trading desk product control teams. In the United States and United Kingdom, a comptroller (or financial controller) is a senior position, often reporting to the chief financial officer.

Risk management

Risk management involves analyzing the market and credit risk that an investment bank or its clients take onto their balance sheet during transactions or trades. Middle office "Credit Risk" focuses around capital markets activities, such as syndicated loans, bond issuance, restructuring, and leveraged finance. These are not considered "front office" as they tend not to be client-facing and rather 'control' banking functions from taking too much risk. "Market Risk" is the control function for the Markets' business and conducts review of sales and trading activities utilizing the VaR model. Other Middle office risk groups include country risk, operational risk, and counterparty risks which may or may not exist on a bank to bank basis.

Front office risk teams, on the other hand, engage in revenue-generating activities involving debt structuring, restructuring, syndicated loans, and securitization for clients such as corporates, governments, and hedge funds. Here "Credit Risk Solutions", are a key part of capital market transactions, involving debt structuring, exit financing, loan amendment, project finance, leveraged buy-outs, and sometimes portfolio hedging. The "Market Risk Team" provides services to investors via derivative solutions, portfolio management, portfolio consulting, and risk advisory.

Well-known "Risk Groups" are at JPMorgan Chase, Morgan Stanley, Goldman Sachs and Barclays J.P. Morgan IB Risk works with investment banking to execute transactions and advise investors, although its Finance & Operation risk groups focus on middle office functions involving internal, non-revenue generating, operational risk controls. The credit default swap, for instance, is a famous credit risk hedging solution for clients invented by J.P. Morgan's Blythe Masters during the 1990s. The Loan Risk Solutions group within Barclays' investment banking division and Risk Management and Financing group housed in Goldman Sach's securities division are client-driven franchises.

Note, however, that risk management groups such as credit risk, operational risk, internal risk control, and legal risk are restrained to internal business functions - including firm balance-sheet risk analysis and assigning the trading cap - that are independent of client needs, even though these groups may be responsible for deal approval that directly affects capital market activities. Similarly, the Internal corporate strategy group, tackling firm management and profit strategy, unlike corporate strategy groups that advise clients, is non-revenue regenerating yet a key functional role within investment banks.

This list is not a comprehensive summary of all middle-office functions within an investment bank, as specific desks within front and back offices may participate in internal functions.

Back office

The back office data-checks trades that have been conducted, ensuring that they are not wrong, and transacts the required transfers. Many banks have outsourced operations. It is, however, a critical part of the bank.

Technology

Every major investment bank has considerable amounts of in-house software, created by the technology team, who are also responsible for technical support. Technology has changed considerably in the last few years as more sales and trading desks are using electronic trading. Some trades are initiated by complex algorithms for hedging purposes.

Firms are responsible for compliance with local and foreign government regulations and internal regulations.

Other businesses

Global transaction banking is the division which provides cash management, custody services, lending, and securities brokerage services to institutions. Prime brokerage with hedge funds has been an especially profitable business, as well as risky, as seen in the bank run with Bear Stearns in 2008.

Investment management is the professional management of various securities (stocks, bonds, etc.) and other assets (e.g., real estate), to meet specified investment goals for the benefit of investors. Investors may be institutions (insurance companies, pension funds, corporations etc.) or private investors (both directly via investment contracts and more commonly via investment funds e.g., mutual funds). The investment management division of an investment bank is generally divided into separate groups, often known as private wealth management and private client services.

Merchant banking can be called "very personal banking"; merchant banks offer capital in exchange for share ownership rather than loans, and offer advice on management and strategy. Merchant banking is also a name used to describe the private equity side of a firm. Current examples include Defoe Fournier & Cie. and JPMorgan Chase's One Equity Partners. The original J.P. Morgan & Co., Rothschilds, Barings and Warburgs were all merchant banks. Originally, "merchant bank" was the British English term for an investment bank.

Financial crisis of 2007–2008

The financial crisis of 2007–2008 led to the collapse of several notable investment banks, such as the bankruptcy of Lehman Brothers (one of the largest investment banks in the world) and the hurried sale of Merrill Lynch and the much smaller Bear Stearns to much larger banks, which effectively rescued them from bankruptcy. The entire financial services industry, including numerous investment banks, was rescued by government loans through the Troubled Asset Relief Program (TARP). Surviving U.S. investment banks such as Goldman Sachs and Morgan Stanley converted to traditional bank holding companies to accept TARP relief. Similar situations occurred across the globe with countries rescuing their banking industry. Initially, banks received part of a $700 billion TARP intended to stabilize the economy and thaw the frozen credit markets. Eventually, taxpayer assistance to banks reached nearly $13 trillion – most without much scrutiny – lending did not increase, and credit markets remained frozen.

The crisis led to questioning of the business model of the investment bank without the regulation imposed on it by Glass–Steagall.[neutrality is disputed] Once Robert Rubin, a former co-chairman of Goldman Sachs, became part of the Clinton administration and deregulated banks, the previous conservatism of underwriting established companies and seeking long-term gains was replaced by lower standards and short-term profit. Formerly, the guidelines said that in order to take a company public, it had to be in business for a minimum of five years and it had to show profitability for three consecutive years. After deregulation, those standards were gone, but small investors did not grasp the full impact of the change.

A number of former Goldman Sachs top executives, such as Henry Paulson and Ed Liddy were in high-level positions in government and oversaw the controversial taxpayer-funded bank bailout. The TARP Oversight Report released by the Congressional Oversight Panel found that the bailout tended to encourage risky behavior and "corrupt[ed] the fundamental tenets of a market economy".

Under threat of a subpoena, Goldman Sachs revealed that it received $12.9 billion in taxpayer aid, $4.3 billion of which was then paid out to 32 entities, including many overseas banks, hedge funds, and pensions. The same year it received $10 billion in aid from the government, it also paid out multimillion-dollar bonuses; the total paid in bonuses was $4.82 billion. Similarly, Morgan Stanley received $10 billion in TARP funds and paid out $4.475 billion in bonuses.

Investment Banking in India – History, Evolution and Development:

The team investment banking has come into common use only within recent years. It is now employed to designate a distinct work or branch of banking, which is characterized primarily by the fact that it is concerned with long-term credits.

The old generic term of “banking”, on the one hand, has been broadened considerably to permit this inclusion, and, on the other hand, the concept has been more sharply limited and defined through division

into the two branches of commercial and investment banking, the one devoted to short-term financing, and the other to the financing of long-term or capital requirements.

The development of this distinction has assumed greater importance during the past few years, and has brought with it sharp differences of opinion as to the proper limitations of each, and the suitable relationship between commercial and investment banking.

In its most primitive form, the bank merely receives and safeguards the funds of the individuals. In earlier days, this type of banking was well illustrated by the operations of the gold smith bankers of England, who in the seventeenth century were the chief custodians of the public's money in that country. In our own time, this type of banking is still carried on by safe-deposit companies which are formed by banks to rent space in safe-keeping vaults to individuals and corporations.

A step forward in the evolution of banking occurred when the bankers lent out at interest the funds which they received from the public. The added vital features to the banking process the study and analysis of credit for the purpose of assuring the safety of the loan.

The Lombard bankers in Italy and the German bankers in the Rhine cities carried on lending operations, with both their own money and that of depositors, even in the Middle Ages. The bank thus became an intermediary between the owners of capital who could not themselves use it productively and those who wished to utilize this capital in one form or another.

A third step in the evolution of commercial banking was the issue by the bank of its own obligations in the form of notes or deposit credits, while the bank retained from its own funds and those of depositors merely enough actual cash to assure its ability to meet such obligations on demand. Instead of merely handling the existing media of exchange, the bank thus came to create such media.

Instead of acting as an intermediary between those who are in possession of cash and those who wish to borrow it, the bank agreed to permit those who are in possession of any form of property or wealth to gain possession of buying power in the form of bank credit. With this property as the basis, the bank made loans which gave current purchasing power to the borrower.

As banking has developed, furthermore, it was inevitable that there should be market differences in the rate of turnover of bank funds. Some deposits have a low rate of turnover-they are idle or almost idle awaiting the decision of their owner as to the way in which they shall be used.

Other funds are active-constantly drawn against, and constantly rebuilt through new deposits. Where these two classes of funds and others representing varying rates of turnover are held and carried by the same institution, there is likely to be a strong tendency toward their intermixture in use.

The bank which feels the pressure of strong demands from borrowers who want funds for long-term uses to create capital goods is inclined to make such loans out of any resources it may have, regardless of whether they are constantly liable to withdrawal by their owners. On the other hand, the bank which finds itself compelled to hold an undue amount of funds with slow turnover may allow itself to make advances for commercial uses that are not as well protected by the actual operations of business as they might be.

Accordingly, commercial banks have developed different branches such as those dealing with savings, trust funds, thrift accounts, and the like, and certain of these are more concerned with investment than with commercial banking- the division, however, is based upon the obvious requirements of book-keeping and administration, rather than the essential nature of the use of the funds received by these departments. The bank carefully classifies its liabilities, but its portion of assets is not correspondingly classified.

In the course of this evolution of technique there has been evolved a separate type of banking activity which only in recent years has developed into a distinct division of the credit system with a recognized individuality. Efforts to determine which type of banking first appeared in history would be fruitless, for some of the most primitive banking operations recorded even in ancient time's smack of both.

Suffice it to say that investment banking has followed a line of development somewhat parallel to commercial banking. In its more primitive form, investment banking involved a loan of the capital of the investment banker, or that of a few clients, on a long-term basis to some sovereign.

Such loans were common in Europe in the later Middle Ages and after, and were often represented by long-term securities. Now, however, the investment banker buys issues of securities from governments and corporations which desire capital, after he has made some analysis of the credit risk corresponding to the study of credit made by the commercial banker, and then he resells these obligations to others.

In special fields of investment banking, an intermediate step may be taken, where the investment institution sells its own obligations to investors, advancing the proceeds those who can utilize the capital. The mortgage bank and the investment trust are examples of these.

Investment Banking in India – Concept:

The concept of wealth from the investment banking standpoint is perhaps the simplest and may therefore be used as starting point. By wealth is meant, any economic good or service which satisfies a human need, and has, consequently, the power of commanding other goods or services in exchange. The exchange value resulting from the fact that a given object or service is desired must, however, be measured in terms of some unit, and the rate of exchange between goods is their price.

One such good is money, which marks money a form of wealth devised for the special purpose of acting as a means of promoting exchange and of measuring the value of commodities in exchange. We thus include money under the head of wealth, but of course, cannot regard wealth in any sense as money except that it is indirectly a means of commanding money.

Production is the process of ringing wealth into existence- that is to say, of changing the character or form of goods and services so as to adopt them for use. Consumption, on the other hand, is the application of these goods and services to their specific objects. That is, to the satisfaction of human needs or desires.

Capital comprises forms of wealth especially adopted for further production as tools and machines, which themselves do not satisfy any consumption desires. Ordinarily, savings are defined as that part of the periodic production of wealth which is devoted to the creation of capital.

Investment is the process of applying such savings to the creation of specific forms of capital. There has been a long controversy about the question whether savings are or are not, in fact, practically equivalent

to investments. The use made of the term, however, differentiates the two concepts and regards saving as his mere decision not to consume produce goods, whereas investment is the actual use of the savings thus made to some specified purpose.

Investment Banking in India – Theory:

The theory of investment can be considered from the social point of view. The social point of view which regards the flow of the annual income into investment, the influence of speculation upon the community, etc., is important in connection with the control of investment banking, as well as the forecasting of changes in investment conditions.

For the individual investment banker and investor, a corresponding series of problems arises, involving the shaping of policies that best conform to these broad social changes. As the more fundamental set of consideration, those which relate to the social theory of investment should receive first attention.

Viewing investment as a process which goes on in every society, we may ask exactly what that process consists of, and what limits or conditions it. By investment in the border sense of the term is meant what is usually referred to by economists under the name of savings, but including the further thought that money savings are actually applied to the creation of what are called capital goods.

By capital in the economic sense is meant the forms of wealth whose service is found in the production of consumable goods, either directly or indirectly. They do not themselves yield any satisfaction, but they make it possible to obtain such satisfactions by the use of the product which they turn out.

For example, if a person having a deposit of Rs. One Crore in his bank account, devotes himself to the construction of a power house, and thereafter sells the power so generated, he has used his one crore rupees in the Creation of capital, and that capital yields a service in the form of "power", which can be sold and so reconverted into "money". This process may be described as "investment".

The outcome of investment is the establishment of a flow of income from the capital in question, corresponding to a continuous stream of resulting economic goods or services. Thus, it is clear that investment is a process of converting funds into capital, using the capital for the production of goods and services which are sold for funds that can be expended as may be desired.

This last process of re conversion is the earning or receipt of income, such income being the flow of values which comes from the use of capital in the way indicated. It is clear that the process has no necessary connection with money, although it is usually described in terms of money, so that we can say that "investing money" or getting money income out of investment.

The application of money to a purpose which does not involve immediate use on the part of the owner is investment. Therefore, the investment of money involves the use of current funds for a purpose other than to satisfy the immediate consumption needs of the owner. This is known as investing of money.

It is an operation which involves, as a rule, the transfer of titles to money, they being passed into the hands of others who agree to return them with a payment for their use which is known as "interest or dividend". Thus others who obtain the use of such funds cannot pay interest or dividend, however, unless they succeed in earning it.

They must therefore use what they thus borrow not for consumption but for the purpose of producing more goods or services which re disposed of to others, and which consequently bring back a larger amount of goods or, in current phrase, money, than what was parted with. If we eliminate these intermediaries, and look simply at the basic character of the operation, we shall see that it consists of using current funds to the production of more and more wealth.

Every use of wealth involves risk element. The investor may succeed in transferring his responsibility to others. Investor may put his money into saving banks, Life Insurance Corporation or investment trust, but such a transfer of responsibility does not eliminate the risk element. It merely places the duty of making the decision upon the shoulders of the investment institutions. Their decision may be correct or may be incorrect.

The typical investor wishes to find enterprises for the use of his capital in which the risk element is minimum, but he can never find such an enterprises, in which risk element is eliminated. Therefore, risk is a regular element in investment, and any theory of investment must recognize the function of risk bearing as a part of the process by which capital is placed at the service of the society, and is made to yield an income.

The investment theory in a government controlled or managed economy or planned economy says that through governmental action, it is asserted that far wiser and better use could be made of the savings of the society than is made under the capitalistic economy.

Here is an assumption that the government can use the savings of the society better and with greater foresight than can the individual at the present time or the corporate organisation working for him. To this is sometimes added the thought that the Central Bank or investment institutions can direct these investment and serves as abridge for determining when and how they shall be made.

Investment must be regarded as either positive or negative. It may result in rendering existing capital forms obsolete and thus result in loss, though the effect may be the turning out of a much greater supply of goods than was previously available. On the other hand, it may simply result in marginal gains or profits, or, in rare cases, it may produce practically no effect whatever from the earnings point of view.

In the analysis of the investment process from the money point of view, it is desirable to consider to factor entering into demand for, and supply of, investment funds. Looking to the demand for investment funds, we can recognize some factors which determine its intensity.

They are the rate of economic development, the financial market and the business cycles. The activity of demand for investment resources, other things being equal will be greater or less as the business cycle passes through one or the other of its various phases.

The demand for capital for domestic investment reaches a peak when industrial development attains its full growth. In a country which is practically fully exploited and in which industry is sufficiently equipped, the need for new investment funds is likely to be less; and even if savings are more, it is difficult to find an outlet for them in the domestic market.

It is for this reason that some developed countries are exporters of capital, and that in many cases they have found it necessary to seek outlets in so many developing countries of Asia and Africa. In such

countries, the volume of savings is greater than the opportunities for investment, with the result that funds must be invested in other countries.

In the reverse case, in which a country has reached a phase of active economic development, and has more opportunities opened to it wherein new capital can be employed to advantage in increasing industrial production, every effort will be made to attract savings; and when their supply is less from the internal resources, the attempt will be made to arrange them from external resources.

The supply of investment resources is always largely affected by the amount of risk which is involved in their use. In a country like India and Jordan, where political unsuitability and weak central government exist or where road, rail and communication network is insufficient in such countries the risk of investment is fairly high. Where risk is limited, the return on investment is lower, and the result is a study, reliable flow of funds into investment channels at reasonable cost.

Along with these factors which tend to control the supply of capital available for investment, it is desirable to consider also the character of the investment set-up that can be used by the investors. Thus, for instance, the existence of satisfactory arrangements for banking and security distribution invariably tends to stimulate the growth of savings.

Postal savings systems have been found in many countries to be great stimulators of savings, and the same thing is true for the investment banks, popularly known as life insurance corporation of India, Unit Trust of India, Jordan Investment and Finance Bank, Amman Bank for Investment, Union Bank for Savings and Investment and so many other institutions known by other names in Asian Countries, the presence of stock exchanges tend to create an interest in securities, and a more receptive attitude on the part of the investors at large with respect to the investment of funds in companies which involve some risk.

The satisfactory institution of banking largely influences the ability of businessmen to obtain the funds needed for the development of their operations. Thus it may be fairly said that both the supply and the use of capital are greatly affected by the character of the organizational set-up which is available for savings, distributing and using the capital.

Income on investment is a payment to the owner of the funds for their use. It must be sufficient in amount to induce the investor to prefer the application of these resources to investment rather than to immediate purchase of commodities. If an absolutely safe investment could be conceived, the interest on that investment would be merely the minimum amount necessary to induce owners of funds to save and part with them.

No such investments, however, can be found; and accordingly, income on investments must be regarded as consisting of at least two elements. First is interest on capital and second is payment for risk. In addition to these above elements, a third is usually to be recognized as payment for management to cover the time and expense involved in dealing with the funds, transferring them, rendering them available, keeping them idle for the average time between investment changes, and the like.

The amount of the funds available for capital investment at any time may be increased or decreased by the policy decisions of the central bank or the commercial banks. Bank deposits represent the liquid funds of

the country which can be directed to anyone of the several channels. Any unit of it may be employed for consumption of devoted to investment, according to the decision of its owner.

The rate charged for bank funds, or the rate of interest for short term loans, is ordinarily more sensitive and readily changed than is the rate on long term investment, on the other hand, the policies of the central bank may depress artificially rates of interest on long term capital advances, through creating a plethora of short term funds available for investment.

Investment Banking in India – Objectives:

Investment is the sacrifice of certain present value for the uncertain future reward. It entails arriving at numerous decisions such as type, mix, amount, timing, grade etc. of investment and disinvestment. Further, such decision making has not only to be continuous but rational too. Broadly speaking, an investment decision is a tradeoff between risk and return. All investment choices are made at points of time in accordance with the personal investment ends and in contemplation of an uncertain future.

Since investments in securities are revocable, investment ends are transient and investment environment is fluid, the reliable bases for reasoned expectations become more and more-vague as one conceives of the distant future. Investors in securities will, therefore, from time to time, reappraise and re-evaluate their various investment commitments in the light of new information, changed expectations and ends.

Investment decisions are found to be the outcome of three different but related classes of factors. The first may be described as factual or informational premises. The factual premises of investment decisions are provided by many streams of data which are taken together, represent to an investor the observable environment and general as well as particular features of the securities and firms in which he may invest.

The second class of factors entering into investment decisions may be described as expectational premises. Expectations relating to the outcomes of alternative investments are subjective and hypothetical in any case but their foundations are necessarily provided by the environmental and financial facts available to investors. These limit not only the range of investments which may be undertaken but also the expectations of outcomes which may legitimately be entertained.

The third and final class of factors may be described as valuational premises. For investors generally these comprise the structure of subjective preferences for the size and regularity of the income to be received from and for the safety and negotiability of specific investments or combinations of investments as these are appraised from time to time.

“Investment” or “Investing”, like “value” is a word of many interpretations.

There are basically three concepts of investment:

1. Economic investment-that is, an economist’s definition of investment;

2. Investment in a more general or extended sense, which is used by “the man on the street”;

3. The sense in which we are going to be very much interested namely, financial investment.

Let us briefly review these types of investments to get a feel of some of the characteristics they possess.

The term economic investment has a rather precise meaning in the literature of economic theory. Typically it includes net additions to the capital stock of society. By "capital stock of society" is meant those goods which are used in the production of others goods. This is a gross societal or aggregate point of view. In society there are a number of goods (such as building and equipment) which are used to produce other goods, and that these means of production are considered part of the capital stock of society.

For a number of reasons, economists also include inventories (that is, the goods produced and still in the manufacturer's hands) as part of that capital stock. Thus, a net addition to the capital stock-an investment means an increase in buildings, equipments or inventories over the amount of equivalent goods that existed, say, one year ago at the same time.

The everyday usage of the term investment can mean a variety of things, but to the man on the street it usually refers to a money commitment of some sort. For example, a commitment of money to buy a new car is certainly an "investment" from an individual's point of view. But these are so in very general and in very extended sense of the word since no rate of return is involved, nor is a financial return or capital growth expected.

Financial investment is a form of this general or extended sense of the term. It means an exchange of financial claims-stocks and bonds (collectively termed securities), real estate mortgages, etc. The term financial investment is often used by investors to differentiate between the pseudo-investment concept of the consumer and the real investment of the businessman.

Semantics aside, there is still a difference between an "investment" in a ticket on a horse and a construction of a new plant; between the pawning of a watch and the planting of afield of corn. Some investments are simply transactions among people, other involve nature. The latter are "real" investments; the former are "financial" investments. In this study investment would imply the employment of funds with the objective of realising additional income or growth in value of investment at a future date.

In the foregoing numerous academic definitions of investment speculation and gambling, it can be observed that most of them are framed around the following three differentiating factors:

1. What is the motive of the buyer? The investor presumably buys to procure an annual return under conditions of safety, whereas others buy for appreciation.

2. What type of security is bought-high grade or low grade? The investor presumably buys high-grade securities, the others low-grade.

3. How long is the security held? The investor presumably holds for the long-term, the speculator for the short-term.

Investment Banking in India – Features and Growth:

In choosing specific investments, investors will need definite ideas regarding features which their portfolios should possess. These features should be consistent with the investors' general objectives and, in addition, should afford them all the incidental conveniences and advantages which are possible under

the circumstances. The following are the suggested features as the ingredients from which many successful investors compound their selection policies.

Feature – 1. Safety of Principal:

The safety sought in investment is not absolute or complete; it rather implies protection against loss under reasonably likely conditions or variations. It calls for careful review of economic and industry trends before deciding types and/or timing of investments. Thus, it recognizes that errors are unavoidable for which extensive diversification is suggested an antidote.

Adequate diversification means assortment of investment commitments in different ways. Those who are not familiar with the aggressive-defensive approach nevertheless often carry out the theory of hedging against inflation-deflation. Diversification may be geographical, wherever possible, because regional or local storms, floods, droughts, etc. can cause extensive real estate damage.

Vertical and horizontal diversification can also be opted for the same. Vertical diversification occurs when securities of various companies engaged in different phases of production from raw material to finished goods are held in the portfolio. On the other hand, horizontal diversification is the holding by an investor in various companies all of which carry on activity in the same stage of production.

Another way to diversify securities is to classify them according to bonds and shares and reclassify according to types of bonds and types of shares. Again, they can also be classified according to the issuers, according to the dividend or interest income date, according to the product which are made by the firms represented by the securities.

But over-diversification is undesirable. By limiting investment to a few issues, the investor has an excellent opportunity to maintain knowledge of circumstances surrounding each issue. Probably the simplest and most effective diversification is accomplished by holding different media at the same time having reasonable concentration in each.

Feature – 2. Adequate Liquidity and Collateral Value:

An investment is a liquid asset if it can be converted into cash without delay at full market value in any quantity. For an investment to be liquid it must be (1) reversible or (2) marketable. The different between reversibility and marketability is that reversibility is the process whereby the transaction is reverse or terminated while marketability involves the sale of the investment in the market for cash.

To meet emergencies, every investor must have a sound portfolio to be sure of the additional funds which may be needed for the business opportunities. Whether money raising is to be done by sale or by borrowing it will be easier if the portfolio contains a planned proportion of high-grade and readily salable investment.

Feature – 3. Stability of Income:

Stability of income must be looked at in different ways just as was security of principal. An investor must consider stability of monetary income and stability of purchasing power of income. However, emphasis upon income stability may not always be consistent with other investment principles. If monetary income stability is stressed, capital growth and diversification will be limited.

Feature – 4. Capital Growth:

Capital appreciation has today become an important principle. Recognising the connection between corporation and industry growth and very large capital appreciation, investors and their advisers constantly are seeking "growth stocks". It is exceedingly difficult to make a successful choice. The ideal "growth stock" is the right issue in the right industry, bought at the right time.

Feature – 5. Tax Benefits:

To plan an investment programme without regard to one's status may be costly to the investor. There are really two problems involved here, one concerned with the amount of income paid by the investment and the other with the burden of income taxes upon that income.

When investors' incomes are small, they are anxious to have maximum cash returns on their investments, and are prone to take excessive risks. On the other hand, investors who are not pressed for cash income often find that income taxes deplete certain types of investment incomes less than others, thus affecting their choices.

Feature – 6. Purchasing Power Stability:

Since an investment early always involves the commitment of current funds with the objective of receiving greater amounts of future funds, the purchasing power of the future fund should be considered by the investor. For maintaining purchasing power stability, investors should carefully study;

(i) The degree of price level inflation they expect,

(ii) The possibilities of gain and loss in the investment available to them, and

(iii) The limitations imposed by personal and family considerations.

Feature – 7. Concealability:

To be safe from social disorders, government confiscation or unacceptable levels of taxation, property must be concealable and leave no record of income received from its use or sale. Gold and precious stones have long been esteemed for these purposes because they combine high value with small bulk and are readily transferable.

Investment Banking in India – Scope and Structure:

General usage would hardly sanction any single clear-cut and definite distinction between commercial and investment banking. The factor which is most frequently used in making rough practical distinctions between the two is that of the commercial banking involving short-terms advances to borrowers, while investment banking involves long-term advances which generally are represented by negotiable securities.

But, as will be seen below, other factors, which as the purpose of the loan, the character of the institution making it, etc., are also frequently to be considered in making a full distinction between these two concepts as they are customarily employed in current usage.

Although there is no intrinsic reason why this must necessarily be the case, commercial banking institutions operate in the main through the system of deposit and discount, while investment banking is carried on through the purchase of security issues and their subsequent sale, at a profit, to investors.

Commercial paper may be bought and sold like securities; and commercial banks, after making short-term loans, may rediscount such paper with a Federal Reserve Bank. On the other hand, the savings bank, an investment banking institution, receives deposits in much the same way as to commercial banks, but uses the proceeds to buy securities in the capital market and make mortgage loans.

Further-more, investment houses have been known to keep short-term securities purchased from issuing governments and corporations until their maturity, instead of selling them to others. Hence, from the point of view of method of operation, only rough and approximate distinctions can be made.

This distinction, however inadequate and approximate, must not be regarded on that account as any the less real and fundamental. The fact that the community is not always willing to classify its banking practices does not of itself reduce the need for keeping these distinctions clearly in mind in the management of banks.

The distinctions indicated above grow out of the essential nature of the banking business. Successful banking over long periods will invariably be dependent upon recognition of the necessity of adapting asset holdings to the nature of the liabilities incurred.

In any case, it must be remembered that the two divisions of banking are closely related, and in practice one cannot be adequately understood without a knowledge of the other. Thus, one connection between the two is found in the fact that the commercial banker is the custodian of the liquid funds of the community, so that when an individual wishes to put his money into investment securities to be purchased from or through an investment banker, he draws the amount he needs out of the commercial bank.

Thus, inflation or deflation of commercial bank deposits profoundly affects the volume of funds available in the security markets. It is also true that the commercial banker often finds it desirable, in order to keep his own resources at work, to purchase securities which are issued by an investment banker.

In what has been said thus far, reference has been made to investment and commercial banking as distinct types of financial operations. But it is not possible to pick out or designate certain commercial banks as carrying on the one kind of banking, and certain investment banks as carrying on the other.

This clean-out functional distinction is permissible for the purpose of clarifying underlying ideas, but it does not correspond to what is found in practice. It is, therefore, necessary to consider commercial and investment banking also from the institutional view-point, and see how actual banking institutions carry on one, or the other, or both types of operations.

For many years banking or financial institutions have existed which have carried on both kinds of banking concurrently- the practice prevails now perhaps more than ever. The evolution of pure investment banking institutions on a large scale began with the stabilization of government credit in Western Europe and the consequent growth of popular investment in government securities.

This resulted in the formation of houses of issue, such as those of the early generations of the Rothschild's. The vast development of corporate financing in recent decades has enormously expanded the field of operation of such firms in buying, selling and dealing in securities. At the same time, many institutions have exercised both commercial banking functions and some, or in a few cases all, of the investment banking functions.

In order to bring out more clearly this institutional overlapping within these two fundamental banking functions we may survey briefly the principal financial institutions founding some countries.

1. National Banks:

The national banking system was originally organized as a commercial banking system primarily, but it gradually took on investment banking functions, particularly in the farming regions where a large part of country's bank loans came to consist of long-term accommodations secured in one way or another by land, though such loans were nominally not permitted by law.

2. State Bank:

The state banking systems were originally organized along lines paralleling those of the National Bank.

They also have tended during recent years to develop an investment banking business.

3. Trust Companies:

Trust companies organized under state laws were from the beginning chiefly designed to carry on an investment banking business by managing the investment funds of others. At first, they devoted themselves primarily to the management of the property of client establishing trusts, but many of them in the course of time, developed commercial banking departments so large as to dominate the rest of the business, while national and state banks have been authorized to conduct trust business on a broad scale.

4. Saving Bank:

Savings banks, either mutual or stock, are recognized as investment banking institutions that receive deposits from the community on a time basis and use them to make loans on real estate, as well as to buy other securities allowed by law. Legal limitations prevent them from going into commercial banking, from 1950 onward; there was a strong tendency in many states to broaden the classes of securities which might thus be purchased by the savings banks.

This has now been succeeded by an opposite tendency looking in the direction of closer classification of savings bank assets and a restriction of the kinds of securities that may properly be purchased by such banks.

5. Mortgage Banks:

Mortgage banks, best represented in the United States by the Federal Farm Land Banks, devote them-selves to the financing of agricultural and real estate development. They sell securities to raise funds to be used in this way, and thus constitute a highly developed, albeit narrowly specialized, type of investment banking institution.

The building and loan association is a special, but very important, variant of the mortgage bank. The business of such building and loan associations has grown rapidly of recent years, but the failure to understand the necessity for proper separation between long and short-term obligations has, in a good many cases, resulted in the taking on of liabilities that could not be satisfied.

Accordingly, in many states where building and loan associations have sought to broaden their operating methods, they have found it necessary to work back into their traditional field-a process of devolution which in some cases has been extremely painful.

6. Investment Houses:

The investment house, sometimes called the bond house, devotes itself exclusively to investment banking operations in most instances. The following discussion is devoted to a full analysis of this kind of institution, which supplies investment securities for purchase by other financial institutions or individual investors.

7. Brokerage Houses and the Stock Exchanges:

These organizations buy and sell already issued securities, thus making a market for them. They facilitate the distribution of securities, and constitute a highly important cog in the investment banking machinery.

8. Investment Trusts:

Investment trusts are organizations which issue their own securities for the purpose of raising capital with which to buy other securities. They thus act as securities substitution companies and, as such, facilitate the investment banking process.

9. Other Institution:

A variety of other types of institutions may be properly classified in the investment banking field, although not always thought of in that connection. Thus, insurance companies are properly grouped as operating on the demand or buying side of investment banking, since they are large buyers and holders of investment securities which they purchase in order to keep the funds of their policy holders profitably employed.

Large business corporations and eleemosynary institutions are also frequently large-scale security buyers, thus constitution important factors in the investment banking business.

The Capital Market:

The buyers and sellers of securities taken together constitute what is often loosely defined as the capital market. All of the institutions connected with investment banking, as described above, therefore constitute factors in the capital market. The capital market is often distinguished from the money market. The latter includes buyers and sellers of short-term credits, including loans, commercial paper, acceptances and government obligations of short date.

The term investment banking which at times is used in a narrow sense to signify only the purchase of securities from their original issuers and their sale to all types of investors, institutional an individual, is to an increasing extent being expanded to include the operation of the entire capital market.

This is quite proper, as the mechanism which has been evolved to take care of and direct the flow of long-term capital is complicated, and so closely interlocked in its various elements that it can best be studied as a whole.

As a preliminary to a study of the investment banking institutions which together constitute the main factors in the capital market, we may consider in a general way the character of the demand for capital which comes on the market.

Investment Banking in India – Types of Investment Banking Institutions:

There are a number of different types of institutions performing their own particular functions in the capital market. The investment house will first be considered, for, as the security middleman, it is the core of the investment banking system. Taken together, these organizations originate new security issues through purchasing them from governments and corporations that seek to raise funds in the capital market.

After the investment house, we shall consider the brokers and the stock exchanges, which furnish a market for these securities after they have been issued.

After these two broad classes of investment banking institutions, consideration will be given to two other major groups of organizations which devote themselves to purchasing investment securities for others. First, there are the specialized in vesting institutions, such as the savings bank, investment trust, trust company, and mortgage bank.

Secondly, there are institutions which are formed primarily for some other purpose, but which incidentally carry on large-scale security-buying operations because of the vast funds they accumulate in the course of their other activities. The insurance companies, commercial banks, eleemosynary institutions and large business corporations all fall within this class.

The position of the various types of institutions which have been developed to facilitate the investment of the savings of the public in the securities of governments and corporations that turn to the capital market for funds.

Investment Banking in India – Indian Investment Banking System and Growth:

India inherited an under-developed economy and the underdeveloped capital market from the British rulers. In the immediate post-independence period things did not improve fast because of the unchanged economic environment. Concentration of money power, managerial skills and entrepreneurship, all rested with the handful of managing agency houses which wanted to move with gains and individual achievements creating acute dearth of long-term capital for industrial ventures.

The various reasons for this dearth were noted viz.:

(a) Lack of new investment- tax evaded income held in cash and mostly used for speculation in the bullion and commodity market.

(b) Impact of socio-economic and political reforms curtailed the investible funds because of drastic cut in privy purses of erstwhile rulers and princes, zamindari abolition curtailed income of zamindars who used to invest their surplus money in investment channels,

(c) Lower savings and meager saving capacity dominated the economic scene. The unequal distribution of sources of income and wealth caused continuing existence of vicious circle of poverty in the country, and

(d) Post-independence flight of foreign capital and evil effects of the country's partition created wide gaps in resources particularly availability of monetary resources.

A network of planned economic development was taken up by the Government duly supported by legislative and other measures. Growth of capital market was considered as one of the key areas for accelerating the pace of economic development by mobilising savings of the household and business sector into investible channels in industry and trade. Efforts to boost the capital market were supplemented through legislative measures, policy frame-work and institutional support.

Drastic amendments were made in the legislative framework regulating the growth of business enterprise viz. Companies Act, Capital Issues (Control) Act, Banking Companies Act, etc. The managing agency system was sought to be abolished from the horizon of corporate management vide Companies Act, 1956, to do away with the stumbling blocks it had created in the development of a free capital market in India.

To improve investment climate in the country and boost capital market activity Industrial Finance Corporation of India (IFCI) was established at national level under the IFC Act, 1948 to provide long and medium term finance to the industrial enterprises and give underwriting coverage to new issues. At State levels, State Financial Corporations (SFCs) were also established onwards 1951 under State Financial Corporation Act, 1950 with a view to provide financial assistance to industry.

These efforts were not enough to accelerate the pace of Industrial development in the country in a planned way as envisaged in the five years plans. In the report of the committee on finance for the Private Sector, Bombay 1954 highlighting the difficulties of the Industrial sector, it was observed that "it has been the experience of industries in general that it is more difficult to raise such capital in India than in more industrialised countries of the West".

Capital Market for Planned Growth of the Country has explored the reasons for the inability of capital market to shelter new issues as "lack of issue houses, investment trusts or investments companies" like those in "UK and USA" which have the role to play for arranging equity finance for the corporate sector industries, thus, the absence of merchant bankers to attend to the issue house activity was felt at every stage and a search for the lie institutions at Government level was continuously persuade.

The Government anxiety to improve capital market in the country so as to make financial facilities easily and more readily available is reflected in the network of financial and investment institutions established over the years to achieve this objective. These institutions emerged one by one to meet the specific need felt at times as precisely narrated in the following paragraphs.

The Industrial Credit and Investment Corporation of India (ICICI) was set up in 1955, with the support of Indian and Foreign financial institutions and bankers under the Companies Act with a view to facilitate the foreign participation in terms of funds as well as technical know-how in the development of industry in India.

It is a non-Government organisation and aimed to provide developmental finance to industrial concerns inter alia, covering medium and long-term lending, investment in equity by way of direct subscription, underwriting of shares and debentures, etc.

Life Insurance Corporation of India (LIC) was established in 1956 under Life Insurance Corporation Act, 1956 as a result of nationalisation of Life Insurance business in the country which gave boost to investment climate and added improvement in the capital market.

The Refinance Corporation for Industry Ltd. (RCI) was set up in 1958 by Reserve Bank of India (RBI) with a view to enable banks to make medium and long term finance available to industries.

Industrial Development Bank of India (IDBI) was set up in 1964 by RBI under Industrial Development Bank Act, 1963 as an apex financial institution for providing term finance to industry and co-ordinate the activities of other financial institutions to make finance readily available to industries. Activities of RCI were taken over by IDBI.

Unit Trust of India (UTI) was established in 1964 under Unit Trust of India Act, 1963 to mobilise the savings in the corporate securities. The main objective of the UTI remains to encourage savings and investment and participation in the income, profits and gains accruing to the corporation from the acquisition, holding, management and disposal of securities.

More financial and investment institutions emerged with specialised purposes both at national as well as state levels viz., National Industrial Development Corporation (NIDC) in 1965, State Industrial Development Corporation (SIDC), State Industrial and Investment Corporations (SIIC) in 1966 and onwards over the years, Industrial Reconstruction Corporation of India (IRCI) etc.

IRCI was subsequently, converted into Industrial Reconstruction Bank of India (IRBI). The basic objective of these institutions remained to fillip to industrial climate and provide infrastructural and financial backup to industry and support the investment climate in the country.

General Insurance Corporation of India (GIC) is another important investment institution besides the institutions that provides full participation in capital market in the country. GIC emerged as a result of nationalisation of General Insurance business in India in 1972 and functions with its four subsidiaries.

GIC along with its subsidiaries provides financial assistance to the industrial sector in addition to insurance business by way of under-writing of new issues of companies, granting term loans, subscribing to equity shares as well as debentures.

Nationalisations of commercial banks from time to time have also helped in spreading the network of financial institutions and investment organisations to meet varied demands for capital of the growing industrial sector and the corporate enterprises.

Thus, all the above institutions viz. IFCI, IDBI, ICICI, SFCs, IRBI, LIC UTI, GIC, NIDC, SIDCs, SIICs, provide a network of financial assistance to industry and activities the capital market.

The participation of these institutions in capital market has been growing ever since their respective emergence. For example, during 1950s, only IFCI, ICICI and LIC were in existence and these institutions had participated to the extent possible in the capital market activity.

With a view to boost capital market for long-term and medium-term finance for industrial development, these institutions had taken up underwriting the capital issues of corporate units in mid-1950 along with the stock brokers and dealers.

Of the total amount of Rs.14.4 core underwritten in 1962 about one half was underwritten by financial institutions viz. LIC 22%, bank 18%, ICICI 7% and IFCI 4% whereas the balance 50% was underwritten by brokers and the investment companies.

Stock brokers had switched over to act as principal brokers or managing brokers for the public issues of reputed companies. These brokers were able to manage the public issues quite satisfactorily.

Investment Banking in India – Recent Developments:

Recent Development – 1. Bank's Subsidiaries:

With a view to strengthening the organisational and managerial capabilities, broad-base the resources position, enlarge the scope of operations and activities and to offer more specialised services with professional expertise and skills, the erstwhile Investment Banking Divisions of the nationalised banks have started forming independent subsidiary companies.

The first of such subsidiary company was formed by State Bank of India known as SBI Capital Markets Ltd. incorporated on the 2nd July, 1986 and commenced its operations on the 1st August, 1986. The company is wholly owned subsidiary of SBI and took over the investment banking business previously carried on by SBI's investment banking division.

The main reason adduced by SBI in the formation of the above subsidiary has been "to meet adequately and effectively the emerging demand for broad based financial services from the corporate sector".

Followed by this came the Canbank Financial Services Ltd., a wholly owned subsidiary of Canara Bank in 1987, BOB Fiscal Services Ltd., promoted by Bank of Baroda, PNB Capital Services Ltd., promoted by Punjab National Bank during mid-1988. These subsidiaries have taken over the existing investment banking business of their respective Merchant Banking Divisions. Many more such subsidiaries are in the offing by the other nationalised banks.

Recent Development – 2. Reorganisation of Private Firms of Investment Bankers:

Some of the private sector investment bankers have also taken steps to reorganise their activities in the expectation of facing tough competition with the growing number of investment banking subsidiary companies of the nationalised banks, amongst these the prominent ones are DSP Financial Consultants Ltd., J. M. financial & Investment Consultancy Ltd., Champaklal Investment & Financial Constancy Ltd.

(CIFCO), the 20th Century Finance Corporation Ltd., V.B. Desai Financial services Ltd., Credit Capital finance Corporation Ltd. and LKP merchant Finance Ltd.

Recent Development – 3. Stock Broker Underwriters Association:

To Professionalise the underwriting activity for promoting new issues market, the 'Stock broker Underwriters Association' (SUA) with its registered office at Bombay and the membership of 95 leading underwriters has also been established during 1984 with broad objectives being, namely-

(1) Educate and protect the interest of the general public on various issues related to the capital markets,

(2) Provide information about new issues of capital market to members and public,

(3) Evolve a code of conduct for under-writers, and

(4) Represent grievances to the concerned authorities and companies and render legal and other services to members and public.

The Association envisages effective participation of various stock exchange members by opening chapters at other places. At Calcutta and Bangalore the SUA has already opened the chapters and efforts are being made to establish chapters at other places also.

SUA co-ordinates its activities with the investment bankers and takes steps for promoting the activities of capital market, in particular, by attending to the following tasks:

(i) Hold discussions amongst members on issues like appraisal of issues, mailing facilities in new issues, development cases, etc. and make recommendations to appropriate authorities, the problems relating to promotion and development of capital market,

(ii) Hold discussion with eminent persons on subjects pertaining to investment banking areas like capital issues, capital markets, etc.,

(iii) Hold discussions, relating particularly to the new issues,

(iv) Analyse the problems of the investing public and devise solutions thereof. SUA members contemplate to make efforts to professionalise the underwriting activity to strengthen the capital market.

Recent Development – 4. Securities & Exchange Board of India:

The Central Government has constituted on April 4, 1988 the Securities and Exchange Board of India (SEBI) as apex Board to promote orderly and healthy growth of the securities market and for investor protection. The Board shall-

(a) Deal with all matters relating to development and regulation of securities market and investor protection and advise Government on these matters,

(b) Prepare a comprehensive legislation for the regulation and development of the securities market, and

(c) Carry out such functions as may be delegated to the Board/Chairman by the Central Government for the development and regulation of securities market.

Government of India proposes to bring out a comprehensive legislation to rationalise existing legislation relating to securities markets contained in the companies Act, the Capital Issues (Control) Act, and the Securities Contract (Regulation) Act, so as to ensure fairness, efficiency, confidence and flexibility in the capital market, persons dealing in investment business like merchant bankers, underwriters, sub-brokers and brokers, dealers, investment advisors, portfolio managers, mutual funds, agents for new issues and company deposits, etc. will have to seek authorisation from the Board.

Recent Development – 5. Discount and Finance House of India (DFHI):

DFHI has been incorporated as a company under the Companies Act. 1056 jointly by the Reserve Bank of India, financial institutions and commercial banks with respective shares in its authorised and paid up capital of Rs.100 crores being RBI Rs.51 crores, FIs. Rs.16 crores and Public Sector Banks Rs.33 crores.

DFHI will deal in money market instruments like commercial bills in order to provide liquidity in the money market. Besides, its own share capital, DFHI would have a line of credit from the public sector banks and refinance lines from RBI so as to augment its working funds. The development of short-term money market would definitely lend support to the country's capital market.

Recent Development – 6. Credit Rating Information Services of India Ltd. (CRISIL):

CRISIL has been set up as a joint effort of ICICI and UTI as an independent professional agency to help the investors, investment bankers, underwriters, brokers, banks and financial institutions etc. for taking decisions in making investment in various types of instruments as debt equity and other fixed return securities viz. debentures, preference shares etc.

The CRISIL has become operational in 1987. CRISIL would rate various types of financial instrument offered to the investing public. CRISIL will establish market standards and thereby improve the efficiency of the capital market and widen the investor base.

Recent Development – 7. Stock-Holding Corporation of India Ltd. (SHC):

SHC set up in 1986 by the All-India Financial Institutions has started its operations in 1987. SHC takes care of safe custody, delivery of shares and collection of sale proceeds of the securities held by the all-India financial institutions to cope with the increase in volume of holding of securities and resultant increase in the transactions and the business in the stock market in recent years. Establishment of SHC is bound to affect in the due course of time, the capital market as the all India financial institutions would operate in the market regularly.

Money Market in India

The Money market in India in India is a correlation for short-term funds with maturity ranging from overnight to one year in India including financial instruments that are deemed to be close substitutes of money. Similar to developed economies the Indian money market is diversified and has evolved through many stages, from the conventional platform of treasury bills and call money to commercial paper, certificates of deposit, repos, forward rate agreements and most recently interest rate swaps.

The Indian money market consists of diverse sub-markets, each dealing in a particular type of short-term credit. The money market fulfills the borrowing and investment requirements of providers and users of short-term funds, and balances the demand for and supply of short-term funds by providing an equilibrium mechanism. It also serves as a focal point for the central bank's intervention in the market.

The Indian money market consists of the unorganised sector: moneylenders, indigenous bankers, and unregulated Non-Bank Financial Intermediaries (e.g. Finance companies, Chit funds, Nidhis); organised sector: Reserve Bank of India, private banks, public sector banks, development banks and other non-banking financial companies (NBFCs) such as Life Insurance Corporation of India (LIC), the International Finance Corporation, IDBI, and the co-operative sector.

1. Call/Notice/Term money market 2. Repurchase Agreement (Repo & Reverse Repo) market 3. Treasury bill market 4. Commercial Bill market 5. Commercial paper market 6. Certificate of Deposit market 7. Money Market Mutual Fund. 8. Cash Management Bill (CMB).

Call money market

Call money market deals in short term finance repayable on demand, with a maturity period varying from one day to 14 days. S.K. Muranjan commented that call loans in India are provided to the bill market, rendered between banks, and given for the purpose of dealing in the bullion market and stock exchanges. Commercial banks, both Indian and foreign, co-operative banks, Discount and Finance House of India Ltd.(DFHI), Securities trading corporation of India (STCI) participate as both lenders and borrowers and Life Insurance Corporation of India (LIC), Unit Trust of India(UTI), National Bank for Agriculture and Rural Development (NABARD)can participate only as lenders. The interest rate paid on call money loans, known as the call rate, is highly volatile. It is the most sensitive section of the money market and the changes in the demand for and supply of call loans are promptly reflected in call rates. There are now two call rates in India: the Inter bank call rate and the lending rate of DFHI. The ceilings on the call rate and inter-bank term money rate were dropped, with effect from May 1, 1989. The Indian call money market has been transformed into a pure inter-bank market during 2006–07. The major call money markets are in Mumbai, Kolkata, Delhi, Chennai, Ahmedabad.

Treasury bill market

Treasury bills are instrument of short-term borrowing by the Government of India, issued as promissory notes under discount. The interest received on them is the discount, which is the difference between the price at which they are issued and their redemption value. They have assured yield and negligible risk of default. Under one classification, treasury bills are categorised as ad hoc, tap and auction bills. Under another one, it is classified on the maturity period like 91-days TBs, 182-days TBs, 364-days TBs and also 10-days TBs which has two types. In the recent times (2002–03, 2003–04), the Reserve Bank of India has been issuing only 91-day and 364-day treasury bills. The auction format of 91-day treasury bill has changed from uniform price to multiple price to encourage more responsible bidding from the market players. The bills are of two kinds- Adhoc and regular. The adhoc bills are issued for investment by the state governments, semi government departments and foreign central banks for temporary investment. They are not sold to banks and general public. The treasury bills sold to the public and banks are called regular treasury bills. They are freely marketable and commercial banks buy entire quantities of such

bills, issued on tender. They are bought and sold on discount basis. Ad-hoc bills were abolished in April 1997.

Ready forward contract (Repos)

Repo is an abbreviation for Repurchase agreement, which involves a simultaneous "sale and purchase" agreement. When banks have any shortage of funds, they can borrow it from Reserve Bank of India or from other banks. The rate at which the RBI lends money to commercial banks is called repo rate, a short term for repurchase agreement. A reduction in the repo rate will help banks to get money at a cheaper rate. When the repo rate increases borrowing from RBI becomes more expensive.

Money market mutual funds

Money market mutual funds invest money in specifically, high-quality and very short maturity-based money market instruments. The RBI has approved the establishment of very few such funds in India. In 1997, only one MMMF was in operation, and that too with very small amount of capital.

Reserve Bank of India

The influence of the Reserve Bank of India's power over the Indian money market is confined almost exclusively to the organised banking structure. It is also considered to be the biggest regulator in the markets. There are certain rates and data which are released at regular intervals which have a huge impact on all the financial markets in INDIA. The unorganised sector, which consists mostly of indigenous bankers and non-banking financial companies, although occupying an important position in the money market have not been properly integrated with the rest of the money market.

Reforms

The recommendations of the Sukhmoy Chakravarty Committee on the Review of the Working of the Monetary system, and the Narasimham Committee Report on the Working of the Financial System in India, 1991, The Reserve Bank of India has initiated a series of money market reforms basically directed towards the efficient discharge of its objectives. The bank reduced the ceiling rate on bank advances and on inter-bank call and short-notice money. There has been a significant lowering of the minimum lending rate of commercial banks and public sector development financial institutions from 18% in 1990–91 to 10.5% in 2005–06.

Reforms made in the Indian Money Market are:- Deregulation of the Interest Rate : In recent period the government has adopted an interest rate policy of liberal nature. It lifted the ceiling rates of the call money market, short-term deposits, bills rediscounting, etc. Commercial banks are advised to see the interest rate change that takes place within the limit. There was a further deregulation of interest rates during the economic reforms. Currently interest rates are determined by the working of market forces except for a few regulations. Money Market Mutual Fund (MMMFs): In order to provide additional short-term investment revenue, the RBI encouraged and established the Money Market Mutual Funds (MMMFs) in April 1992. MMMFs are allowed to sell units to corporate and individuals. The upper limit of 50 crore investments has also been lifted. Financial institutions such as the IDBI and the UTI have set up such funds. Establishment of the DFI: The Discount and Finance House of India (DFHI) was set up in April 1988 to impart liquidity in the money market. It was set up jointly by the RBI, Public sector Banks and

Financial Institutions. DFHI has played an important role in stabilizing the Indian money market. Liquidity Adjustment Facility (LAF): Through the LAF, the RBI remains in the money market on a continue basis through the repo transaction. LAF adjusts liquidity in the market through absorption and or injection of financial resources. Electronic Transactions: In order to impart transparency and efficiency in the money market transaction the electronic dealing system has been started. It covers all deals in the money market. Similarly it is useful for the RBI to watchdog the money market. Establishment of the CCIL : The Clearing Corporation of India limited (CCIL) was set up in April 2001. The CCIL clears all transactions in government securities, and repurchase agreements (repos) reported on the Negotiated Dealing System. Development of New Market Instruments: The government has consistently tried to introduce new short-term investment instruments. Examples: Treasury Bills of various duration, Commercial papers, Certificates of Deposits, MMMFs, etc. have been introduced in the Indian Money Market.