FINANCE 101 COURSE BOOK

INTRODUCTION

This course of Financial Management offers (future) professionals with a non-specific financial position, an understanding of finance related issues, at such a level that they can act as a fully-fledged interlocutor of financial specialists. Furthermore, the course is also intended as a basic training to prepare readers in financial-economic education programs for a more in-depth study of the subjects.

The course comprises of five module:

- Personal Finance
- Basics of Stock Market and Mutual Funds
- Financial Institutions/ Intermediaries and Key Economic Terms
- Government Investment and Insurance Schemes
- Entrepreneurship

ABOUT INDIAN FINANCIAL LITERACY INITIATIVE

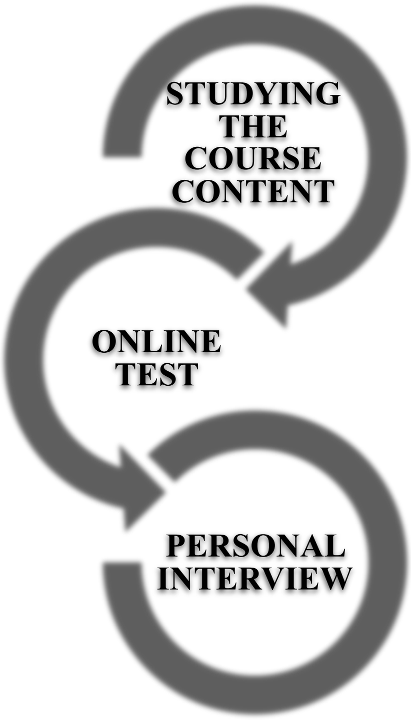
The Indian Financial Literacy Initiative (IFLI) is a social start-up that trains underprivileged people in essential financial skills such as money management, investing and insurance, with a special focus on government schemes and private schemes relevant for low-income groups. We are registered as a public charitable trust, Jigyasa Foundation, and IFLI is an initiative under this trust.

We have been successfully operating in Mumbai and West Bengal reaching over 60,000 people in various communities across the states, we have collaborated with the NGO Aangan trust for conducting these awareness programs.

IFLI one of the only social organisations creating content on finance in Indian vernacular languages other than English and Hindi.

We use stories and games to make the content more engaging. Moreover, we are also creating animated videos to improve our effectiveness. Further we can also curate content for a specific group as per your requirement.

JOINING THE INDIAN FINANCIAL LITERACY INITIATIVE



The goal of Indian Financial Literacy Initiative is to pioneer a movement wherein underprivileged people are trained in Financial Literacy so that they can make good financial decisions and secure their future.

To this end, the way we operate is that we train students in our course content. Thereafter, they then train the communities we work with in this content.

Induction program

The induction program for a new volunteer is as follows:

1st Step: We will send you our 5 modules of content over email.

2nd Step: You have to answer our test of 75 marks, based on the aforementioned content. Passing score is 40 marks.

3rd Step: Personal interview.

After successful completion of this process you can join the Indian Financial Literacy Initiative Team. You can teach communities only after completion of at least 2 demo classes with our team in the field.

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- Rise in inflation: During high levels of inflation, RBI makes strong attempts to bring down the flow of money in the economy. One way to do this is by increasing the repo rate. This makes borrowing a costly affair for businesses and industries, which in turn slows down investment and

1. MODULE 1: PERSONAL FINANCE

1.1. Introduction

Every woman is doing cash budgeting or capital expenditure in her lifetime and every man is doing business or investment in his life. Still there is a lack of awareness about personal financial management. Even if there is some awareness, there is a lack of will to follow the personal financial management process. Because of this, people might fail to take better and efficient personal financial decisions. Financial illiteracy is impacting financial decision making.

Finance is an integral part of everyone's life and financial principles are based on pure and simple common sense. The ability to take financially intelligent decisions is financial management. Financial management is the ability to understand the impact of every financial decision on net worth and to ensure that all those actions should be undertaken that will strengthen it and do nothing that weakens it.

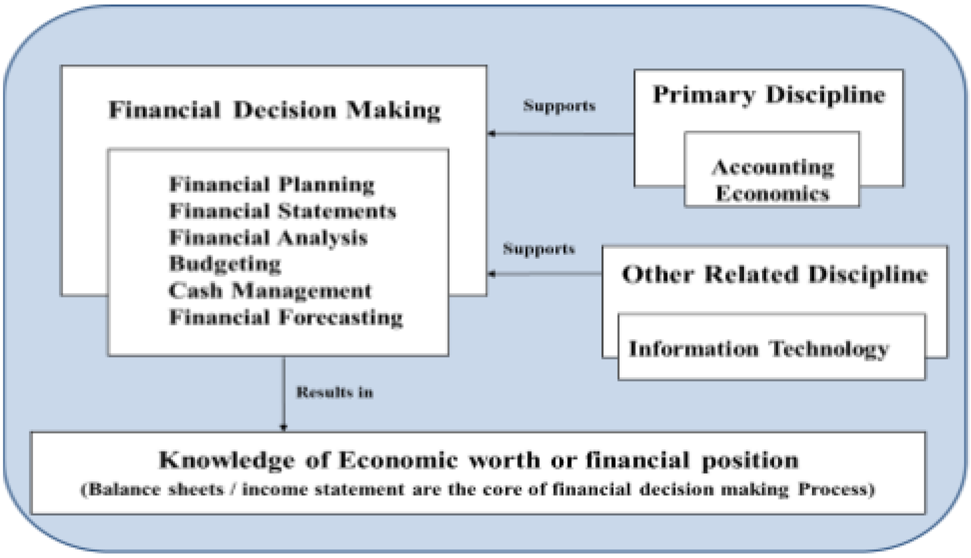
Managing personal finances is essential to one's financial wellbeing. Money management is a critical function in financial-management. It aims to give the power and the knowledge to take control of the money. It provides the means to keep track of personal expenses, personal debt and subsequently helps in calculation and enhancement of personal net worth.

Personal financial management can be defined as the management of the finances of an individual, in order to achieve his/her financial goals including long-term financial security. It is concerned with procurement and utilization of funds for an individual. It is concerned with efficient planning and controlling of the financial affairs, budgeting, financial forecasting, cash management, credit administration, investment analysis, and fund management and so on. It helps individuals determine the past performance, predict future performance, and assess the capability of generating future cash flows.

1.2. Framework of Personal Financial Management:

Personal financial management covers aspects of financing like accessing the need of capital, raising sufficient amount of funds, cost of financing, budgeting, maintaining liquidity, lending policies, borrowing policies, and dividend policy. Financial analysis is the process of evaluating the financial position and the results of operation of a business. Projection of financial statements is the last step of accounting and results in presentation of information useful to an individual.

The framework of Personal Financial Management comprises of 3 parts:
A) Finance and related discipline
B) Financial Decision Making
C) Economic Worth/Net Worth



A) Finance and related discipline

The base of personal financial management comes from recommended practices from Economics, Accounting, and Information Technology.

(i) Personal Finance and Economics

Basic knowledge of economics is necessary to understand both the environment and decision techniques of financial management. Economics is the knowledge about how to make best possible use of money. It deals with

- Inflow of money: - This is the sum total of money that is coming in a household from the various sources of Income.
- Outflow of money: - This is the sum total of money that is going out from a household in form of various expenditures.

Most people are aware of the seen costs when it comes to personal finance. We understand the direct costs for our actions. However, the unseen costs could be more important to realize. Understanding the opportunity cost is critical to making the best possible decisions with our money. This principal is quickly becoming a budgeting essential. Opportunity cost factors into any decision that involves a trade-off between two or more options.

An opportunity cost is defined as the value of a forgone activity or alternative when another item or activity is chosen. It is expressed as the relative cost of one alternative in terms of the next-best alternative. From choosing whether to invest in "safe" treasury bonds or share and deciding to purchase a home theatre over a family holiday, there are plenty of things to consider when making a decision in financial life. Consider the decision to buy a high-end television. The simple cost is the cash outlay of thousands of rupees. But this does not reflect the true cost. The true opportunity cost is all the things that could have done with the money instead. The same money could have been used to enjoy a holiday, or give a gift to friend, or invest in stocks or to pay off loans. When all these factors are taken into account, it is apparent that buying a television if not needed, is a very costly adventure indeed.

The other important principle of economics that is applied to financial management is marginal analysis, a cost-benefit approach which suggests that financial decisions should be made on the basis of comparison of marginal revenue and marginal cost.

Marginal analysis is the fundamental economic decision-making procedure. It allows an individual to measure the additional benefits of financial activity versus its costs. The theory states that whenever marginal benefit exceeds marginal cost, the financial activity should be increased to reach highest net benefit, otherwise if the marginal cost is higher than marginal benefit, activity should be decreased. This analysis can help to understand whether an activity is profitable and thus make a decision based on that information. Consider an individual who is shopping for groceries and he has to decide whether to buy organic or conventional vegetables. Will the marginal cost (how much more the organics cost) be greater than the marginal benefit (healthier food, perhaps, and less impact on the environment) including control on lifestyle risks and challenges.

(ii) Personal Finance and Accounting

Accounting is a sub function of finance. Accounting generates info/data relating to operations or activities of finance. Accounting is the process of recording, classifying, summarizing, analysing, interpreting and communicating results in terms of money. The financial management uses this data for financial decision making. Thus, accounting is an information system which involves identification, measurement and communication of economic information for financial decision making. It provides consistently developed and easily interpreted data on past, present and future operations.

The primary objective of financial accounting is to ascertain the financial position of an individual as on date. The end product of accounting constitutes the financial statements such as balance sheet, income statement, cash flow statement and fund flow statement. The info contained in these statements and reports assist a person in assessing past performance and predicting future directions. The angle of finance relating to the treatment of funds is based on cash flow method which recognizes revenues and expenditure with respect to actual inflows and outflows of cash.

(iii) Personal Finance and Information Technology (IT)

Information technology helps in automation of personal financial management process, and thereby acts as a tool for efficient decision making. It is related to the knowledge about how to use Information Technology to do financial calculations correctly, accurately and quickly.

a) Usage Skills: - A little knowledge of working on computer is required to use the desktop or pen drive operated money management tool. Knowledge of Internet is required for working on online software.

b) Money Management Tools: - Financial tools provide a common platform where a person can view all his accounts, banks, credit cards, insurance, fixed deposit and even public provident fund. Financial tools give a window to analyse a person's income and expense and help to understand spending. These tools help disciplining people. Using the tools makes them aware about their spending pattern and understands their financial liability. For late payments, the reminder tools works wonder. There are several IT tools available to manage the money.

- Excel spread sheet: - Spread sheets are good personal productivity tools while they are not collaborative planning applications. Spread sheets are fundamentally unsuited for a complex, dynamic, shared financial for several reasons, including data distribution. Consolidation is time-consuming and error-prone. Spread sheets can be a good foundation for budgeting and planning process simply because they are inexpensive and familiar.
- Specialty Software Packages: - Streamlining the planning process demands technological tools capable of supporting faster, more flexible and adaptive approach. Monitoring of income, expenses and bank balances are the things that become easy with such customized tools. By using an on-demand, dedicated budgeting and planning application that is delivered over the web, individuals are able to implement the best practices. There are several categories of specialty software packages available that are designed to create and track budget like mint, quicken, xpenser, budgetpluse etc.

B) Financial Decision Making

The core of personal financial management is financial decision making. Financial management forms the basis for financial planning, analysis and decision making. Financial information is contained in financial statements and is required to aid in financial decision making. Financial management provides a framework for financial decision making which involves the following:

(i) Financial Planning:-

It involves the process of assessing the financial situation, determining financial objectives and formulating a plan to achieve them. It is the process of meeting life's goals through proper management of one's finances. Life goals could include buying a house, saving for children's education or planning for retirement. A financial plan should include a review of net worth, goals/objectives, investment portfolio, cash flow, investments, retirement planning, tax planning and insurance needs.

(ii) Financial Statements:-

These are collection of data organized in accordance with logical and consistent accounting procedure. They reflect an individual's performance over a period of time and the financial position at a point of time. The analysis of financial statement is a process of evaluating the relationship between components of statement to obtain a better understanding of financial position.

- *Balance Sheet* is a quantitative summary of one's financial condition at a specific point in time which includes assets, liabilities and net worth. It is a snapshot of the financial health.

- *Income Expense statement* provides information of the income earned and the costs and expenses incurred to earn such incomes during a given period. It is a score board of an individual performance during a period of time.

- *Fund Flow Statements* reflect the change in cash or change in working capital. Working capital is the difference between current assets and current liabilities. They determine the liquidity position of an individual. It describes the sources from which additional funds are derived and the uses to which these funds are put. Thus, Fund Flow analysis consists of two distinctively different analyses namely.
  - The output of working capital analysis is fund flow statement which is an important indicator of financial analysis and control. It is valuable aid in evaluating the future flow of fund on the basis of past data and to assess the growth. It is useful in planning intermediate and long term financing.
  - The output of cash flow analysis is cash flow statement that provides the information about cash flows associated with operating, investing and financial activities of an individual during an accounting period. It is useful in cash planning.

(iii) Financial analysis: -

It is a process of selection, relation and evaluation of financial data. It is a mathematical classification of data. It includes

- Transforming financial data into a relational form that can be analysed
- Evaluating the financial data for achievement of financial goals

There are two methods of analysis:-

- Comparative Analysis showing the changes in monetary terms of an individual items or group of items from balance sheet.
- Trend Analysis showing the direction upwards/downwards in which an individual items or group of items from balance sheet have moved over a period.

(iv) Budgeting:-

Budgeting is a structured process and planning activity, dealing with a family's financial resources and context. Budget is a pro-active, focused, technical and disciplined strategy to handle the current financial situation of a family. It is a barometer of family's fiscal condition, resources and health.

A budget is a comprehensive and coordinated plan expressed in financial terms for operations (reflected in revenue and expenses) of an individual for some specified period in the future. As a tool of financial planning, budget serves as a guide to the conduct of operations and a basis for evaluating actual results.

PERSONAL BUDGET WORKSHEET

(Spending Plan)

	MONTH:	
INCOME:	Budget	Actual
Salary		
Partner's Salary		
Public Assistance		
Food Stamps		
Other:		
Total Income	$ -	$ -
EXPENSES:		
Living/Housing:		
Rent/Mortgage		$ -
Electric		$ -
Water/Sewer		$ -
Gas/Heating		$ -
Telephone		$ -
Cable TV		$ -
Household/Repairs		$ -
Other:		$ -
Other:		$ -
Regular Payments:		
Student Loan		$ -
Credit Cards		$ -
Other Loan Payments		$ -
Health Insurance		$ -
Car/Home Insurance		$ -
Life Insurance		$ -
Child Care		$ -

(v) Cash Management: -

It involves efficient collection, disbursement and temporary investment of cash. The first and foremost objective of cash management is to meet the payment schedules. The second main objective of cash management is optimization of liquidity through an improved flow of funds.

There are three motives of holding cash:-

- Transaction motive for day-to-day transactions.
- Precautionary motive for unexpected contingencies and uncontrollable situations.
- Speculative motive to take advantage of unexpected opportunities when arise.

(vi) Financial Forecasting:-

It implies the technique of determining in advance the requirement and utilization of funds for a future period. It means systematic projection of the expected action of finance through financial statements. It is a sort of working plan formulated for a particular period by arranging future activities.

- It helps to work as a control device to anticipate financial needs
- It helps to use to pre-test financial feasibility and
- It helps to calculate leverages/profitability

C) Economic Worth/Net Worth

The basis for financial planning, analysis and decision making is the financial information which is needed to predict, compare and evaluate one's net worth. Financial information of an individual is contained in financial statements such as balance sheet, profit/loss account and cash flow statement. The information contained in these financial statements assists a person in assessing past performance and future directions.

Financial decisions impact net economic worth. Hence, the focus area of personal financial management is net worth generation. These statements being important planning tool have an analytical value as it helps to calculate changes in working capital position and changes in fixed assets. Understanding of financial worth/ position at any point of time and changes in it on day-to-day basis, helps in financial decision making.

Net Worth: - It refers to the net value of an individual in terms of its assets and liabilities. It implies excess of assets over liabilities as disclosed by a person's balance. Wealth creation, curtailing expenses and saving in a disciplined manner can help increase financial worth. It is very important to create wealth that is liquid and divisible, otherwise even though it may make balance sheet strong, it will not be of use when it is needed to meet financial goals.

1.3. Personal Financial Management Process

Wattles (2007) in his book 'The Science of Getting Rich' writes that getting rich is not the result of doing certain things; it is the result of doing things in a certain way. There is a science of getting rich, and it is an exact science, like algebra or arithmetic. There are certain laws which govern the process of acquiring riches. Once these laws are learned and obeyed by any person, he will get rich with mathematical certainty.

Personal financial management process uses a stepwise process that helps to determine where the person stands financially. The process involves gathering financial information, setting life goals, examining the current financial status and coming up with a strategy/plan for meeting the goals given the current situation and future plans. It is an on-going process. The six steps are explained in details as follows.

Good financial management starts with

1. setting financial goals,
2. determining all sources of income and planning for all types of expenses (budgeting),
3. ascertaining all assets and liabilities as part of managing fund flows,
4. recording financial transactions under all the heads,
5. automating the process of calculation and generation of financial statements using a personal financial management IT tool,
6. finally, evaluating the financial statements for financial decision making.

Periodic review of progress towards financial goal is evaluated. If financial growth is in line with financial goals, the process needs to be continued; otherwise some financial adjustments need to be made including revision of goals if necessary.

Step 1: Set Goals

Setting financial goals is the most important indicator of ones being financially evolved. Knowing what is important to an individual and his family is a critical first step in a successful personal financial plan. Any major decision of life like buying a house/car, travel, retirement or higher studies that needs money for its fruition is a financial goal.

There are three categories of goals

- Short term (within one year)
- Intermediate (one to five years)
- Long term (more than five years)

A well-defined financial goal is SMART

- **S**pecific - what you want to achieve.
- **M**easurable - how much money you will need.
- **A**chievable – which can be achievable.
- **R**easonable – whether it can be achieved with the time and money available.
- **T**ied to a time frame - when you want to achieve the goal.

Write Financial Goals: - Given below is the list of financial goals that a person has set and how much would it cost today and the date on which this goal is to be achieved. This table can be referred while developing spending plan. Financial goals need to be given a target date and cost while writing. It helps in tracking and monitoring.

Sample- Financial Goal Plan

S.No	Your life Goals	Need or Wish	Duration	Priority	Present Value of Goal(Lacs)	Time to achieve goal (years)	Expected Inflation Rate	Future Value of Goal (Lacs)
1	Vacation Abroad	Wish	Short term	Medium	₹ 2	1	6%	₹ 2.12
2	Buy a Car	Wish	Short term	Low	₹ 8	3	6%	₹ 9.53
3	Buy a House	Need	Medium term	High	₹ 50	10	6%	₹ 89.54
4	Childs Graduation	Need	Long Term	High	₹ 25	20	6%	₹ 80.18
5	Childs Marriage	Need	Long Term	High	₹ 30	25	6%	₹ 128.76
6	Retirement Corpus	Need	Long Term	High	₹ 100	30	6%	₹ 574.35

Prioritize Goal: - After writing down financial goals, they should be prioritized in terms of their importance. While proper planning may fulfil all financial goals, prioritizing helps to focus on more important financial goals as they will differ in the length of time needed to achieve them. It may not be possible to start working on all goals at the same time, as, saving for retirement is more important than buying a luxury car. Both short & long term financial goals will require regular savings.

Step 2: Determine Income/ Expenses (Budgeting)

Keep track of actual expenses incurred during the month and group them into various categories like housing, utilities, insurance, social, recreation, entertainment, and “other". Understand and categorize expenses in fixed, flexible, and periodic expenses.

- *Fixed expenses* are the budget items for which a certain amount of money is paid every month for a specified period of time. Some examples are rent or mortgage, car loans, and credit card payments.
- *Flexible expenses* vary from month to month and can be controlled and managed to some extent. They are generally more difficult to forecast than fixed expenses. Examples of flexible expenses are food, clothing, gas, telephone, and personal care.
- *Periodic expenses* occur perhaps once or on a particular occasion such as insurance, car license tags, and Diwali gifts.

Remember, small expenses add up and can be important in developing a workable spending plan. For personal finance issues, a month is a good resolution to use. After going through each step and making the budget, one will have an idea of where his money is going and how much he has left over to work with.

Determine your monthly Income: - Understand the total income. This will include all sources of income for all contributing members of the household. This is to know from where the money is coming and how it varies. Write down all the funds received during the year. Start with fixed amounts that family members get regularly, such as wages or pensions. Put down the anticipated variable income like interest from savings accounts, dividends from stocks, gifts, and money from other sources.

Step 3: Tracking Assets /Liabilities

In the next step, Assets and liabilities are ascertained.
Assets are valuable economic recourses owned by an individual which adds on to economic worth. They can be classified as:

- *Current assets* also called liquid assets are those resources which are in the form of cash or are expected to be converted into cash within one year duration.
- *Fixed Assets* are long term in nature, are held for longer period than the accounting period. They include tangible fixed assets and intangible fixed assets.
  - *Tangible fixed assets* include land, building, machinery, equipment, furniture etc.
  - *Intangible fixed assets* represent patents, copyrights, franchises, trademarks, trade names and goodwill.

Liabilities refer to total amount of debts and obligations that an individual has to pay or fulfil in future. They can be classified as:

- *Current liabilities* are debt payable within one year duration. Current assets are converted into cash to pay current liabilities. E.g. creditors, bills payable, wages and salaries payable, interest payable, taxes payable, bonds, debentures, borrowing from banks and financial institutions, public deposits etc.

- *Fixed liabilities* are long term in nature, are payable for longer period than the accounting period. They include bonds, debentures, and secured long term loans.

Step 4: Record financial transactions

In addition to track the cash you spend, record every bill payment; debit/credit card expenditures which include the amount paid, and the date on which purchase is made. Don't forget to record all cheque details also. Writing expenditures down provides the unique opportunity to visualize and find out where money goes. Moreover, a written financial plan is far more effective than a mental one. It helps to check financial progress more easily. Seeing the written plan helps to remind what actions are necessary to reach financial goals.

Step 5: Automate the Process

The next step is to look at the present situation by preparing the net worth statement (also referred to as a Balance Sheet) using a spread sheet program, online service, or other personal finance program.

Net worth statement adds up all assets and subtracts liabilities from that. It allows tracking financial progress over time. Financial tools give a window to analyse a person's income and expenses and help to understand spending pattern. On-line financial tools provide a common platform where a person can view all his accounts, banks, credit card, insurance, FDs and even PPF.

Step 6: Evaluate

The last step in a successful financial plan is to periodically evaluate and revise plan. Compare planned spending and saving to the amount actually spent and saved. This step will allow measuring the progress toward financial goals. At the end, if a person is not satisfied with the performance, it's time to make some slight revisions to his plan. In fact, plan should change as the need changes and as a person progresses towards his goal.

1.4. Good Financial Habits

It can take years of experience to develop good financial habits, but the benefits of being responsible with your spending are well worth any effort it takes to develop good practices. When you have your finances under control, you can keep you and your family out of debt, you can maintain a strong credit score, and you can get the financing you need for large purchases such as a home or a car.

When people run into financial problems, it is usually the result of several bad decisions that pile up to create ongoing issues. To protect your financial future, you need to be able to identify bad financial habits and understand the ways in which you can avoid making those types of mistakes on a regular basis.

It is okay to make financial mistakes. What is not acceptable is allowing those mistakes to turn into ongoing bad habits. Here are some good financial habits that you should build into your lifestyle:

A) Use a Financial Plan

Start with a financial plan. There are so many plans that you can use to be a great money manager. You can start with a budget plan. This is actually the most basic of all the plans that you can use. This takes into consideration the relationship between your income and expenses. To be specific, it tells you if your income is enough to support your expenses. Obviously, your expenses should be lower than your income. If it is the other way around, you need to analyze your expenses to make it lower. You have to identify what has to be removed so you will never go beyond your income. Of course, there are other plans like a spending plan or a retirement plan that can really help you manage your limited resources so it goes to your priorities. Use them well to help you manage your finances.

B) Always have Financial Goals

After your financial plans, you need to set financial goals. A goal is a great way to give your life direction. It can help guide your decisions and align all your plans together. Having clear goals can also help you set your priorities. We can sometimes be overwhelmed with all our financial targets. But if you carefully set your goals, you will know what needs your concentration. It will also force you to monitor your finances because you want to make sure that your financial position is strong enough to help you reach your targets. After all, you have to track your progress when it comes to reaching your goals.

C) Schedule Budget Meetings

Being a good money manager means you have to stay on top of your finances all the time. The simplest way to do this is to have a regular meeting about the budget. The important thing is to check if your budget is still aligned with your current priorities. Sometimes, as we age, our priorities change as well. You have to make sure your budget will compliment all these changes.

D) Never Shop Without a List

Our consumerist society requires us to purchase basic necessities. You can grow your own produce but there are things that you still need to buy in the grocery, retail stores, etc. If this is inevitable, then it is best for you to just shop with a list. This is the best way to ensure that you will stick to your budget and a great way to review what you have at home before you go on a shopping errand. That is how you can be a smart spender and manager of your money.

E) Do Not Forget About Seasonal Expenses

One of the mistakes in budgeting is to forget about the seasonal expenses. Sometimes, people focus on the monthly expenses alone. This is a mistake. You have different needs each month. The holiday season increases your expenses exponentially. You need to budget for this. And what about birthday celebrations and anniversaries? You have to allocate money for these expenses. Failing to include this will make your budget fail and that can reflect badly on your money management skills.

F) Spend With a Purpose

To help you be a good money manager, it is also ideal for you to give every expense a purpose. Ask yourself why you are making this particular expense? Why are you buying this product? Why are you paying for this service? Analyze each and every expense to make sure that it will lead you to your financial goals.

G) Save With a Purpose

Just like spending, you should also be conscious of your reasons for saving. For spending, it is necessary to help you decide if you should pursue with the expense or not. For saving, it will help motivate you to save your money. After all, it is harder to save than spend. If you know why you are saving your money, it would be easier to fight the natural urge to spend your money.

H) Monitor Your Credit Report

One of the activities of a good money manager is credit monitoring. You do not have to be afraid of using credit, however, you have to be vigilant about it. Be on your guard because you have to make sure you will not borrow beyond what you can afford to pay back. Not only that, this monitoring will also help you avoid being a victim of identity theft. At least, you can detect when it happens and you can report it immediately.

1.5. Investment

Investment involves making of a sacrifice in the present with the hope of deriving future benefits. Two most important features of an investment are current sacrifice and future benefit. Investment is the sacrifice of certain present values for the uncertain future reward. It involves numerous decision such as type, mix, amount, timing, grade etc, of investment the decision making has to be continues as well as investment may be defined as an activity that commits funds in any financial/physical form in the present with an expectation of receiving additional return in the future. The expectation brings with it a probability that the quantum of return may vary from a minimum to a maximum. This possibility of variation in the actual return is known as investment risk. Thus every investment involves a return and risk.

The idea behind investing is that the money you have earned through hard work is best used if it grows for you. So, you must put the money you have earned and saved into whatever you think will help it grow over time.

The strategy to make money is to buy when the price is low and then sell when the price is high. The additional income is the profit!

Any income that you make by selling the investments at a profit is called capital gains. There is a tax on this called capital gains tax. If you lose money on the investment it is called a capital loss.

Did you know? What is ROI?

ROI Stands for Return on investment. It is the amount of net profit or loss that you make on an investment divided by the amount invested. It helps you understand how good the investment really is.

The formula is ROI = (Current Value of Investment - Cost of Investment) / Cost of Investment

A) Investment Process

An organized view of the investment process involves analyzing the basic nature of investment decisions and organizing the activities in the decision process. Common stocks have produced, on average, significantly larger returns over the years than savings accounts or bonds. Should not all investors invest in common stocks and realize these larger returns? The answer to this question is to pursue higher returns investors must assume larger risks.

Underlying all investment decisions is the trade off between expected return and risk. Therefore, we first consider these two basic parameters that are of critical importance to all investors and the trade-off that exists between expected return and risk.

Given the foundation for making investment decisions the trade-off between expected return and risk- we next consider the decision process in investments as it is typically practiced today. Although numerous separate decisions must be made, for organizational purposes, this decision process has traditionally been divided into a two step process: security analysis and portfolio management. Security analysis involves the valuation of securities, whereas portfolio management involves the management of an investor's investment selections as a portfolio (package of assets), with its own unique characteristics.

B) Return

Why invest? Stated in simplest terms, investors wish to earn a return on their money. Cash has an opportunity cost: By holding cash, you forego the opportunity to earn a return on that cash. Furthermore, in an inflationary environment, the purchasing power of cash diminishes, with high rates of inflation bringing a relatively rapid decline in purchasing power. In investments it is critical to distinguish between an expected return (the anticipated return for some future period) and a realized return (the actual return over some past period). Investors invest for the future for the returns they expect to earn but when the investing period is over, they are left with their realized returns. What investors actually earn from their holdings may turn out to be more or less than what they expected to earn when they initiated the investment. This point is the essence of the investments process; Investors must always consider the risk involved in investing.

C) Risk

Risk is explained theoretically as the fluctuation in returns from a security. A security that yields consistent returns over a period of time is termed as "risk less security "or" risk free security ". Risk is inherent in all walks of life. An investor cannot foresee the future definitely; hence, risk will always exist for an investor. Risk is in fact the watchword for all investors who enter capital markets. Investment risk can be an extraordinary stress for many investors. When the secondary market does not respond to rational expectations, the risk component of such markets are relatively high and most investors fail to recognize the real risk involved in the investment process. Risk aversion is the criteria commonly associated with many small investors in the secondary market. Many small investors look upon the market for a definite return and when their expectations are not met, the effect on the small investors' morale is negative. Hence these investors prefer to lock up their funds in securities that would rather give them back their investment with small returns than those securities that yield high returns on an average but are subject to wild fluctuations.

There are different types and therefore different definition of risk. Risk is defined as the uncertainty about the actual return that will earn on an investment. When one invest, expects some particular return, but there is a risk that he ends up with a different return when he terminates the investment. The more the difference between the expected and the actual the more is the risk. It is not sensible to talk about the investment returns without talking about the risk, because the investment decision involves a trade-off between the two, return and risk.

D) Security Analysis

Traditional investment analysis, when applied to securities, emphasizes the projection of prices and dividends. That is, the potential price of a firm's common stock and the future dividend stream are forecasted, then discounted back to the present. This intrinsic value is then compared with the security's current market price. If the current market price is below the intrinsic value, a purchase is recommended, and if vice versa is the case sale is recommended.

Although modern security analysis is deeply rooted in the fundamental concepts just outlined, the emphasis has shifted. The more modern approach to common stock analysis emphasizes return and risk estimates rather than mere price and dividend estimates.

E) Portfolio Management

Portfolios are combinations of assets. In this text, portfolios consist of collections of securities. Traditional portfolio planning emphasizes on the character and the risk bearing capacity of the investor. For example, a young, aggressive, single adult would be advised to buy stocks in newer, dynamic, rapidly growing firms. A retired widow would be advised to purchase stocks and bonds in old-line, established, stable firms, such as utilities. Modern portfolio theory suggests that the traditional approach to portfolio analysis, selection, and management may yield less than optimum results. Hence a more scientific approach is needed, based on estimates of risk and return of the portfolio and the attitudes of the investor toward a risk-return trade-off stemming from the analysis of the individual securities.

1.6. Characteristics of Investments

The characteristics of investment can be understood in terms of as

- Return
- Risk
- Safety
- Liquidity etc.

A) Return

All investments are characterized by the expectation of a return. In fact, investments are made with the primary objective of deriving return. The expectation of a return may be from income (yield) as well as through capital appreciation. Capital appreciation is the difference between the sale price and the purchase price. The expectation of return from an investment depends upon the nature of investment, maturity period, market demand and so on.

B) Risk

Risk is inherent in any investment. Risk may relate to loss of capital, delay in repayment of capital, non-payment of return or variability of returns. The risk of an investment is determined by the investments, maturity period, repayment capacity, nature of return commitment and so on. Risk and expected return of an investment are related. Theoretically, the higher the risk, higher is the expected returned. The higher return is a compensation expected by investors for their willingness to bear the higher risk.

C) Safety

The safety of investment is identified with the certainty of return of capital without loss of time or money. Safety is another feature that an investor desires from investments. Every investor expects to get back the initial capital on maturity without loss and without delay.

D) Liquidity

An investment that is easily saleable without loss of money or time is said to be liquid. A well developed secondary market for security increase the liquidity of the investment. An investor tends to prefer maximization of expected return, minimization of risk, safety of funds and liquidity of investment.

1.7. Investment Categories

Investment generally involves commitment of funds in two types of assets:

Real assets: Real assets are tangible material things like building, automobiles, land, gold etc.

Financial assets: Financial assets are piece of paper representing an indirect claim to real assets held by someone else. These pieces of paper represent debt or equity commitment in the form of IOUs or stock certificates. Investments in financial assets consist of:

- Securitised (i.e. security forms of) investment
- Non-securities investment

In the above context, security forms of investments include Equity shares, preference shares, debentures, government bonds, Units of UTI and other Mutual Funds, and equity shares and bonds of Public Sector Undertakings (PSUs). Non-security forms of investments include all those investments, which are not quoted in any stock market and are not freely marketable. viz., bank deposits, corporate deposits, post office deposits, National Savings and other small savings certificates and schemes, provident funds, and insurance policies. Another popular investment in physical assets such as Gold, Silver, Diamonds, Real estate, Antiques etc.

There are a large number of investment avenues for savers in India. Some of them are marketable and liquid, while others are non-marketable. Some of them are highly risky while some others are almost risk less. The investor has to choose proper avenues from among them, depending on his specific need, risk preference, and return expectation. Investment avenues can be broadly categorized under the following heads: -

A. Corporate Securities

i. Equity Shares
ii. Preference Shares
iii. Debentures/ Bonds
iv. GDRs/ ADRs
v. Warrants
vi. Derivatives

B. Deposits in banks and non-banking companies
C. Post office deposits and certificates
D. Life insurance policies
E. Provident fund schemes
F. Government and semi government securities
G. Mutual fund schemes
H. Real assets

A) Corporate Securities

Joint stock companies in the private sector issue corporate securities. These include equity shares, preference shares, and debentures. Equity shares have variable dividend and hence belong to the high risk high return category; preference shares and debentures have fixed returns with lower risk. The classification of corporate securities that can be chosen as investment avenues can be depicted as shown below.

Equity Shares-: By investing in shares, investors basically buy the ownership right to that company. When the company makes profits, shareholders receive their share of the profits in the form of dividends. In addition, when a company performs well and the future expectation from the company is very high, the price of the company's shares goes up in the market. This allows shareholders to sell shares at profit, leading to capital gains. Investors can invest in shares either through primary market offerings or in the secondary market.

Equity shares are further classified as:

- ***Blue Chips (also called Stalwarts):*** These are stocks of high quality, financially strong companies which are usually the leaders in their industry. They are stable and matured companies. They pay good dividends regularly and the market price of the shares does not fluctuate widely. Examples are stocks of Reliance, Colgate, Hindustan Lever, TCS etc.
- ***Growth Stocks:*** Growth stocks are companies whose earnings per share is grows faster than the economy and at a rate higher than that of an average firm in the same industry. Often, the earnings are ploughed back with a view to use them for financing growth. They invest in research and development and diversify with an aggressive marketing policy. They are evidenced by high and strong EPS. Examples are ITC, Dr Reddy's Bajaj Auto, Sathyam Computers and Infosys Technologies etc. The high growth stocks are often called "GLAMOUR STOCK' or HIGH FLYERS'.
- ***Income Stocks:*** A company that pays a large dividend relative to the market price is called an income stock. They are also called defensive stocks. Drug, food and public

utility industry shares are regarded as income stocks. Prices of income stocks are not as volatile as growth stocks.

- ***Cyclical Stocks:*** Cyclical stocks are companies whose earnings fluctuate with the business cycle. Cyclical stocks generally belong to infrastructure or capital goods industries such as general engineering, auto, cement, paper, construction etc. Their share prices also rise and fall in tandem with the trade cycles.
- ***Discount Stocks:*** Discount stocks are those that are quoted or valued below their face values. These are the shares of sick units.
- ***Undervalued Stock:*** Undervalued shares are those, which have all the potential to become growth stocks, have very good fundamentals and good future, but somehow the market is yet to price the shares correctly.
- ***Turn Around Stocks:*** Turn around stocks are those that are not really doing well in the sense that the market price is well below the intrinsic value mainly because the company is going through a bad patch but is on the way to recovery with signs of turning around the corner in the near future. Example- Tata Tea (Tata Finlay).

Preference Shares: Preference shares refer to a form of shares that lie in between pure equity and debt. They have the characteristic of ownership rights while retaining the privilege of a consistent return on investment. The claims of these holders carry higher priority than that of ordinary shareholders but lower than that of debt holders.

Debentures and Bonds: These are essentially long-term debt instruments. Many types of debentures and bonds have been structured to suit investors with different time needs. Though having a higher risk as compared to bank fixed deposits, bonds, and debentures do offer higher returns. Debenture investment requires scanning the market and choosing specific securities that will cater to the investment objectives of the investors.

Depository Receipts (GDRs/ADRs): Global Depositary Receipts are instruments in the form of a depositary receipt or certificate created by the overseas depositary bank outside India and issued to non-resident investors against ordinary shares or Foreign Currency Convertible Bonds (FCCBs) of an issuing company.
A GDR issued in America is an American Depositary Receipt (ADR). Among the Indian companies, Reliance Industries Limited was the first company to raise funds through a GDR issue. Besides GDRs, ADRs are also popular in the capital market. As investors seek to diversify their equity holdings, the option of ADRs and GDRs are very lucrative. While investing in such securities, investors have to identify the capitalization and risk characteristics of the instrument and the company's performance in its home country (underlying asset).

Warrants: A warrant is a certificate giving its holder the right to purchase securities at a stipulated price within a specified time limit or perpetually. Sometimes a warrant is offered with debt securities as an inducement to buy the shares at a later date. The warrant acts as a value addition because the holder of the warrant has the right but not the obligation of investing in the equity at the indicated rate. It can be defined as a long-term call option issued by a company on its shares.
A warrant holder is not entitled to any dividends; neither does he have a voting right. But the exercise price of a warrant gets adjusted for the stock dividends or stock splits. On the expiry

date, the holder exercises an option to buy the shares at the predetermined price. This enables the investor to decide whether or not to buy the shares or liquidate the debt from the company. If the market price is higher than the exercise price, it will be profitable for the investor to exercise the warrant. On the other hand, if the market price falls below the exercise price, the warrant holder would prefer to liquidate the debt of the firm.

Derivatives: The introduction of derivative products has been one of the most significant developments in the Indian capital market. Derivatives are helpful risk-management tools that an investor has to look at for reducing the risk inherent in as investment portfolio. The first derivative product that has been offered in the Indian market is the index future. Besides index futures, other derivative instruments such as index options, stock options, have been introduced in the market. Stock futures are traded in the market regularly and in terms of turnover, have exceeded that of other derivative instruments. The liquidity in the futures market is concentrated in very few shares. Theoretically the difference between the futures and spot price should reflect the cost of carrying the position to the future of essentially the interest. Therefore, when futures are trading at a premium, it is an indication that participants are bullish of the underlying security and vice versa. Derivative trading is a speculative activity. However, investors have to utilize the derivative market since the opportunity of reducing the risk in price movements is possible through investments in derivative products.

B) Deposits in Banks and Non-Banking Companies

Among non-corporate investments, the most popular are deposits with banks such as savings accounts and fixed deposits. Savings deposits carry low interest rates whereas fixed deposits carry higher interest rates, varying with the period of maturity, Interest is payable quarterly or half-yearly or annually. Fixed deposits may also be recurring deposits wherein savings are deposited at regular intervals. Some banks have reinvestment plans whereby savings are re-deposited at regular intervals or reinvested as the interest gets accrued. The principal and accumulated interests in such investment plans are paid on maturity.

Savings Bank Account with Commercial Banks: A safe, liquid, and convenient investment option, a savings bank account is an ideal investment avenue for setting aside funds for emergencies or unexpected expenses. Investors may prefer to keep an average balance equal to three months of their living expenses. A bank fixed deposit is recommended for those looking for preservation of capital along with current income in the short term. However, over the long-term the returns may not keep pace with inflation.

Company Fixed Deposits: Many companies have come up with fixed deposit schemes to mobilize money for their needs. The company fixed deposit market is a risky market and ought to be looked at with caution. RBI has issued various regulations to monitor the company fixed deposit market. However, credit rating services are available to rate the risk of company fixed deposit schemes. The maturity period varies from three to five years. Fixed deposits in

companies have a high risk since they are unsecured, but they promise higher returns than bank deposits.
Fixed deposit in non-banking financial companies (NBFCs) is another investment avenue open to savers. NBFCs include leasing companies, hire purchase companies, investment companies, chit funds, and so on. Deposits in NBFCs carry higher returns with higher risk compared to bank deposits.

C) Post Office Deposits and Certificates

The investment avenues provided by post offices are non-marketable. However, most of the savings schemes in post offices enjoy tax concessions. Post offices accept savings deposits as well as fixed deposits from the public. There is also a recurring deposit scheme that is an instrument of regular monthly savings.

National Savings Certificates (NSC) is also marketed by post office to investors. The interest on the amount invested is compounded half-yearly and is payable along with the principal at the time of maturity, which is six years from the date of issue.

There are a variety of post office savings certificates that cater to specific savings and investment requirements of investors and is a risk free, high yielding investment opportunity. Interest on these instruments is exempt from income-tax. Some of these deposits are also exempt from wealth tax.

D) Life Insurance Policies

Insurance companies offer many investment schemes to investors. These schemes promote savings and additionally provide insurance cover. LIC is the largest life insurance company in India. Some of its schemes include life policies, convertible whole life assurance policies, endowment plans, jeevan saathi, money back plan, jeevan dhara, and marriage endowment plan. Insurance policies, while catering to the risk compensation to be faced in the future by investors, also have the advantage of earning a reasonable interest on their investment insurance premiums. Life insurance policies are also eligible for exemption from income tax.

E) Provident Fund Scheme

Provident fund schemes are deposit schemes, applicable to employees in the public and private sectors. There are three kinds of provident funds applicable to different sectors of employment, namely, Statutory Provident Fund, Recognised Provident Fund, and Unrecognised Provident Fund. In addition to these, there is a voluntary provident fund scheme that is open to any investor, employed or not. This is known as the Public Provident Fund (PPF). Any member of the public can join the PPF.

F) Government and Semi-Government Securities

Government and semi-government bodies such as the public sector undertakings borrow money from the public through the issue of government securities and public sector bonds. These are less risky avenues of investment because of the credibility of the government and government undertakings. The government issues securities in the money market and in the capital market.

Money market instruments are traded in the Wholesale Debt Market (WDM) trades and retail segments. Instruments traded in the money market are short term instruments such as treasury bills and repos.

The government also introduced the privatisation programme in many corporate enterprises and these securities are traded in the secondary market. These are the semi-government securities (also called as PSU).

G) Mutual Fund Schemes

The Unit Trust of India is the first mutual fund in the country. A number of commercial banks and financial institutions have also set up mutual funds. Mutual funds have been set up in the private sector also. These mutual funds offer various investment schemes to investors. The number of mutual funds that have cropped up in recent years is quite large and though, on an average, the mutual fund industry has not been showing good returns, select funds have performed consistently, assuring the investor better returns and lower risk options.

Equity Linked Savings Schemes (ELSSs): Investing in ELSSs gets investors a tax rebate of the amount invested. ELSSs are basically growth mutual funds with a lock-in period of three years. ELSSs have a risk higher than PPF and NSCs, but have the potential of giving higher returns.

H) Real Assets

Investments in real assets are also made when the expected returns are very attractive. Real estate, gold, silver, currency, and other investments such as art are also treated as investments since the expectation from holding of such assets is associated with higher returns.

Real Estate: Buying property is an equally strenuous investment decision. Real estate investment is often linked with the future development plans of the location. It is important to check the value while deciding to purchase a movable/immovable property other than buildings. Besides making a personal assessment from the market, the assistance of government-approved valuers may also be sought.

Bullion Investment: The bullion market offers investment opportunity in the form of gold, silver, and other metals. Specific categories of metals are traded in the metals exchange. The bullion market presents an opportunity for an investor by offering returns and end value in future. It has been observed that on several occasions, when the stock market failed, the gold market provided a return on investments. The changing pattern of prices in the bullion market also makes this market risky for investors. Gold and silver prices are not consistent and keep changing according to the changing local/global demands in the market. The fluctuation prices, however, have been compensated by real returns for many investors who have followed a buy and hold strategy in the bullion market.

1.8. The best benefits of investing at a young age are:

A. **Time is on your side:** This is the one which is pretty clear and it is also extremely crucial. History shows us that those who started investing at a young age end up with end up much better financially than those who invest later in life. The advantage of time also means that there is more time to save money to invest and the option to invest in long term investments which will grow gradually over time.

B. **Compounding returns:** Returns in investments are often on compound interest. The prime difference between simple interest and compound interest is that the simple interest is paid only on the principal while the compound interest is paid on both the principal as well as the interest accumulated. Compounding returns are extremely powerful over the long run, and the earlier you get started the greater your chance is to take advantage of this.

C. **More time to learn:** Investing teaches important lessons and the earlier you are able to learn those lessons the more you can benefit. You can learn from your mistakes early on and use them to make smarter investments in the future?

D. **Improved Quality of life:** By being an early investor, the quality of life of the investor can be greatly improved since he will be able to have enough money to sustain himself during his retirement and will be financially secure. This helps reduce stress and live happily.

E. **More Recovery Time:** Starting early gives you more time to make up any losses which you may incur in your investments. An investor who starts investing at a later stage in life, will get less time to recover his losses. Therefore, with early investments, your investment gets more time to grow in value.

Details	X	Y
Amount Invested	Rs.4,000 per month	Rs.8,000 per month
Number of years saved for	35	25
Total amount invested	INR 16,80,000	Rs.24,00,000
Rate of return	10 per cent	10 per cent
Amount at the age of 45	Rs.1.15 crore	Rs.1 crore

	SONU	MONU
AGE OF STARTING INVESTMENT(YRS)	30	45
PERIOD OF INVESTMENT(YRS)	30	15
MONTHLY INVESTMENT(RS)	1000	2000
PRINCIPAL INVESTMENT(RS)	3,60,000	3,60,000
EXPECTED RATE OF RETURN	8%	8%
TOTAL WEALTH ACCUMULATED AT THE AGE OF 60 YRS(RS)	1,500,295	696,690

2. MODULE 2: BASICS OF STOCK MARKET AND MUTUAL FUNDS

2.1. Stock Market: Introduction

Show video: https://www.youtube.com/watch?v=p7HKvqRI_Bo

Understanding what is Stock Market with the help of a simple example.

Let us imagine that you want to start a company that makes t-shirts. You need to build a factory before you can start manufacturing t-shirts. The factory will need a lot of things, such as sewing machines, cloth, thread, dyes, and boxes to ship put in. You will also need to hire workers and start production. So now to finance the factory, you find a hundred people to invest the money needed. But why would someone give you the money for free? They will ask for something in exchange, so in exchange for the money, they each own one-hundredth of the company.

Now you cannot break up the factory into 100 different parts and give one part to each. So, what it means is that these 100 people are entitled to a part of the profits, each person's part of the profit (or their share of the profit) would be one-hundredth. Once the factory is ready and you are selling t-shirts, you have income every year. Some of that income goes to pay expenses (like raw materials, salary of the workers and electricity) some of it will be used to buy better equipment and improve production. But after all that, there will still be some money left over, that's called profit. And that gets evenly distributed between the hundred people who invested, who are called the "**shareholders**", the money they get is called a "**dividend**".

Now if another person likes your business a lot and he also wants to be a shareholder, he goes to one of the existing shareholders and asks to buy his share. The price of the share will be decided based on how much the buyer is willing to pay, how the company's doing now, and how they expect it to do in the future. If the company's making a lot of money and is very profitable, the share becomes worth more money, because there are good dividends. If the company's doing badly, the share becomes worth less.

In the world today, there are thousands of companies with shares being bought and sold every day. So how can it be made easier to buy and sell these shares? We have one market where everyone can trade in their shares. In this market all the shares are bought and sold. The share is also called **stock**, and this market is called the **share market** or the **stock market**. In this market the stock of a company will go up in price when more and more people are willing to pay more for its share. When more people want to sell the share than want to buy, the price goes down.

On the national scale, the stock market plays a very important role because it is the primary way in which the money of individual citizens gets invested in businesses, which is how businesses get money to start and to grow. If everything works well, the business does well, the stockholders make money and the public is able to buy the things the business produces.

2.2. Important Terms Related to Stock Market

A) Dividend

Whenever you buy a company's shares, you will receive dividends from the company, from time to time. If the company does well financially and makes a lot of profits, the management may decide to pay a small amount of its profits, directly back to its shareholders. These payments of profits are called dividends.

As a shareholder, the amount of money that can be earned from dividends, depends on the number of shares owned. For example, if the shareholder owns 100 shares and these shares pay a dividend of Rs. 10 each year, then the shareholder will get Rs. 1000. Similarly if the shareholder owns 1000 shares, then he will get Rs. 10,000. Therefore, more the number of shares, more the dividend which will be received.

B) Bonus Shares

Bonus shares are additional shares given to the current shareholders without any additional cost, based upon the number of shares that a shareholder owns. These are company's accumulated earnings which are not given out in the form of dividends, but are converted into free shares.

The basic principle behind bonus shares is that the total number of shares increases with a constant ratio of number of shares held to the number of shares outstanding. For instance, if Investor A holds 200 shares of a company and a company declares 4:1 bonus that is for every one share he gets 4 shares for free. That is total 800 shares for free and his total holding will increase to 1000 shares.

Companies issue bonus shares to encourage retail participation and increase their equity base. When price per share of a company is high, it becomes difficult for new investors to buy shares of that particular company. Increase in the number of shares reduces the price per share. But the overall capital remains the same even if bonus shares are declared.

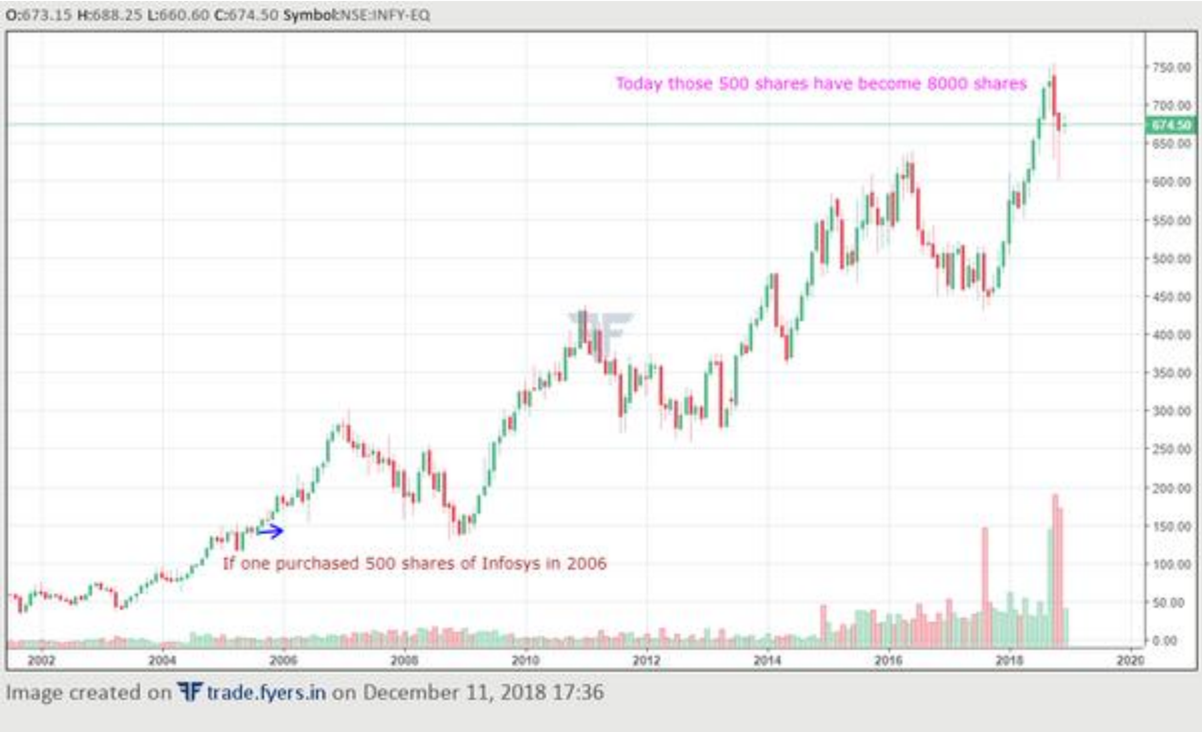
C) Long Term Investment

Fruit trees can be referred to as Long term investment. When we plant fruit trees, we know it will take 2 to 3 years to get fruits. Once we start getting fruits, we will be getting the fruits every year. Similarly, when the company starts performing well, we will be rewarded with dividends and bonus shares.

The way the one mango seed has given many fruits. Our shares can multiply many times.

Let us look at the example of a graph on Infosys. On X-Axis we have the years and on Y-axis we have the price of the share. The share shows how Infosys has given returns on 75000 rupees invested in 2006.

The graph shows how 500 shares of Infosys have become 8000 shares over the years. Now let us understand how that happened.



How 500 shares in 2006 of Infosys became 8000 shares in 2018					
Year	Bonus	No.of Shares	% Dividend	Div/share	Value
2006	1:01	1000	870%	43.5	43500
2007		1000	150%	7.5	7500
2008		1000	645%	32.25	32250
2009		1000	470%	23.5	23500
2010		1000	1100%	55	55000
2011		1000	700%	35	35000
2012		1000	940%	47	47000
2013		1000	940%	47	47000
2014	1:01	2000	1460%	73	146000
2015	1:01	4000	790%	39.5	158000
2016		4000	505%	25.25	101000
2017		4000	555%	27.75	111000
2018	1:01	8000	750%	37.5	300000
			Total Dividend		1106750
Share Value		8000	674.25		5394000
	ROI on 75000 investement				6500750

If a person invested 75000 rupees and bought 500 shares of Infosys in 2006. Today after four 1:1 bonuses, now he will be holding 8000 shares.

After adding the dividends his Return on Investment (ROI) for 75,000 rupees is 65,00,750 rupees.

D) Short Term Investment

Now let's take the example of a vegetable garden. Here the plant life cycle is lesser compared to fruit trees. Some plants have 90 days cycle, one needs to take all the profits within that period. So, we need to plant the seed and harvest the plant within a period of 90 days, therefore, the period of investing the money is small. This can be related to **Short-term investment**.
This chart shows how people use swings to take profits.

E) Intra-Day Trading

Take the example of Jasmine flower plant. The life of the flower is just one day and if not plucked the flower by evening and the next day, the flower is of no use.

This can be related to intra-day trading. In intra-day trading, you have to book profit or loss on the same day. If you are holding the position after 3.30 pm, the system will automatically square-offs. Bombay Stock Exchange has trading from 9:15 am to 3:30 pm.

Intraday trading is high risk as one has to take either profit or loss by 3.30 pm on the same day. One has to have thorough knowledge and be a full-time trader, unlike short term and long-term investor.

F) Index

Definition of Index is *"An Index is a statistical aggregate that measures change."*

Remember this throughout this post – 'statistical aggregate'. All Index are not same – they can be differentiated based on countries, the market cap of stocks they cover or even how any stock will become part of Index. Sometimes I feel even construction of an index is an art & not science. Sensex & Nifty both are large cap Index but from different stock exchanges BSE and NSE.

NSE and BSE:

BSE stands for 'Bombay Stock Exchange', and NSE stands for 'National Stock Exchange'.

(vii) What is BSE?

In 1875, BSE or Bombay Stock Exchange was established, and it was formerly known as 'The native share and stock brokers association'. However, after 1957, Government of India recognized this stock exchange as the premier stock exchange of India, under the Securities Contract Regulation Act, 1956.

SENSEX was also introduced in 1986 as the first ever equity index of India to offer an identifying base for top 30 exchange trading companies. In 1995, BSE on-line trading (BOLT) was established, and at that time, its capacity amounted to 8 million transactions per day. BSE is the first stock exchange of Asia, and it offers varied services such as market data services, risk management, CDSL (Central Depository Services Limited) depository services, etc. Bombay Stock Exchange is additionally 12th biggest stock exchange marketplace in the world, and as of July 2017, its market capitalization is over $2 trillion.

(viii) What is NSE?

NSE or National Stock Exchange is located in Mumbai, and it is India's leading stock exchange market. It first came into existence in 1992 and brought with it an electronic exchange system in India, which led to the removal of the paper based system. NSE introduced Nifty 50 in 1996 as the identifying base for top 50 stock index, and it is extensively utilized as Indian capital markets' barometer and by Indian investors. National Stock Exchange became a stock exchange recognized company by 1993, and in 1992, it was incorporated as a tax paying company under Securities Contracts Act, 1956. Formation of NSDL (National Securities Depository Limited) took place in 1995 to offer investors a safe platform for transferring and holding their bonds and shares electronically. National Stock Exchange is the 10th biggest stock exchange marketplace, and as of March 2017, its market capitalization reached over $1.41 trillion.

(ix) Sensex and Nifty:

Full Form of Sensex is Sensitive Index. Sensitive Index or Sensex is the stock market index indicator for the Bombay Stock Exchange. It is also sometimes referred to as BSE Sensex. It was first published in 1986 and is based the stock of 30 companies based on the financial performance. Usually, The large, established companies that represent various industrial sectors are a part of this.

National Stock Exchange (NSE) is the leading stock exchange of India. Full form of NIFTY is "National Stock Exchange Fifty" – it is the broad index of NSE. NIFTY normally comprises of 50 stocks. It is known as NIFTY 50 or CNX Nifty. It is owned and managed by India Index Services and Products Ltd. (IISL).

People are happy when the Sensex goes up and upset when it goes down. Sensex is the stock market index of the Bombay Stock Exchange or BSE – it is also called BSE Sensex.

It is the market weighted stock index of 30 companies that are selected on the basis of financial soundness and performance. Usually, large and well-established companies that are representatives of the various industrial sectors are chosen.

(x) What is valuation of a company?

The value of a company is the Market Capitalisation of the company.

Market Capitalization = Price of the one share x Number of shares issued by the company.

(xi) How Sensex is calculated?

The Sensex is calculated using the Free-float Market Capitalization' method. In this method, the index shows the free float market value of shares of 30 companies for a particular period.

This method came into existence from September 1, 2003. The free-float method takes into account the shares that can be readily traded in the market. Not all shares can be sold on the stock market, the shares which cant be sold on the stock market are called locked-in shares. Some examples of locked in shares are those which have been used to get a loan, or shares which are with the government etc. Such locked-in shares are not considered free floating.

(xii) What is Market capitalization?

Market capitalization is the combined worth of all the stocks of different companies within the stock exchange.

The market capitalization of a company is arrived at by the product of the price of its stock and number of shares issued by the company.

Market Capitalization = Price of the one share x Number of shares issued by the company

Now we multiply Market Capitalization with the free-floating factor, we get the free float market capitalization.

The free float factor is the fraction of shares in the company that can be publicly traded. A Free-float factor of say 0.55 means that only 55% of the market capitalization of the company will be considered for calculation.

The free float factor is derived from the information each company submits regarding the free-floating shares. Every company has to give the information on a quarterly basis in a format given by BSE.

The free float market capitalization of all companies is summed up.

The free float market capitalisation is then divided by an index divisor to get the Sensex value. This divisor adjusts for changes in stocks and other corporate actions. The divisor is the value of the Sensex Index in the base year.

E.g: For ABC Ltd

	No. of Shares	%
Total Equity Shares	2,50,00,000	100

Category	No. of Shares	%
Promoter and Promoter Group	1,20,00,000	48.00

Promoter Depository Receipts (DR)	10,000	0.04
Public Shareholders Locked in	75,000	0.30
Strategic holding	25,000	0.10
Total		48.44

Free Float Factor in the above case is (100-48.44)/100 = 0.51

(xiii) How Sensex Works – example

Suppose the index has two companies – X and Y.

The total number of shares of Company X has 500 shares out of which 300 are free floating or available for general public to buy and sell. The price of each share is Rs.80.

Company Y has 1000 shares out of which 700 are free floating. The price of each share is Rs. 100

Market capital of Company X = 40000

Market capital of Company Y = 100000

Free-float factor for Company X = 0.60

Free-float factor for Company Y = 0.70

Total free float market capital of the index = (40000*0.60) + (100000*0.70) = 94000

Let us assume the base year index was 5000.

Value of Index = (94000 x 100)/5000 = 1880

So the Value of the Index is 1880.

Suppose the Index consists of only 2 stocks: Stock A and Stock B.

Suppose company A has 1,000 shares in total, of which 200 are held by the promoters, so that only 800 shares are available for trading to the general public. These 800 shares are the so-called 'free-floating' shares.

Similarly, company B has 2,000 shares in total, of which 1,000 are held by the promoters and the rest 1,000 are free-floating.

Now suppose the current market price of stock A is Rs 120.

Thus, the 'total' market capitalisation of company A is:

Market Capitalisation = Price of the one share x Number of shares issued by the company
= 1,000 x 120

= Rs 120,000

but its free-float market capitalisation is:

Free-float market capitalisation = Price of the one share x Number of Free Floating shares

= 800 x 120

= Rs 96,000

Similarly, suppose the current market price of stock B is Rs 200.

Thus, the 'total' market capitalisation of company B is:

Market Capitalisation = Price of the one share x Number of shares issued by the company
= 2,000 x 200

= Rs 400,000

but its free-float market capitalisation is:

Free-float market capitalisation = Price of the one share x Number of Free Floating shares

= 1000 x 200

= Rs 200,000

Therefore, the total market capitalisation of the index (i.e. stocks A and B) = Rs 520,000

= (Rs 120,000 + Rs 400,000).

The free-float market capitalisation of the index is Rs 296,000. (Rs 96,000 + Rs 200,000).

Let us consider the base year to be the year 1980-81 is considered the base year of the index with a value set to 100.

What this means is that suppose at that time the market capitalisation of the stocks that comprised the index then was, say, 60,000 (remember at that time there may have been some other stocks in the index, not A and B, but that does not matter), then we assume that an index market cap of 60,000 is equal to an index-value of 100.

Market Cap Value	Index
60,000	100
296,000	x

Therefore, the index (x) = 296,000 x 100/60,000 = 493.33

This is how the Sensex is calculated.

The factor 100/60000 is called index divisor.

(xiv) What are the Highs and Lows of Sensex in last 10 years?

The market is affected by various political, social and economic factors across the world. The lowest points were reached in 2008 when the stock markets in U.S. started crashing and there were major credit losses in the U.S. There was a steep drop in 2015 as well.

(xv) Why is it important to understand SENSEX and NIFTY for investments?

You can invest in NIFTY based funds to get long-term benefits. It is a good place to invest as it is usually stable and is well-diversified.

1) You can invest in Sensex based funds to take advantage of the rising value.
2) If the markets are volatile, the Sensex is swinging across different values, then it is better to wait for the volatility in the index to get less. (You were expecting this – better invest through SIP)
3) The stocks in the SENSEX are financially sound. Most of them are blue chip companies. You can invest in equity funds that invest in these shares.
4) It serves as an indicator of how the economy is doing and how the companies are performing. This will help in prudent decision-making in your finances.

Sensex is the yardstick (called Index) to measure the “market sentiment”, thereby helping you to invest.

If the Sensex is higher than yesterday then you imply that the stock market is going up (bullish), if it's lower then stock market is going down (bearish). This yardstick is a product of Bombay Stock Exchange (BSE). Similarly, the National Stock Exchange has Nifty.

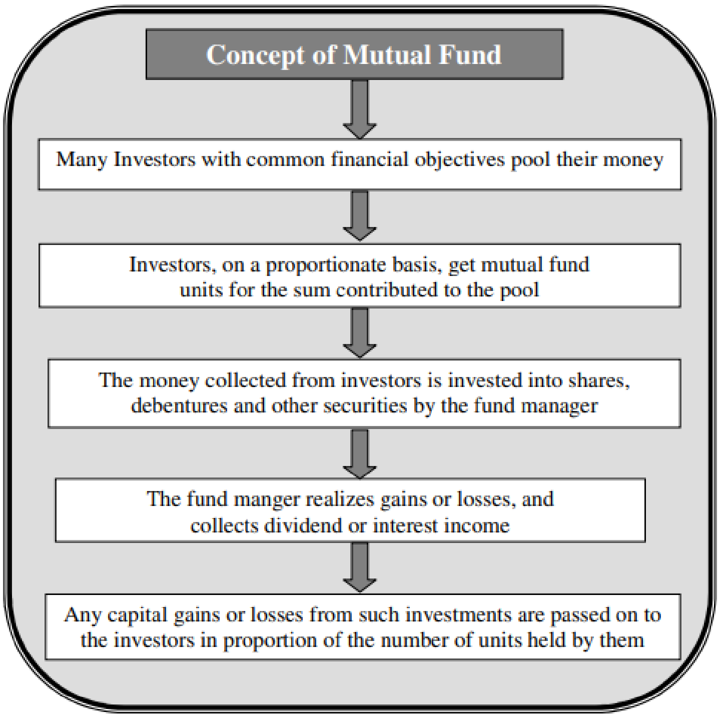
Sensex is computed using stocks that are considered safe to invest (liquid). Thus, Sensex is essentially a list of safe stocks, and the value is nothing but a weighted average.

2.3. Mutual Funds: Introduction

There are many investment avenues available in the financial market for an investor. Investors can invest in bank deposits, corporate debentures and bonds, post office saving schemes etc. where, there is low risk together with low return. They may invest in stock of companies where the risk is high and sometimes the returns are also proportionately high.

For retail investors, who do not have the time and expertise to analyze and invest in stock, Mutual Funds is a viable investment alternative. This is because Mutual Funds provide the benefit of cheap access to expensive stocks.

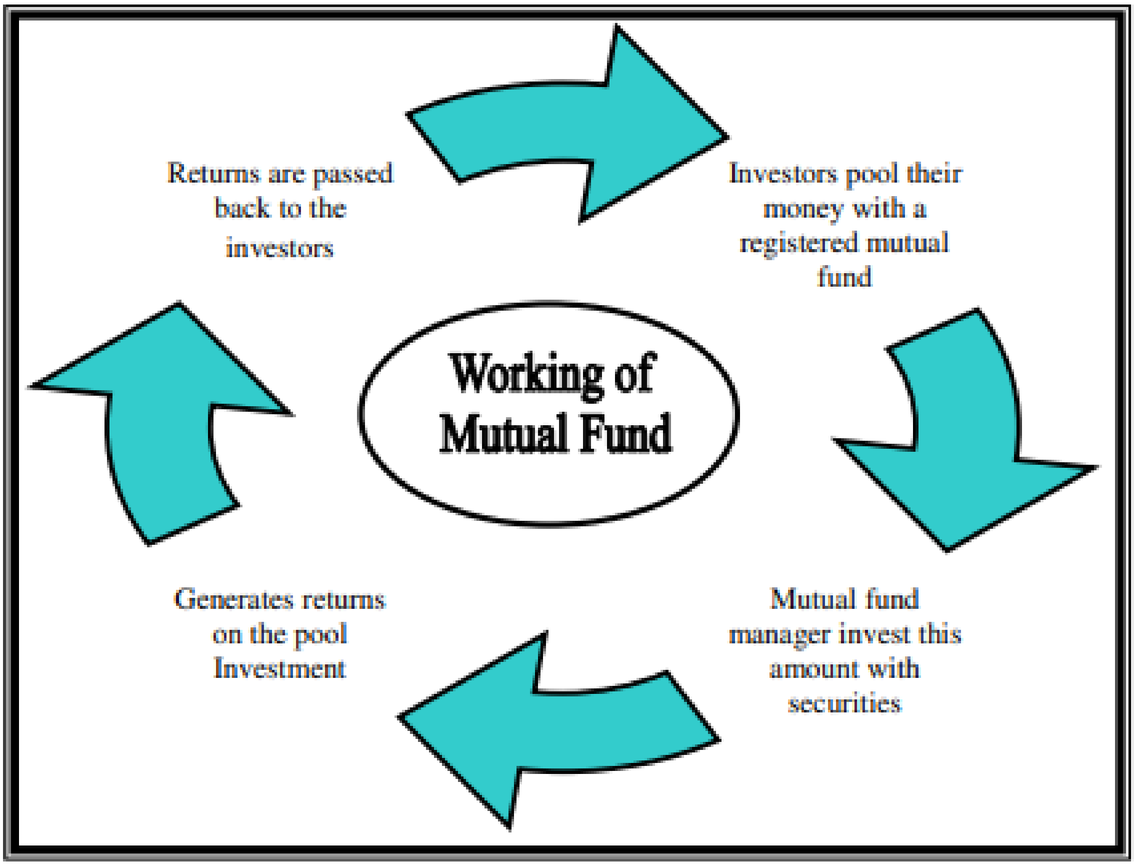
A Mutual Fund is a collective investment vehicle formed with the specific objective of raising money from a large number of individuals and investing it according to a pre-specified objective, with the benefits accrued to be shared among the investors on a pro-rata basis in proportion to their investment.



A Mutual Fund is a trust registered with the Securities and Exchange Board of India (SEBI) which pools up the money from individual/corporate investors and invests the same on behalf of the investors/units holders, in equity shares, government securities, bonds, call money market etc. The income earned through these investments and the capital appreciations realized are shared by its unit holders in proportion to the number of units owned by them. This pooled income is professionally managed on behalf the unit-holders, and each investor holds a proportion of the portfolio.

A) Operational Flow of Mutual Fund

The following diagram depicts the operational flow of Mutual Fund



B) Parties to a Mutual Fund

The following diagram illustrates various entities involve in organizational structure of mutual fund:

(i) Investors

Every investor, given his/her financial position and personal disposition, has a certain inclination to take risk. The hypothesis is that by taking an incremental risk, it would be possible for the investor to earn an incremental return.

Mutual fund is a solution for investors who lack the time, the inclination or the skills to actively manage their investment risk in individual securities. They delegate this role to the mutual fund, while retaining the right and the obligation to monitor their investments in the scheme. In the absence of a mutual fund option, the money of such "passive" investors would lie either in bank deposits or other 'safe' investment options, thus depriving them of the possibility of earning a better return. Investing through a mutual fund would make economic sense for an investor if his/her investment, over medium to long term, fetches a return that is higher than what would otherwise have earned by investing directly.

(ii) Sponsors

Sponsor is the company, which sets up the Mutual Fund as per the provisions laid down by the Securities and Exchange Board of India (SEBI). SEBI mainly fixes the criteria of sponsors based on sufficient experience, net worth, and past track record.

(iii) Asset Management Company(AMC)

The AMC manages the funds of the various schemes and employs a large number of professionals for investment, research and agent servicing. The AMC also comes out with new schemes periodically. It plays a key role in the running of mutual fund and operates under the supervision and guidance of the trustees. An AMC's income comes from the management fees, it charges for the schemes it manages. The management fees, is calculated as a percentage of net assets managed.

An AMC has to employ people and bear all the establishment costs that are related to its activity, such as for the premises, furniture, computers and other assets, etc. So long as the income through management fees covers its expenses, an AMC is economically viable. SEBI has issued the following guidelines for the formation of AMCs:

a) An AMC should be headed by an independent non-interested and nonexecutive chairman.
b) The managing director and other executive staff should be full-time employees of AMC.
c) Fifty per cent of the board of trustees of AMC should be outside directors who are not in any way connected with the bank.
d) The board of directors shall not be entitled to any remuneration other than the sitting fees.
e) The AMCs will not be permitted to conduct other activities such as merchant banking or issue management.

(iv) Trustees

Trustees are an important link in the working of any mutual fund. They are responsible for ensuring that investors' interests in a scheme are taken care of properly. They do this by a constant monitoring of the operations of the various schemes. In return for their services, they are paid trustee fees, which are normally charged to the scheme.

(v) Distributors

Distributors earn a commission for bringing investors into the schemes of a mutual fund. This commission is an expense for the scheme. Depending on the financial and physical resources at their disposal, the distributors could be:

a) Tier 1 distributors who have their own or franchised network reaching out to investors all across the country;
b) Tier 2 distributors who are generally regional players with some reach within their region;
c) Tier 3 distributors who are small and marginal players with limited reach.

The distributors earn a commission from the AMC.

(vi) Registrars

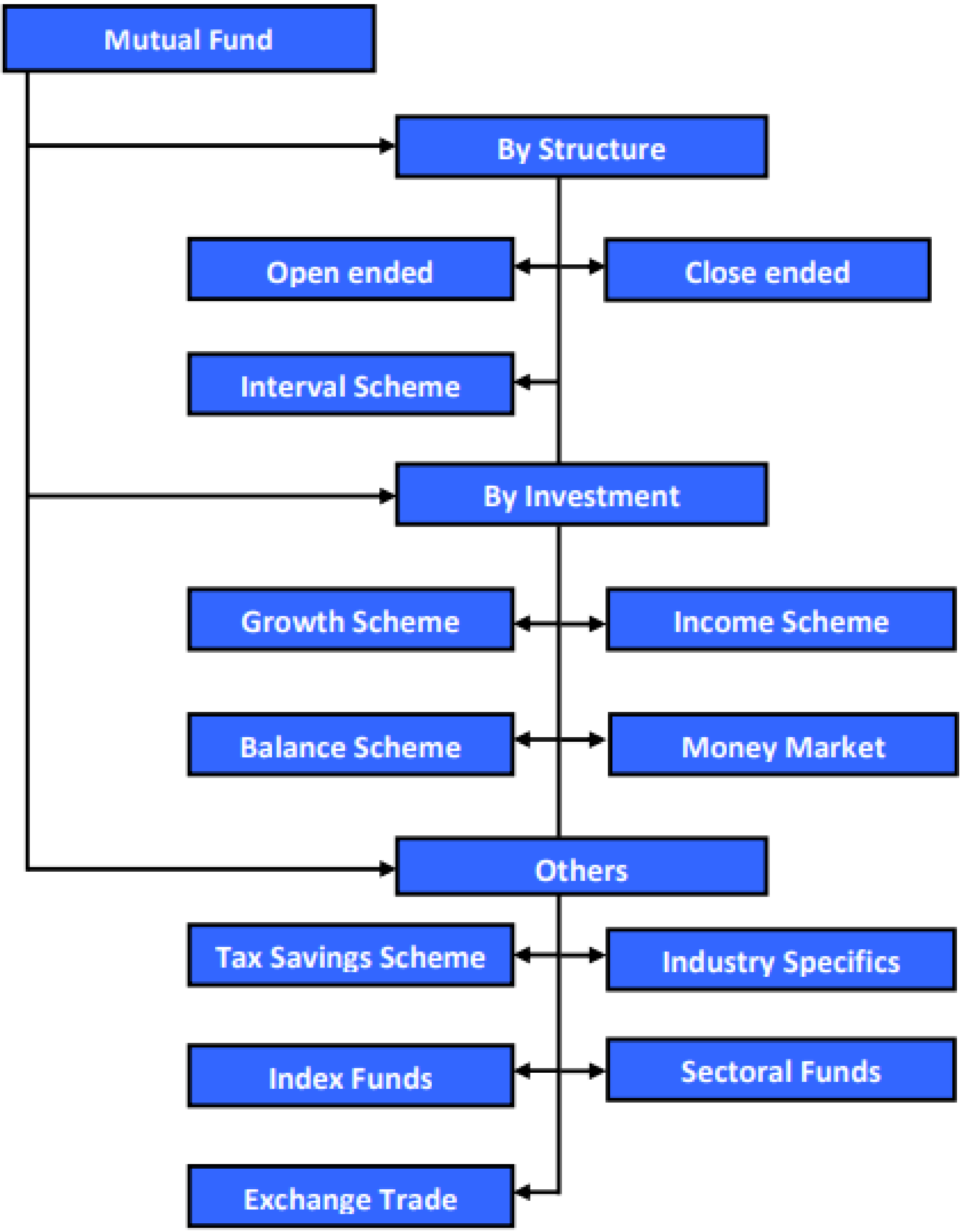
An investor's holding in mutual fund schemes is typically tracked by the schemes' Registrar and Transfer Agent (R & T). Some AMCs prefer to handle this role on their own instead of appointing R & T. The Registrar or the AMC as the case may be maintains an account of the investors' investments and disinvestments from the schemes. Requests to invest more money into a scheme or to redeem money against existing investments in a scheme are processed by the R & T.

(vii) Custodian/ Depository

The custodian maintains custody of the securities in which the scheme invests. This ensures an ongoing independent record of the investments of the scheme. The custodian also follows up on various corporate actions, such as rights, bonus and dividends declared by investee companies. At present, when the securities are being dematerialized, the role of the depository for such independent record of investments is growing. No custodian in which the sponsor or its associates hold 50 percent or more of the voting rights of the share capital of the custodian or where 50 per cent or more of the directors of the custodian represent the interest of the sponsor or its associates shall act as custodian for a mutual fund constituted by the same sponsor or any of its associates or subsidiary company.

2.4. Types of Mutual Fund

Mutual Fund schemes may be classified on the basis of its structure and investment objective.



A) Based on Structure:

(i) Open Ended Funds

An open-ended fund is one that is available for subscription all through the year. These do not have a fixed maturity. Investors can conveniently buy and sell units at Net Asset Value (NAV) related prices. The key feature of open-end schemes is liquidity.

(ii) Close Ended Funds

A closed-ended fund has a stipulated maturity period which generally ranges from three to fifteen years. The fund is open for subscription only during a specified period. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchanges where they are listed. In order to provide an exit route to the investors, some close-ended funds give an option of selling back the units to the Mutual Fund through periodic repurchase at NAV related prices.

(iii) Interval Funds

Interval funds combine the features of open-ended and close-ended schemes. They are open for sale or redemption during pre-determined intervals at NAV related prices.

B) Based on Investment Objective:

(i) Growth Funds

The aim of growth funds is to provide capital appreciation over medium to long-term. Such schemes normally invest a majority of their corpus in equities. Studies have shown that returns from stocks, have outperformed most other forms of investments held over long term. Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time.

(ii) Income Funds

The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debentures and Government securities. Income Funds are ideal for capital stability and regular income.

(iii) Balanced Funds

The aim of balanced funds is to provide both growth and regular income. Such schemes periodically distribute a part of their earning and invest both in equities and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace, or fall equally when the market falls. These are ideal for investors looking for a combination of income and moderate growth.

(iv) Money Market Funds

The aim of money market funds is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short-term instruments such as treasury bills, certificates of deposit, commercial paper and inter-bank call money. Returns on these schemes may fluctuate depending upon the interest rates prevailing in the market. These are ideal for corporate and individual investors as a means to park their surplus funds for short periods.

C) Others

(i) Tax Saving

These schemes offer tax rebates to the investors under specific provisions of the Indian Income Tax laws as the Government offers tax incentives for investment in specified avenues. Investments made in Equity Linked Savings Schemes (ELSS) and Pension Schemes are allowed as deduction u/s 88 of the Income Tax Act, 1961. The Act also provides opportunities to investors to save capital gains u/s 54EA and 54EB by investing in Mutual Funds.

(ii) Sector Specific

Industry Specific Schemes invest only in the industries specified in the offer document. The investment of these funds is limited to specific industries like InfoTech, Fast Moving Consumer Goods (FMCG), and Pharmaceuticals etc.

(iii) Index Funds

Index Funds attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE.

(iv) Sectoral Funds

Sectoral Funds are those, which invest exclusively in a specified industry or a group of industries or various segments such as 'A' Group shares or initial public offerings.

(v) Exchange Traded Funds

Exchange Traded Funds, (ETF) just like their index fund counterparts, also track indexes. The difference is that the stocks of individual companies that comprise a given index are bundled into an equity-like investment vehicle that is traded on an exchange, exactly like a stock. That means that those purchasing ETF shares can place orders for them throughout the day, and even use limit orders to make trades. Because they are traded on an exchange and share many of the attributes of individual equities, ETFs can also be shorted and offer underlying options as an investment opportunity.

D) Systematic Investment Plan (SIP)

The plan of investing the same amount of money every month over an extended period of time regardless of whether the market is up or down is known as Systematic Investment Plan (SIP). Mutual Fund gives us four good reasons for investing through SIP:

- Lighter on the wallet
- Makes timing of market irrelevant
- Helps build for future by the power of compounding
- Rupee cost averaging lowers your chances of losses.

Rupee cost averaging is an effective market-timer mechanism that eliminates the need to time the markets. All one has to do is to invest a fixed, pre-decided amount of money on a regular basis over a long period of time. Since the amount invested per month is constant, one buys more units when the price is low and fewer units when the price is high. As a result the average unit cost will always be less than the average sale price per unit, irrespective of the market rising, falling or fluctuating.

2.5. Advantages/ Limitations of Mutual Fund

A) Advantages

Mutual Funds are professionally managed companies or schemes that pool money from investors and invest it in stock markets, shares, derivative markets and other securities. By investing in Mutual funds, investors can avail of the following advantages:-

(i) Professional Management

The investor avails of the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

(ii) Diversification

Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion. This diversification is achieved through a Mutual Fund.

(iii) Convenient Administration

Investing in a Mutual Fund reduces paperwork and helps to avoid many problems such as bad deliveries, delayed payments and follow up with brokers and companies. Mutual Funds save time and makes investing easy and convenient.

(iv) Return Potential

Over medium to long-term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

(v) Low Cost

Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because of the benefits of scale in brokerage, custodial and other fees which translate into lower costs for investors.

(vi) Liquidity

In open-end schemes, an investor can get his money back promptly at net asset value. With closed-ended schemes, an investor can sell his units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase at NAV related prices which some close-ended and interval schemes offer periodically.

(vii) Transparency

Regular information can be obtained by the investors on the value of investment in addition to disclosure on the specific investments made in the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

(viii) Flexibility

Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, an investor can systematically invest or withdraw funds according to his needs and convenience.

(ix) Choice of Schemes

Mutual Funds offer a family of schemes to suit an investor's varying needs over a lifetime. For e.g. Growth schemes are ideal for investors having a long-term outlook seeking growth over a period of time. Income Funds are ideal for capital stability and regular income. Balanced Funds are ideal for investors looking for a combination of income and moderate growth. Money Market Funds are ideal for corporate and individual investors as a means to park their surplus funds for short periods.

(x) Well Regulated

All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

(xi) Affordability

Mutual funds allow even small investors to indirectly reap the benefit of investment in shares of a big company because of its large corpus, which an individual investor may not be able to do so because of insufficient funds.

B) Limitations

Following are some of the limitations of mutual funds:

(i) Tax Issues

Although, the returns on investment are quite high, a mutual fund cannot guarantee lower tax bills. The tax amounts are usually high, especially in case of short-term gains.

(ii) Investor Issues

A mutual fund requires a deep and long term analysis of the amount of investment and its potential investment areas. If the company fund manager changes regularly, it may adversely affect the returns on investment.

(iii) Fluctuating Returns

Mutual funds are like many other investments where there is always the possibility that the value of mutual fund will depreciate, unlike fixed income products, such as bonds and treasury bills, mutual funds experience price fluctuations along with the stocks that make up the fund.

(iv) Over Diversification

Although diversification is one of the keys to successful investing, many mutual fund investors tend to over diversify. The idea of diversification is to reduce the risks associated with holding a single security; over diversification occurs when investors acquire many funds that are highly related and, as a result, reduce benefits of diversification.

(v) High Costs and Risks

Mutual funds provide investors with professional management, but it comes at a cost. Funds will typically have a range of different fees that reduce the overall payout. In mutual funds, the fees are classified into two categories: shareholder fees and annual operating fees. The shareholder fees, in the forms of loads and redemption fees are paid directly by shareholders purchasing or selling the funds. The annual fund operating fees are charged as an annual percentage – usually ranging from 1-3%. These fees are assessed to mutual fund investors regardless of the performance of the fund. Mutual funds are subjected to market risks or assets risks. If the investment is not sufficiently diversified, it may involve huge losses.

3. MODULE 3: FINANCIAL INSTITUTIONS/REGULATORS AND KEY ECONOMIC TERMS

3.1. Financial Institutions/ Regulators: Introduction

Financial sector plays an indispensable role in the overall development of a country. The most important constituent of this sector is the financial institutions, which act as a conduit for the transfer of resources from net savers to net borrowers, that is, from those who spend less than their earnings to those who spend more than their earnings. The financial institutions have traditionally been the major source of long-term funds for the economy. These institutions provide a variety of financial products and services to fulfil the varied needs of the commercial sector. Besides, they provide assistance to new enterprises, small and medium firms as well as to the industries established in backward areas.

A financial institution is an institution that provides financial services for its clients or members. Any institution that collects money and puts it into assets such as stocks, bonds, bank deposits, or loans is considered a financial institution.

There are two types of financial institutions primarily, viz.,
1. Depository institutions and
2. Non-depository institutions.

Depository institutions pay you interest on your deposits and use the deposits to make loans. Examples:
1. Banks
2. Credit unions
3. Trust companies
4. Mortgage loan companies.

Non-depository institutions, on the other hand undertake the function of selling financial products. In other words, those government or private that serve as an intermediary between savers and borrowers, but do not accept time deposits, are known as non-depository institutions. Such institutions fund their lending activities either by selling securities or insurance policies to the public. Their liabilities (depending on the liquidity of the liability) may fall under one or more money supply definitions, or may be classified as near money.

Examples:
1. Insurance companies
2. Pension funds
3. Brokerage firms
4. Underwriting firms
5. Mutual fund companies
6. Investment trust

Many financial institutions provide both depository and non-depository services.

Probably the most important financial service provided by financial institutions is acting as financial intermediaries. Most financial institutions are highly regulated by government bodies.

Finance companies typically enjoy high credit ratings and are hence able to borrow at the lowest market rates, enabling them to make loans at rates not much higher than banks. Even though their customers usually do not qualify for bank credit, these companies have experienced a low rate of default. Finance companies in general tend to be interest rate-sensitive-increases and decreases in market interest rates affect their profits directly.

3.2. International Financial Institution

A) World Bank

The World Bank is an international financial institution that provides loans to countries of the world for projects requiring a lot of capital. It comprises two institutions:

1. The International Bank for Reconstruction and Development (IBRD),
2. The International Development Association (IDA).

The World Bank is a component of the World Bank Group.
The World Bank's most recent stated goal is the reduction of poverty. As of November 2018, the largest recipients of World Bank loans were India ($859 million in 2018) and China ($370 million in 2018), through loans from IBRD.

B) International Monetary Fund

Comprised of 189 member countries including the United States, the International Monetary Fund's main mission is to ensure monetary stability around the world. Member countries work together to foster global monetary cooperation, secure financial stability, facilitate international trade, and promote employment and economic growth. It also aims to reduce poverty around the world.

The IMF maintains its mission in three ways.

1. First, it keeps track of the global economy and those of its member countries. The group employs a number of economists who monitor member countries' economic health. Each year, the IMF provides each country with an economic assessment.
2. Secondly, it gives practical help to members by providing policymakers by helping them plan fiscal policies, coming up with tax and fiscal legislation, and overseeing the economy through analysis.
3. Finally, it lends to countries with balance of payments difficulties. It provides this financial assistance as long as the borrowing country implements initiatives suggested by the IMF.

C) Difference between IMF and World Bank

The IMF oversees the world's monetary system's stability, while the World Bank aims to reduce poverty by offering assistance to middle-income and low-income countries.

D) Asian Development Bank (ADB)

The Asian Development Bank, a multilateral development finance institution, was founded in 1966 by 31 member governments to promote the social and economic progress of the Asian and Pacific region. The Bank gives special attention to the needs of the smaller or less-developed countries and priority to regional, sub-regional, and national projects and programs.

The Bank's principal functions are

a) To extend loans and equity investments for the economic and social development of its developing member countries (DMCs);
b) To provide technical assistance for the preparation and execution of development projects and programs, and for advisory services;
c) To promote and facilitate investment of public and private capital for development purposes; and
d) To respond to requests for assistance in coordinating development policies and plans of its DMCs.

3.3. National (or Regional) Financial Institutions

A) Reserve Bank of India (RBI)

The central bank of India is called the Reserve Bank of India (RBI). It was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934 with a view to organize the financial frame work and facilitate fiscal stability in India.

RBI plays the most important role in:
1. Securing monetary stability in India and
2. Operate the currency and credit system of the country.

Apart from these two role plays, RBI being the central monetary authority plays a very significant role in the Indian Economy.

- *Guarantor of Price Stability*: Being the monetary authority of the economy, RBI is responsible for implementing, formulating and monitoring the monetary policy of India. Keeping this authority in mind the RBI is required to maintain price stability and ensure adequate flow of credit to productive sectors.

- *Regulator and Supervisor of the Financial System*: The Supreme financial body sets down broad parameters of banking operations within which the country's banking and financial system operates. This reasonably helps in maintaining public confidence in the system. It in turn protects depositors' interest and provides lucrative banking services to the public.

- *Manager of Exchange Control:* The RBI is responsible for managing the Foreign Exchange Management Act, 1999. It is the nodal agency which facilitates external trade and payment and promotes orderly development and maintenance of foreign exchange market in India.

- *Issuer of Currency:* It is the only supreme body which issues and exchanges or destroys currency and coins not fit for circulation. This facilitates in giving the public adequate quantity of currency notes and coins and in good quality.

- *Developmental Role:* The RBI since its inception performs a wide range of promotional functions to support national objectives and generate goodwill among the citizens of the country.

Functions of RBI:

The Reserve Bank of India Act of 1934 entrust all the important functions of a central bank the Reserve Bank of India.

- ***Monetary Authority***
  The Reserve Bank of India formulates, implements and monitors the monetary policy with an objective of maintaining price stability and ensuring adequate flow of credit to productive sectors. Monetary Policy can be broadly defined as "the deliberate effort by the Central Bank to influence economic activity by variations in the money supply, in availability of credit or in the interest rates consistent with specific national objectives." The Reserve Bank adopts expansionary or contractionary methods of investment and consumption expenditure to regulate the money supply in Indian economy. For this RBI resorts to quantitative as well as qualitative methods.
  A. Quantitative Measures
  1. *Open market operations:* Open market operations make quite an important instrument of credit control. The Reserve Bank of India purchases and sells securities in open market operations. In times of inflation, RBI sells securities to mop up the excess money in the market. Similarly, to increase the supply of money, RBI purchases securities.
  2. *Bank rate policy:* Bank rate, also referred to as the discount rate, is the rate of interest which a central bank charges on the loans and advances that it extends to commercial banks and other financial intermediaries. Changes in the bank rate are often used by central banks to control the money supply. During inflation, the bank rate is increased and during deflation, bank rate is decreased.
  3. *Repo/ reverse Repo:* Repo comes from the repurchasing agreement. Whenever the banks have any shortage of funds they can borrow it either from Reserve Bank of India (RBI) or from other banks. The repo rate is the rate at which the banks borrow these excess funds. The borrowing bank mortgages its government securities to carry out this loan transaction. 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.

Reverse repo rate is the rate that RBI offers the banks for parking their funds with it. Reverse repo operations suck out liquidity from the system. While repo rate is a short-term measure, i.e. applicable to short-term loans and used for controlling the amount of money in the market, bank rate is a long-term measure and is governed by the long-term monetary policy of the Reserve Bank.

4. *Cash Reserve Ratio (CRR):* All commercial banks are required to keep a certain amount of their total deposits with RBI in form of cash. This percentage is called the cash reserve ratio. This instrument can change the money supply very soon. Higher the CRR, lower will be the loanable funds available with the commercial banks and so will be the amount of credit created by them. Higher the CRR, lower is the money supply in the economy and vice versa.
5. *Statutory Liquidity Ratio (SLR):* Statutory Liquidity Ratio is the percentage of demand and time deposits that banks need to keep with themselves in any or combination of the following forms:

   (a) Cash

   (b) Gold valued at a price not exceeding the current market price

   (c) Unencumbered approved securities valued at a price as specified by the RBI from time to time.

   This is the proportion of deposits which Banks have to keep liquid in addition to CRR. This also has the same bearing on money supply in the economy as CRR.

B. Qualitative Measures

1. *Fixation of Margin Requirement:* Banker lends money against price of securities. The amount of loan depends upon the margin requirements of the banker. The word margin here means the difference between the loan value and market value of securities. The central bank has the power to change the margins, which limits the amount of loan to be sanctioned by the commercial banks. As obvious, during inflation higher margin would be fixed while during deflation, lower margin would be fixed.
2. *Regulation of consumer credit:* Customer gets this type of foreign exchange reserves and exchange value of the rupee in relation to other country's currencies. Currencies should be exchanged only with RBI or its authorized banks.
3. *Credit rationing:* It is a method of regulating and controlling purpose for which credit is guaranteed by the commercial bank. It may be of two types:

   (a) Variable portfolio ceilings: In this method, the central bank fixes a maximum amount of loans and advances for every commercial bank.

   (b) Variable capital assets ratio: In this method, the central bank fixes a ratio, which the capital of the commercial bank must bear to the total assets of the bank. By changing these ratio the credit can be regulated.

4. *Moral suasion:* This is a gracious method followed by RBI. In this method the RBI gives advices and suggestions to the bankers to follow the instructions given by it, by sending letters and conducting meeting of the Board of Directors.
5. *Direct action:* To regulate the volume of bank loans the central bank may issue directives to the commercial banks from time to time. The directives may be in the form of oral or written statements or appeals or warnings. By means of these directives the RBI may decrease or increase the volume of credit.

- ***Bank of Issue***

  Under Section 22 of the Reserve Bank of India Act, the Bank has the sole right to issue bank notes of all denominations.

  The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the Banking Department. Originally, the assets of the Issue Department were to consist of not less than two-fifths of gold coin, gold bullion or sterling securities provided the amount of gold was not less than 40 crores in value. The remaining three-fifths of the assets might be held in rupee coins, Government of India rupee securities, eligible bills of exchange and promissory notes payable in India. Due to the exigencies of the Second World War and the post-war period, these provisions were considerably modified. Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of 200 crores, of which at least 115 crores should be in gold. The system as it exists today is known as the minimum reserve system.

- ***Banker to Government***

  The second important function of the Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank is agent of Central Government and of all State Governments in India excepting that of Jammu and Kashmir. The Reserve Bank has the obligation to transact Government business, via. to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the Government and to carry out their exchange remittances and other banking operations. The Reserve Bank of India helps the Government - both the Union and the States to float new loans and to manage public debt. The Bank makes ways and means advances to the Governments for 90 days. It makes loans and advances to the States and local authorities. It acts as adviser to the Government on all monetary and banking matters.

- ***Bankers' Bank and Lender of the Last Resort***

  The Reserve Bank of India acts as the bankers' bank. According to the provisions of the Banking Companies Act of 1949, every scheduled bank was required to maintain with the Reserve Bank a cash balance equivalent to 5% of its demand liabilities and 2 per cent of its time liabilities in India. By an amendment of 1962, the distinction between demand and time liabilities was abolished and banks have been asked to keep cash reserves equal to 3 per cent of their aggregate deposit liabilities. The minimum cash requirements can be changed by the Reserve Bank of India.

The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities or get financial accommodation in times of need or stringency by rediscounting bills of exchange. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crisis the Reserve Bank becomes not only the banker's bank but also the lender of the last resort.

- ***Controller of Credit***

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank.

The Reserve Bank of India is armed with many more powers to control the Indian money market. Every bank has to get a licence from the Reserve Bank of India to do banking business within India, the licence can be cancelled by the Reserve Bank of certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank before it can open a new branch. Each scheduled bank must send a weekly return to the Reserve Bank showing, in detail, its assets and liabilities. This power of the Bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

As supreme banking authority in the country, the Reserve Bank of India, therefore, has the following powers:

1. It holds the cash reserves of all the scheduled banks.
2. It controls the credit operations of banks through quantitative and qualitative controls.
3. It controls the banking system through the system of licensing, inspection and calling for information.
4. It acts as the lender of the last resort by providing rediscount facilities to scheduled banks.

- ***Custodian of Foreign Reserves***

The Reserve Bank of India has the responsibility to maintain the official rate of exchange. According to the Reserve Bank of India Act of 1934, the Bank was required to buy and sell at fixed rates any amount of sterling in lots of not less than 10,000. After India became a member of the International Monetary Fund in 1946, the Reserve Bank has the responsibility of maintaining fixed exchange rates with all other member countries of the I.M.F.

Besides maintaining the rate of exchange of the rupee, the Reserve Bank has to act as the custodian of India's reserve of international currencies. Further, the RBI has the responsibility of administering the exchange controls of the country.

- ***Supervisory Functions***
  In addition to its traditional central banking functions, the Reserve bank has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India. The Reserve Bank Act, 1934, and the Banking Regulation Act, 1949 have given the RBI wide powers of supervision and control over commercial and co-operative banks, relating to licensing and establishments, branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction, and liquidation.
  The supervisory functions of the RBI have helped a great deal in improving the standard of banking in India to develop on sound lines and to improve the methods of their operation.

- ***Publication of Data***
  The Reserve Bank of India collects data related to all economic matters such as finance, production, balance of payments, prices etc. and are published in the form of reports, bulletins etc.

- ***Bank of Central Clearance***
  The Reserve Bank of India acts as a bank of central clearance in settling the mutual accounts of commercial banks. If there is no RBI branch to do this service, the State Bank of India discharges these functions.

B) Security and Exchange Board of India (SEBI)

SEBI is the Regulator for the Securities Market in India. The Securities and Exchange Board of India was established in 1988 and was given the statutory status on April, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.

Section 11 of the Act lays down that it shall be the duty of the board to protect the interests of the investors in securities and to promote the development of and to regulate the securities markets by such measures as it thinks fit. These measures would include:

- Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities market in any manner.
- Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the board may, by notification, specify in the behalf.
- Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.
- Promoting and regulating self-regulatory organizations.

- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Promoting investors education and training of intermediaries of securities markets.
- Prohibiting insider trading in securities.
- Regulating substantial acquisition of shares and takeover of companies.
- Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organizations in the securities market.
- Performing such functions and exercising such powers under the provisions of the Securities Contracts Act, 1956, as may be delegated to it by the Central Government.
- Levying fees or other charges for carrying out the purposes of this section.
- Conduction research for the above purposes.
- Calling from or furnishing to any such agencies, as may be specified by the board, such information as may be considered necessary by it for the efficient discharge of its functions.
- Performing such other functions as may be prescribed.

C) National Bank for Agriculture and Rural Development (NABARD)

National Bank for Agriculture and Rural Development, more popularly known as NABARD was established by an Act of Parliament on 12th July 1982 to implement the National Bank for Agriculture and Rural Development Act, 1981.

The main objectives of the NABARD as stated in the statement of objectives while placing the bill before the Lok Sabha were categorized as under:

- The National Bank will be an apex organisation in respect of all matters relating to policy, planning operational aspects in the field of credit for promotion of Agriculture, Small Scale Industries, Cottage and Village Industries, Handicrafts and other rural crafts and other allied economic activities in rural areas.
- The bank will serve as a refinancing institution for institutional credit such as long-term, short-term for the promotion of activities in the rural areas.
- The bank will also provide direct lending to any institution as may be approved by the Central Government.
- The bank will have organic links with the Reserve Bank and maintain a close link with in.

Its mission includes promoting sustainable and equitable agriculture and rural development through effective credit support, related services, institution building and other innovative initiatives.

D) Non-banking Financial Companies (NBFC’s)

The Reserve Bank of India defines a non-banking financial company as, "A Non-banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by Government or local authority or other securities of like marketable nature, leasing, hirepurchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property. A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme or arrangement or any other manner, or lending in any manner is also a non-banking financial company.

Non-banking financial companies frequently acts as:

- Suppliers of loans and credit facilities,
- Supporting investments in property,
- Trading money market instruments,
- Funding private education,
- Wealth management such as managing portfolios of stocks and shares and underwrite stock and shares, TFCs and other obligations,
- Retirement planning,
- Advise companies in merger and acquisition,
- Prepare feasibility, market or industry studies for companies,
- Discounting services e.g., discounting of instruments.

However they are not allowed to take demand deposits from the general public and consequently have to find other means of funding their operations such as issuing debt instruments.

E) State Industries Development Bank of India (SIDBI)

SIDBI was established on April 2, 1990. The Charter establishing it, The Small Industries Development Bank of India Act, 1989 envisaged SIDBI to be "the principal financial institution for the promotion, financing and development of industry in the small scale sector and to co-ordinate the functions of the institutions engaged in the promotion and financing or developing industry in the small scale sector and for matters connected therewith or incidental thereto".

SIDBI was established to empower the Micro, Small and Medium Enterprises (MSME) sector with a view to contributing to the process of economic growth, employment generation and balanced regional development.

The business domain of SIDBI consists of small scale industrial units, which contribute significantly to the national economy in terms of production, employment and exports. Small scale industries are the industrial units in which the investment in plant and machinery does not exceed Rs10 million.

The vision of SIDBI is to emerge as a single window for meeting the financial and developmental needs of the MSME sector to make it strong, vibrant and globally competitive, to position SIDBI Brand as the preferred and customer-friendly institution and for enhancement of share-holder wealth and highest corporate values through modern technology platform four basic objectives are set out in the SIDBI Charter. They are:

- Financing
- Promotion
- Development
- Co-ordination

F) Insurance Regulatory and Development Authority (IRDA) and Insurance Companies

Insurance may be described as a social device to reduce or eliminate risk of life and property. Under the plan of insurance, a large number of people associate themselves by sharing risk, attached to individual. The risk, which can be insured against include fire, the peril of sea, death, incident, & burglary. Any risk contingent upon these may be insured against at a premium commensurate with the risk involved.

Insurance is actually a contract between 2 parties whereby one party called insurer undertakes in exchange for a fixed sum called premium to pay the other party happening of a certain event. Insurance is a contract whereby, in return for the payment of premium by the insured, the insurers pay the financial losses suffered by the insured as a result of the occurrence of unforeseen events.

With the help of insurance, large number of people exposed to a similar risk make contributions to a common fund out of which the losses suffered by the unfortunate few, due to accidental events, are made good.

IRDA:
The mission of IRDA is to protect the interests of the insurance policyholders and to regulate, promote and ensure orderly growth of the insurance industry. This required effective legislation. Therefore, in 1999, the governing legal framework was significantly strengthened with the enactment of the Insurance Regulatory and Development Authority (IRDA) Act.

Role of IRDA:
Insurance regulator IRDA was set up as there felt the need:

- To set up an independent regulatory body, that provides greater autonomy to insurance companies in order to improve their performance.
- To enable the insurance companies to act as independent companies with economic motives.
- To protect the interest of holders of insurance policies.
- To amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalisation) Act, 1972.
- To end the monopoly of the Life Insurance Corporation of India and General Insurance Corporation and its subsidiaries

G) Asset Management Company (AMC):

Asset management companies (AMCs) are firms pooling investments from various individual and institutional investors. The company manages the investment by investing in capital assets such as stocks, real estate, bonds, and so on. The asset management companies have professionals called fund managers who decide where the pooled money is invested. Fund managers identify the investment options that are in line with the objectives of the investors.

The fund manager first evaluates various metrics such as market and industry risks, before making a decision that is in line with the investment goals. For instance, a debt fund invests mostly in bonds and government securities to keep the risks minimal. But an equity fund mainly focuses on equities (shares) of companies. The ultimate aim here is to make profitable investment decisions that will give investors maximum returns.

H) Merchant Banking:

In banking, a merchant bank is a financial institution primarily engaged in offering financial services and advice to corporations and to wealthy individuals. A merchant bank can be defined as a bank that deals mostly in (but is not limited to) international finance, long-term loans for companies and underwriting. Merchant banks do not provide regular banking services to the general public. Their knowledge in international finances make merchant banks specialists in dealing with Notes multinational corporations.

A merchant bank deals with the commercial banking needs of international finance, long term company loans, and stock underwriting. A merchant bank does not have retail offices where one can go and open a savings or checking account. A merchant bank is sometimes said to be a wholesale bank, or in the business of wholesale banking. This is because merchant banks tend to deal primarily with other merchant banks and other large financial institutions.

Functions of merchant banking:

- Project Counselling
- Issue Management
- Underwriting Public Issue
- Managers, Consultants or Advisors to the Issue
- Portfolio Management
- Advisory Service relating to Mergers and Takeovers
- Off-shore Finance
- Non-resident Investment
- Loan Syndication
- Corporate Counselling

There are various other financial regulators/ institutions like:

- Commercial Banks
- Regional Rural Banks
- Venture Capital

- Industrial Finance Corporation of India
- State Finance Corporation

3.4. Key Economic Terms

A) Inflation

Inflation refers to the rise in the prices of most goods and services of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc. Inflation measures the average price change in a basket of commodities and services over time.

In India, inflation is primarily measured by two main indices — WPI (Wholesale Price Index) and CPI (Consumer Price Index), which measure wholesale and retail-level price changes, respectively. The CPI calculates the difference in the price of commodities and services such as food, medical care, education, electronics etc, which Indian consumers buy for use.
On the other hand, the goods or services sold by businesses to smaller businesses for selling further is captured by the WPI. In India, both WPI (Wholesale Price Index) and CPI (Consumer Price Index) are used to measure inflation.

The main causes of inflation in India have been subject to considerable debates and discussions. These are some of the chief reasons for the increase in prices:

- High demand and low production or supply of multiple commodities create a demand-supply gap, which leads to a hike in prices.
- Excess circulation of money leads to inflation as money loses its purchasing power.
- With people having more money, they also tend to spend more, which causes increased demand.
- Spurt in production prices of certain commodities also causes inflation as the price of the final product increases. This is called cost-push inflation.
- Increase in the prices of goods and services is also a factor to consider as the involved labour also expects and demands more costs/wages to maintain their cost of living. This spirals to further increase in the prices of goods.

B) Gross Domestic Product (GDP)

GDP measures the total value of all final goods and services produced within a country's borders during a period of time. GDP is one of the most widely used tools to measure a country's economy, and it is calculated by countries themselves as well as occasionally by world organizations such as the World Bank, the International Monetary Fund, and the United Nations.

There are three different ways that economists and statisticians can calculate a country's GDP and they should all, theoretically, produce the same number:

1. **Expenditures**. This is the value of everything that is purchased within the country plus that country's net exports to other countries.

2. **Income**. This is the income of all the individuals and businesses within the country. Also called domestic income.
3. **Production**. This is the market value of everything that is produced within the country.

There are four different types of GDP and it is important to know the difference between them, as they each show different economic outlooks.

- **Real GDP:** Real GDP is a calculation of GDP that is adjusted for inflation. The prices of goods and services are calculated at a constant price level, which is usually set by a predetermined base year or by using the price levels of the previous year. Real GDP is considered the most accurate portrayal of a country's economy and economic growth rate.
- **Nominal GDP**: Nominal GDP is calculated with inflation. The prices of goods and services are calculated at current price levels.
- **Actual GDP:** Actual GDP is the measurement of a country's economy at the current moment in time.
- **Potential GDP**: Potential GDP is a calculation of a country's economy under ideal conditions, like a steady currency, low inflation, and full employment.

C) Balance of Payments

The balance of payments is the record of all international trade and financial transactions made by a country's residents. A country's balance of trade refers to the difference of how much a country is importing versus exporting. A country's balance of payments tells you whether it saves enough to pay for its imports. It also reveals whether the country produces enough economic output to pay for its own growth.

A balance of payments deficit means the country imports more goods, services and capital than it exports. It must borrow from other countries to pay for its imports. A balance of payments surplus means the country exports more than it imports. It provides enough capital to pay for all domestic production. The country might even lend outside its borders.

The balance of payments has three components.

- **Current Account:** The current account measures a country's trade balance plus the effects of net income and direct payments. When the activities of a country's people provide enough income and savings to fund all their purchases, business activity, and government infrastructure spending, then the current account is in balance.
- **Financial Account:** The financial account measures changes in domestic ownership of foreign assets and foreign ownership of domestic assets. If foreign ownership increases more than domestic ownership does, it creates a deficit in the financial account. This means the country is selling off its assets, like gold, commodities, and corporate stocks, faster than it is acquiring foreign assets.
- **Capital Account:** The capital account measures financial transactions that don't affect a country's income, production, or savings. For example, it records international

transfers of drilling rights, trademarks, and copyrights. Many capital account transactions happen infrequently, such as cross-border insurance payments. The capital account is the smallest component of the balance of payments.

D) Repo Rate

Repo rate refers to the rate at which commercial banks borrow money by selling their securities to the Central bank of our country i.e Reserve Bank of India (RBI) to maintain liquidity, in case of shortage of funds or due to some statutory measures. It is one of the main tools of RBI to keep inflation under control.

When you borrow money from the bank, the transaction attracts interest on the principal amount. This is referred to as the cost of credit. Similarly, banks also borrow money from RBI during a cash crunch on which they are required to pay interest to the Central Bank. This interest rate is called the repo rate.

Technically, repo stands for ‘Repurchasing Option’ or ‘Repurchase Agreement’. It is an agreement in which banks provide eligible securities such as Treasury Bills to the RBI while availing overnight loans. An agreement to repurchase them at a predetermined price will also be in place. Thus, the bank gets the cash and the central bank the security.

Repo rate is a powerful arm of the Indian monetary policy that can regulate the country’s money supply, inflation levels, and liquidity. Additionally, the levels of repo have a direct impact on the cost of borrowing for banks. Higher the repo rate, higher will be the cost of borrowing for banks and vice-versa.

- **Rise in inflation: During high levels of inflation, RBI makes strong attempts to bring down the flow of money in the economy. One way to do this is by increasing the repo rate. This makes borrowing a costly affair for businesses and industries, which in turn slows down investment and money supply in the market. As a result, it negatively impacts the growth of the economy, which helps in controlling inflation.**

- **Increasing Liquidity in the Market:** On the other hand, when the RBI needs to pump funds into the system, it lowers the repo rate. Consequently, businesses and industries find it cheaper to borrow money for different investment purposes. It also increases the overall supply of money in the economy. This ultimately boosts the growth rate of the economy.

E) Reverse Repo Rate

Reverse Repo Rate is a mechanism to absorb the liquidity in the market, thus restricting the borrowing power of investors.

Reverse Repo Rate is when the RBI borrows money from banks when there is excess liquidity in the market. The banks benefit out of it by receiving interest for their holdings with the central bank.

During high levels of inflation in the economy, the RBI increases the reverse repo. It encourages the banks to park more funds with the RBI to earn higher returns on excess funds. Banks are left with lesser funds to extend loans and borrowings to consumers.

F) Cash Reserve Ratio (CRR)

Cash reserve ratio (CRR) is generally defined as a particular minimum amount of deposits that needs to be maintained as a reserve by every commercial bank in India according to the requirement of the RBI. The CRR will be fixed as per the rules and regulations of the RBI.

Need for CRR

The Reserve Bank of India constantly works towards monitoring the cash flow in the entire economy of the nation. It has several monetary tools and instruments in order to control and manage the economy in terms of different aspects. One of these important monetary instruments is the cash reserve ratio. The RBI wants every bank in India to adhere to the specific CRR rules provided to each bank.

When every bank maintains the necessary CRR, the overall liquidity will be administered and managed thoroughly. This, in turn, will benefit each bank also. A bank will always have the right amount of cash and not fall short of funds when depositors or customer require funds for their various personal needs. This is a very good advantage for any bank’s operations.

However, one needs to note that when the CRR maintained with the RBI is high, the liquidity will be low in the economic system. It works vice versa wherein the lower the CRR maintained with the RBI, the higher will be the overall liquidity of the financial system.

Effects of CRR

- **Effect on interest rates:** When the cash reserve ratio is decreased by the RBI, banks will have more money to invest in other businesses since the amount of funds that needs to be kept with the RBI is low. This shows that banks will have an excess of funds and hence, there will be a decline in the interest rates that are charged on loans.
- **Effect on inflation:** When the cash reserve ratio is minimised, commercial banks will have more funds and hence, the money supply of the banking system will increase. When there is a rise in the money supply, excessive funds will result in high inflation.

When the CRR is minimised, funds are drawn out from the economic system excessively and then the money supply is affected negatively wherein there is a shortage of funds. Since the money supply has declined in this situation, the inflation also reduces.

G) Statutory Liquidity Ratio (SLR)

In Indian banking terms, statutory liquidity ratio (SLR) refers to the minimum reserve requirement that needs to be maintained by commercial banks in the nation. This term is used by the Indian government. The word 'statutory' indicates that it is mandatorily and legally required. The Reserve Bank of India (RBI) Act states that every commercial bank in India has to keep a certain amount of time deposits as well as demand deposits as liquid assets in its independent and own vault.

In the case of statutory liquidity ratio, these assets can be gold, cash, securities that are approved by the Indian government, etc. Apart from these assets, securities that are sanctioned under market stabilisation schemes (MSS) as well as market borrowing programmes, and treasury bills are included in the statutory liquidity ratio. Every bank must maintain this particular SLR as it assists in the process of increasing bank credit.

Need for SLR

The fundamental justification for laying the Statutory Liquidity Ratio (SLR) by the Reserve Bank of India is cautiousness. In any financial activity, it is very important to be cautious and wary. Any bank in the world functions with a chief principle and that is to collect deposits from the public and then guarantee to offer customers with funds at par or more. However, this is a very risky activity for every bank. In order to protect the risk of each bank and to reduce their risk rate, the Reserve Bank of India makes it mandatory that each and every bank deploys at least one small part of its funds with the RBI so that its funds are safe in the hands of the most secure entity in the form of the most secure assets.

Many tend to wonder how the SLR helps in enhancing the economy. It is an amazing direct monetary instrument that has assisted the Indian government from time to time in selling its debt instruments as well as securities to banks. It has promoted and uplifted the debt management programme of the government. The programme is designed to help banks offer first-class loans to all sectors in the country.

The SLR also aims at minimising the holdings of commercial banks in government securities and slowly move towards private security holdings. The securities associated with SLR are securities that are free of risks.

CRR Vs SLR

Basis For Comparison	CRR	SLR
Meaning	CRR is the percentage of money which the bank has to keep with the Central Bank of India in the form of cash.	The bank has to keep a certain percentage of their Net Time and Demand Liabilities in the form of liquid assets as specified by RBI.
Reserves in the Form of	Cash	Cash and other assets like gold and government securities viz. Central and State government securities.
Effect	It controls excess money flow in the economy.	It helps in meeting out the unexpected demand of any depositor by selling the bonds.
Maintained with	RBI	Bank itself
Regulates	Liquidity in the economy	Credit growth in the economy
Interest on Reserve	Banks don’t earn any interest on amount deposited in CRR	Banks can earn interest on SLR

4. MODULE 4: GOVERNMENT INVESTMENT AND INSURANCE SCHEMES

4.1. Government Investment Schemes

There are various schemes launched by the Government of India that help in strengthening the financial stability of the people. All these schemes are known for their long-term benefits, attractive interest rates and tax exemption.

Mentioned below are some of the top investment schemes that are best suited for the citizens of India:

A) Public Provident Fund (PPF)

Public Provident Fund (PPF) was introduced in India in 1968 with the objective to mobilize small saving in the form of an investment, coupled with a return on it. It can also be called a savings-cum-tax savings investment vehicle that enables one to build a retirement corpus while saving on annual taxes. Anyone looking for a safe investment option to save taxes and earn guaranteed returns should open a PPF account.

- ***What is a PPF account?***

Public Provident Fund(PPF) scheme is a long term investment option which offers an attractive rate of interest and returns on the amount invested. The interest earned and the returns are not taxable under income Tax. One has to open an PPF account under this scheme and the amount deposited during a year will be claimed under section 80C deductions.

- ***How to open a PPF account?***

A PPF account can be opened with either a Post Office or with any nationalized bank like the State Bank of India or Punjab National Bank, etc. These days, even certain private banks like ICICI, HDFC and Axis Bank among others are authorized to provide this facility. You need to submit the duly filled application form along with the required documents i.e. the KYC documents like identity proof, address proof, and signature proof. Post submitting these documents you can deposit a prescribed amount towards the opening of the account.

- ***What is the interest rate on PPF?***

The current interest rate is 7.1% (for quarter April to June 2020 prior to which it was 7.9%) that is compounded annually. The Finance Ministry set the interest rate every year, which is paid on 31st March. The interest is calculated on the lowest balance between the close of the fifth day and last day or every month.

The Interest Rate is reviewed quarterly by the government, so be informed about any changes regarding the same

- ***Essential features of PPF***
  - ***Tenure:*** The PPF has a minimum tenure of 15 years, which can be extended in blocks of 5 years as per your wish.

  - ***Investment Limits:*** PPF allows a minimum investment of Rs 500 and a maximum of Rs 1.5 lakh for each financial year. Investments can be made in lump sum or in a maximum of 12 instalments.

  - ***Opening Balance:*** The account can be opened with just Rs 100. Annual investments above Rs 1.5 lakh will not earn interest and will not be eligible for tax saving.

  - ***Deposit Frequency:*** Deposits into a PPF account has to be made at least once every year for 15 years.

  - ***Mode of deposit:*** The deposit into a PPF account can be made either by way of cash, cheque, Demand Draft or through an online fund transfer.

  - ***Nomination:*** A PPF account holder can designate a nominee for his account either at the time of opening the account or subsequently.

  - ***Joint accounts:*** A PPF account can be held only in the name of one individual. Opening an account in joint names is not allowed.

  - ***Risk factor:*** Since PPF is backed by the Indian government, it offers guaranteed, risk-free returns as well as complete capital protection. The element of risk involved in holding a PPF account is minimal.

  - ***Who can invest in PPF:*** Any Indian citizen can invest in PPF. One citizen can have only one PPF account unless the second account is in the name of a minor. NRIs and HUFs are not eligible to open a PPF account.

  - ***Loan against PPF:*** You can take a loan against your PPF account between the 3rd and 5th year. The loan amount can be a maximum of 25% of the 2nd year immediately preceding the loan application year. A second loan can be taken before the 6th year if the first loan is repaid fully.

- ***PPF withdrawal***

As a rule, one can close a PPF account only upon maturity i.e. after the completion of 15 years. Upon completion of 15 years, the entire amount standing to the credit of an account holder in the PPF account along with the accrued interest can be withdrawn freely and the account can be closed.

However, if account holders are in need of funds, and wish to withdraw before 15 years, the scheme permits partial withdrawals from year 7 i.e. on completing 6 years.

An account holder can withdraw prematurely, up to a maximum of 50% of the amount that is in the account at the end of the 4th year (preceding the year in which the amount is withdrawn or at the end of the preceding year, whichever is lower). Further, withdrawals can be made only once in a financial year.

- ***What are the tax benefits of investing in PPF?***

PPF is one investment vehicle that falls under the Exempt-Exempt-Exempt (EEE) category. This, in other words, means that all deposits made in the PPF are deductible under Section 80C of the Income Tax Act. Furthermore, the accumulated amount and interest is also be exempt from tax at the time of withdrawal.

It is important to note that a PPF account cannot be closed before maturity. A PPF account, however, can be transferred from one point of designation to another. But, do remember that a PPF account cannot be closed prematurely. Only in the case of the account holder’s demise can the nominee’s file for the closure of the account.

B) Sukanya Samriddhi Yojana:

As part of the Beti Bachao Beti Padhao Campaign, Prime Minister Narendra Modi launched a scheme called ‘Sukanya Samriddhi Yojana (SSY)’, the campaign literally translates to ‘Girl Child Prosperity Scheme’ in line with the above objectives.

SSY aims at tackling a major problem associated with the girl child – education and marriage. It is focused on securing a bright future for the girl child in India by facilitating the parents of a girl child in building a fund for the proper education and a carefree marriage expenses of their child. SSY has introduced the Sukanya Samriddhi Account for this very purpose.

- ***What are its rules?***

Particulars	**Provisions as per the SSY Rules 2016**
Who would be the beneficiary of the SSY account?	▪ Any girl child who is a resident Indian, from the time of opening the account, till the time of maturity/closure
Who can open the account?	▪ Parents or legal guardian of a girl child who has not attained the age of 10 years, can open the account

Who can deposit and operate the account?	▪ Either the guardian or the girl child (if she has attained the age of 10 years) may deposit the amount and operate the account ▪ The account shall be mandatorily operated by the girl child after she attains the age of 18 years.
Number of accounts	▪ Only one account per girl child ▪ Accounts can be opened for a Maximum of two girl children in one family, (including adopted children) ▪ Accounts for more than two girl children are allowed in case of more than two girls being born in the first order of birth, or in a scenario of one girl child in the first order of birth, and twins or more than twins in the second order of birth
Where can an SSA account be opened?	▪ In any post office or authorized branch of commercial banks
When can an SSA account be opened?	▪ Any time between the birth of the girl child till the time she attains the age of 10 years
Deposit threshold and tenure	▪ Minimum of Rs 250 (this amount was previously Rs 1,000), and a maximum of Rs 1,50,000 in every financial year, up to 15 years ▪ Multiples of Rs 100, subject to the above cap
Mode of Deposit	▪ Through cash, cheque, demand draft or online transfer
Interest on deposits	▪ The rate of interest for the 1st quarter of FY 2020-21 i.e. 1 April 2020 to 30th June 2020 has gone down from 8.4% to 7.6% ▪ The entire deposit in 'Account under default' (where a minimum amount of Rs 250 has not been deposited), which is not regularised within the prescribed time, would earn interest on the post savings bank account; except if the default is due to the death of the guardian who opened the Account ▪ No interest is payable after the completion of tenure of the SSY, i.e after 21 years from account opening

	▪ No interest accrues after the girl child becomes a non-citizen or a non-resident of India
Consequences of excess or short deposit	▪ Excess – Any deposit above the maximum cap will not earn any interest and can be withdrawn anytime by the depositor ▪ Shortage – Account shall be considered as 'Account under default' if no minimum deposit is made in a financial year, and can be regularised within 15 years of Account opening on payment of a penalty of Rs 50 per default year
Tenure of SSA	▪ 21 years from the account opening date
Rules pertaining to the closure of SSA	▪ Closure on maturity ▪ Account matures after completion of tenure of 21 years and the balance in the SSA, including interest, is paid to the child on submitting an application and proof of identity, residence, and citizenship documents ▪ Premature Closure Allowed only in the following situations: ➢ Reasons of intended marriage after a girl child attains the age of 18 years, an application can be submitted between one month prior to marriage and 3 months after marriage along with her age proof documents ➢ Death of the girl child on the production of the death certificate the balance in the SSA will be paid to the guardian ➢ Deemed closure in case of a change in the status of girl child i.e., girl child either becomes a non-resident or a non-citizen of India. Such a status change shall be communicated by the girl child or her guardian within one month of the status change ➢ After completion of 5 years from the opening of an SSA, if the post office or Bank is satisfied that the operation or the continuation of the SSA is causing undue hardship to the girl child (such as the death of the guardian, medical reasons of the girl child), the girl child or guardian may order for premature closure

	➢ For any other reasons, if the SSA is to be closed anytime after the opening of this account, it will be permitted, but the entire deposit would only earn an interest rate applicable to post office savings bank
Withdrawal	▪ This is allowed for purposes of higher education if the girl child has either attained 18 years or completed 10th standard of school, for meeting the actual fee or other charges required at the time of admission ▪ Documentary proof by way of a confirmed offer of admission in an educational institution, or a fee slip shall accompany the application for withdrawal ▪ Withdrawal has a maximum cap of 50% of the balance in the SSA at the end of the preceding financial year. This can be made in either one lump sum or in 5 installments
Transfer of balance of the SSA	▪ Balance in the SSA can be transferred anywhere in India – from or to post offices, from or to banks, and between post offices and banks free of cost. This can be done upon furnishing of proof of change of residence of either the guardian or the girl child. Under any other circumstance, such a transfer can be made by paying a fee of Rs 100.

- **What are the tax benefits provided to SSY?**

In order to encourage investments in SSY, the SSA has also been provided with certain tax benefits:

- Investments made in the SSY scheme are eligible for deductions under Section 80C, subject to a maximum cap of Rs 1.5 lakhs.
- The interest that accrues against this account which gets compounded annually is also exempt from tax.
- The proceeds received upon maturity/withdrawal are also exempt from income tax.

C) National Savings Certificate (NSC)

The National Savings Certificate is a fixed income investment scheme that you can open with any post office. A Government of India initiative, it is a savings bond that encourages subscribers (mainly small to mid-income investors) to invest while saving on income tax.

Individuals mainly use NSC for small and medium investments as well as for tax-saving purposes. Similar to a fixed income instrument like Public Provident Fund and Post Office FDs, this scheme too is a secure and low-risk product.

- ***Who Should Invest in NSC?***

Anyone who is looking for a safe investment avenue to save taxes while earning a steady income can opt for this scheme. The NSC offers guaranteed interest and complete capital protection. However, like most fixed income schemes, they cannot deliver inflation-beating returns like tax-saving mutual funds and National Pension System. The government has made it easily accessible for prospective investors by making it available in post offices. Let us also clarify as to who can and cannot invest in this scheme, while at it. Basically, the Government has promoted the National Savings Certificate as a savings scheme for individuals. Hence, Hindu Undivided Families (HUFs) and trusts cannot invest in it. Furthermore, even non-resident Indians (NRI) cannot purchase NSC certificates. The scheme is open to only Indian individual citizens.

- ***Features & Benefits of NSC***
  - ***Fixed income:*** Presently, you get guaranteed returns (6.8% annual interest) and can enjoy a regular income.

  - ***Types:*** The scheme originally had two types of certificates – NSC VIII Issue and NSC IX Issue. The Government discontinued NSC IX Issue in December 2015. So, only the NSC VIII Issue is open for subscription currently.

  - ***Tax saver:*** As a government-backed tax-saving scheme, you can invest for up to Rs 1.5 lakhs to claim the benefits of 80C deductions.

  - ***Start small:*** You can invest as small as Rs. 100 (or multiples of 100) as an initial investment, and increase the amount when feasible.

  - ***Interest rate:*** Currently, the rate of interest 6.8% annually – the government revises this rate every quarter.

  - ***Maturity period:*** There are two maturity periods to choose from: 5 years and 10 years. (However 10 year maturity period certificate has been discontinued)

  - ***Loan collateral:*** Banks and NBFCs accept NSC as a collateral or security for secured loans.

  - ***Power of compounding:*** Interest gets compounded and reinvested by default, though the returns do not beat inflation.

  - ***Nomination:*** An investor can nominate a family member (even a minor) so that they can inherit it in the unfortunate event of the investor’s demise.

- ***Corpus after maturity:*** Upon maturity, you will receive the entire maturity value. Since there is no TDS on NSC payouts, the subscriber should pay the applicable tax on it.

- ***Premature withdrawal:*** Generally, one cannot exit the scheme early. However, they accept it in exceptional cases like the death of the investor or with a court order.

- ***Tax benefits of NSC investment***

Investments of up to Rs 1.5 lakh in the National Savings Certificate can earn the subscriber a tax rebate under Section 80C. Furthermore, the interest earned on the certificates are also added back to the initial investment and qualify for a tax break as well.

For instance, if you purchase certificates worth Rs. 1000, you are eligible for a tax respite on that initial investment amount in the first year. But in the second year, you can claim a tax deduction on the NSC investment(s) that year as well as the interest earned in the first year. This is because the interest is added to the original investment and compounded annually.

D) Atal Pension Yojana

Atal Pension Yojana is a pension scheme mainly aimed at the unorganized sector such as maids, gardeners, delivery boys, etc. The goal of the scheme is to ensure that no Indian citizen has to worry about any illness, accidents or diseases in old age, giving a sense of security. Private sector employees or employees working with such an organization that does not provide them pension benefit can also apply for the scheme. There is an option of getting a fixed pension of Rs 1000, Rs 2000, Rs 3000, Rs 4000, or Rs 5000 on attaining an age of 60.

The pension will be determined based on the individual's age and the contribution amount. The contributor's spouse can claim the pension upon the contributor's death and upon the death of both the contributor and his/her spouse, the nominee will be given the accumulated corpus. However, if the contributor dies before completing 60 years of age, the spouse is also given an option to either exit the scheme and claim the corpus or continue the scheme for the balance period. As per the investment pattern laid down by the government of India, the collected amount under the scheme is to be managed by the Pension Funds Regulatory Authority of India ("PFRDA").

- ***Eligibility:***
  - To avail benefits from the Atal Pension Yojana, you must fulfil the below requirements:
  - Must be a citizen of India.
  - Must be between the age of 18-40
  - Should make contributions for a minimum of 20 years.
  - Must have a bank account linked with your Aadhar
  - Must have a valid mobile number

Those who are availing benefits of Swavalamban Yojana will be automatically migrated to Atal Pension Yojana.

- ***Important Facts to know about APY:***
    - Since you will be making periodic contributions, the amounts will be debited automatically from your account. You need to make sure that you have sufficient balance in your account before each debit.
    - You can increase your premium at your will. You just have to visit your bank and talk to your manager and make the necessary changes.
    - In case you default on your payments, a penalty will be levied. A penalty of Rs. 1 per month for a contribution of every Rs. 100 or part thereof.
    - In case you default on your payments for 6 months, your account will be frozen and if the default continues for 12 months, the account will be closed and the remaining amount will be paid to the subscriber.
    - Early withdrawal is not entertained. Only in cases like death or terminal illness, the subscriber, or his/her nominee will receive the entire amount back.
    - In the event that you close the scheme before the age of 60 for any other reason, only your contribution plus interest earned will be returned. You will not be eligible to receive the government's co-contribution or the interest earned on that amount.
- ***Monthly Contributions:***

The monthly contribution depends upon the amount of pension you want to receive upon retirement and also the age at which you start contributing. The following table tells you how much you need to contribute per annum based on your age and pension plan.

ATAL PENSION YOJANA – Contribution Chart

		Minimum Guaranteed Pension of Rs. 1000/month			Minimum Guaranteed Pension of Rs.2000/month			Minimum Guaranteed Pension of Rs.3000/month			Minimum Guaranteed Pension of Rs.4000/month			Minimum Guaranteed Pension of Rs.5000/month		
Return of Corpus Amount to the Nominee		Rs. 1.7 Lakh			Rs. 3.4 Lakh			Rs. 5.1 Lakh			Rs. 6.8 Lakh			Rs. 8.5		
		CONTRIBUTIONS														
Age at entry	Vesting period	Monthly	Quarterly	Half Yearly	Monthly	Quarterly	Half Yearly	Monthly	Quarterly	Half Yearly	Monthly	Quarterly	Half Yearly	Monthly	Quarterly	Half Yearly
18	42	42	125	248	84	250	496	126	376	744	168	501	991	210	626	1239
19	41	46	137	271	92	274	543	138	411	814	183	545	1080	228	679	1346
20	40	50	149	295	100	298	590	150	447	885	198	590	1169	248	739	1464
21	39	54	161	319	108	322	637	162	483	956	215	641	1269	269	802	1588
22	38	59	176	348	117	349	690	177	527	1046	234	697	1381	292	870	1723
23	37	64	191	378	127	378	749	192	572	1133	254	757	1499	318	948	1877
24	36	70	209	413	139	414	820	208	620	1228	277	826	1635	346	1031	2042
25	35	76	226	449	151	450	891	226	674	1334	301	897	1776	376	1121	2219
26	34	82	244	484	164	489	968	246	733	1452	327	975	1930	409	1219	2414
27	33	90	268	531	178	530	1050	268	799	1582	356	1061	2101	446	1329	2632
28	32	97	289	572	194	578	1145	292	870	1723	388	1156	2290	485	1445	2862
29	31	106	316	626	212	632	1251	318	948	1877	423	1261	2496	529	1577	3122
30	30	116	346	685	231	688	1363	347	1034	2048	462	1377	2727	577	1720	3405
31	29	126	376	744	252	751	1487	379	1129	2237	504	1502	2974	630	1878	3718
32	28	138	411	814	276	823	1629	414	1234	2443	551	1642	3252	689	2053	4066
33	27	151	450	891	302	900	1782	453	1350	2673	602	1794	3553	752	2241	4438
34	26	165	492	974	330	983	1948	495	1475	2921	659	1964	3889	824	2456	4863
35	25	181	539	1068	362	1079	2136	543	1618	3205	722	2152	4261	902	2688	5323
36	24	198	590	1169	396	1180	2337	594	1770	3506	792	2360	4674	990	2950	5843
37	23	218	650	1287	436	1299	2573	654	1949	3860	870	2593	5134	1087	3239	6415
38	22	240	715	1416	480	1430	2833	720	2146	4249	957	2852	5648	1196	3564	7058
39	21	264	787	1558	528	1574	3116	792	2360	4674	1054	3141	6220	1318	3928	7778

E) Kisan Vikas Patra

Kisan Vikas Patra is a certificate scheme from the Indian post office. It doubles a one-time investment in a period of approximately 10 years & 4 months (124 months). For instance, a Kisan Vikas Patra for Rs. 5000 will get you a corpus of Rs. 10,000 postmaturity.

The minimum investment is Rs. 1000 and there is no upper limit. And if you invest a lumpsum today, you can get double the amount at the end of the 124th month. Initially, it was meant for farmers to enable them to save for long-term, and hence the name. Now it is available for all.

- ***Types of Certificates Available:***

A Kisan Vikas Patra certificate can be of the following types:

- Single Holder Type Certificate: This kind of certificate is issued to an adult for self or on behalf of a minor or to a minor.
- Joint 'A' Type Certificate: This type of certificate is issued jointly to two adults, payable to both the holders jointly or to the survivor.
- Joint 'B' Type Certificate: This type of certificate is issued jointly to two adults, payable to either of the holders or to the survivor.

- ***Features & benefits of Kisan Vikas Patra:***
  - ***Guaranteed returns:*** Regardless of the market fluctuations, you will get the sum guaranteed. As this scheme was originally intended for the farming community, the priority was to encourage them to save for rainy days.

  - ***Capital protection:*** It is a safe mode of investment and not subject to market risks. You will receive the investment and gains when the tenure ends.

  - ***Interest:*** The effective interest rate for Kisan Vikas Patra varies depending on the number of years invested in KVP at the time of purchase. The current interest rate is 6.9% prior to which the rate was 7.6%, compounded yearly.

  - ***Tenure:*** The maturity period for Kisan Vikas Patra is 124 months and you can avail the corpus then. The maturity proceeds of KVP will continue to accrue interest till you withdraw the amount.

  - ***Taxation:*** It doesn't come under the 80C deductions, and the returns are completely taxable. However, Tax Deducted at Source (TDS) is exempt from withdrawals after the maturity period.

  - ***Rules to premature withdrawal:*** You can withdraw the amount after 124 months. But the lock-in period is 30 months. Encashing the scheme early is not allowed, unless in the account holder's demise or court order.

  - ***Ease & affordability:*** KVP is available in denominations of Rs. 100, Rs. 500, Rs. 1000, Rs. 5000, Rs. 10,000 and also Rs. 50,000 for investment. There is no maximum limit.

Please note that denominations of Rs. 50,000 are available only at the head post office of a city.

- ***Loan against KVP certificate:*** You can use your KVP certificate as collateral or security to avail secured loans. The interest rate is comparatively lesser for such loans.

- ***Nomination facility:*** Collect a nomination form from the post office, and fill up the required information of the nominee. If you are nominating a minor, mention the date of birth.

- ***KVP Identity Slip:*** This includes the Kisan Vikas Patra Certificate, the KVP serial number, the amount, the maturity date and the amount to be received on the date of maturity.

F) Post Office Monthly Income Scheme (POMIS)

Post Office Monthly Income Scheme is a scheme in which you invest a certain amount and earn a fixed interest every month. As the name suggests, you can invest in this from any post office.

Post office offers POMIS among a host of banking products and services, under the purview of the Finance Ministry. Hence, it is highly reliable. It is a low-risk MIS and generates a steady income. You can invest up to Rs. 4.5 lakhs individually or Rs. 9 lakhs jointly, and the investment period is 5 years. Capital protection is its primary objective. For the quarter ending 31 June 2020, interest rate is 6.6% per annum, payable monthly.

For instance, if Sharma has invested Rs. 4.5 lakhs in the post office monthly investment scheme for 5 years. As mentioned above, the interest rate is 6.6%. His monthly income will be Rs. 2475 for that period. Post-maturity, he can withdraw his 4.5 lakhs, either from any post office or get it to his savings account via Electronic Clearance Service.

- ***Features & Benefits of Post Office Monthly Income Scheme***
  - ***Capital protection:*** Your money is safe until maturity as this is a government-backed scheme.

  - ***Tenure:*** The lock-in period for Post Office MIS is 5 years. You can withdraw the invested amount when the scheme matures or reinvest it.

  - ***Low-risk investment:*** As a fixed income scheme, the money you invested is not subject to market risks and is quite safe.

  - ***Start small:*** You can start with a nominal initial investment of Rs. 1500. As per your affordability, you can multiply this amount.

- ***Guaranteed returns:*** You earn income in the form of interest every month. The returns are not inflation-beating, but is higher compared to other fixed income investments like FD.

- ***Tax-efficiency:*** Though your post office investment doesn't fall under Section 80C and the income is subject to taxation. On the other hand, it has no TDS either.

- ***Eligibility:*** Only a resident Indian can open a POMIS account. NRIs cannot enjoy the benefits of this scheme. You can open it in your child's name too, provided he/she is aged 10 or above.

- ***Payout:*** You will receive the payout one month from making the first investment, and not the beginning of every month.

- ***Multiple account ownership:*** You can open more than one account in your name. But the total deposit amount cannot exceed Rs. 4.5 lakhs in all of them together.

- ***Joint account:*** You can open a joint account with 2 or 3 people. Regardless of who is contributing, it belongs to all account holders equally.

- ***Fund movement:*** The investor can move the funds to an RD (recurring deposit), which is a feature Post Office has added recently.

- ***Age:*** As mentioned above, you can start an account on behalf of a minor who is of age 10 and above. They can avail they fund when they become 18. However, the investment cannot exceed Rs. 3 lakhs for a minor. Minor after attaining majority has to apply for conversion of the account in his name.

- ***Nominee:*** The investor can nominate a beneficiary (a family member) so that they can claim the benefits and corpus if the investor passes away.

- ***Ease of money/interest transaction:*** You may collect the monthly interest directly from the post office or transfer it to your savings account. Reinvesting the interest in an SIP is also lucrative option.

- ***Transfer:*** In the event of shifting from one city to another, you can easily transfer your investment to your post office in the current city at no extra cost.

- ***Reinvestment:*** You may reinvest the corpus post maturity in the same scheme for another 5 years to get double benefits.

- ***Consequences of early withdrawal of the scheme***

Time of POMIS withdrawal	Outcome of premature withdrawal
If you withdraw before one year	Zero benefits
To close the account between 1st and 3rd year	The whole deposit refunded after 2% penalty
If you close the scheme between 3rd and 5th year	Entire corpus refunded with only 1% penalty

G) Senior Citizen Savings Scheme

The Senior Citizens Savings Scheme (SCSS) is primarily for the senior citizens of India. The scheme offers a regular stream of income with the highest of safety and tax saving benefits. It is an apt choice of investment for those over 60 years of age.

This is an effective and long-term saving option which offers security and added features that are usually associated with any government-sponsored savings or investment scheme. These schemes are available through certified banks and post offices across India.

- ***Eligibility for SCSS:***

The following people/groups are eligible to opt for SCSS:

- Senior citizens of India aged 60 years or above.
- Retirees who have opted for the Voluntary Retirement Scheme (VRS) or Superannuation in the age bracket 55-60. Here the investment has to be done within a month of receiving the retirement benefits.
- Retired defense personnel with a minimum age of 50 years.
- HUFs and NRIs are not allowed to invest in this scheme.

- ***Investment Amount:***

An individual can invest a maximum amount of Rs 15 lakhs, individually or jointly in an SCSS account (in multiples of Rs 1,000). The amount invested in the scheme cannot exceed the money that has been received on retirement. Hence, the individual can invest either Rs 15 lakhs or the amount received as a retirement benefit, whichever is lower.

- ***Benefits of investing in SCSS:***
  - ***Safe and Reliable:*** This is an Indian government-sponsored investment scheme and hence is considered to be one the safest and most reliable investment options.

- ***Simple and easy process:*** The process to open an SCSS account is simple and can be opened at any authorized bank or any post office in India. It is also transferable across India.

- ***Interest Rate:*** At 7.4 % the return rate is very good as compared to a savings or FD account.

- ***Nomination:*** Nomination facility is available at the time of opening an SCSS account by means of submitting an application as part of Form C. This submission is also accompanied by the passbook to the Branch.

- ***Tax benefits:*** Tax deduction of up to Rs 1.5 lakh can be claimed under Section 80C of the Indian Tax Act, 1961.

- ***Flexible:*** The tenure of this investment scheme is flexible with an average tenure of 5 years which can be extended up to 3 additional years.

- ***Tenure of the fund and withdrawal:***

The tenure of this scheme is 5 years with the option to extend it for 3 more years. In order to extend the scheme for another 3 years after the completion of the 5-year tenure, the investor is required to submit the duly filled Form B for the extension of the scheme. Only one extension is allowed, and such extended accounts can be closed after one year of extension without any penalty.

Premature withdrawals are allowed but only after a year of opening an account. If the closure of the account takes place after one year but before the end of 2 years, 1.5% of the deposit is deducted in the form of pre-mature withdrawal charges. Upon closure of the account after 2 years an amount equal to 1% of the deposit shall be deducted as charges.

In the event of the death of the depositor, no charges or penalty is levied for the premature closure of the account.

4.2. Government Insurance Schemes

Government supported insurance schemes are a form of social security in India. These schemes are initiated by the Government to provide protection to certain sections of population against income losses. The need for public support for these schemes arises from the fact that risk adjusted premium rates are often unaffordable for the weaker sections of the population to which the schemes are targeted and the Government needs to step in to provide financial support to facilitate the provisioning of insurance for these sections of population.

In India, a number of Government supported insurance schemes have been initiated over the last decade. A number of schemes that existed earlier have also been modified substantially. While some of these changes have taken place at the State level, the most important changes, in particular some of the largest insurance schemes in terms of implementation across the country have been initiated by the Central government.

A) Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY):

The Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) is a one year life insurance scheme, renewable from year to year, offering coverage for death due to any reason and is available to people in the age group of 18 to 50 years (life cover upto age 55) having a savings bank account who give their consent to join and enable auto-debit.

Under PMJJBY scheme, life cover of Rs. 2 lakhs is available for a one year period stretching from 1st June to 31st May at a premium of Rs.330/- per annum per member and is renewable every year. It is offered / administered through LIC and other Indian private Life Insurance companies. For enrolment banks have tied up with insurance companies.

- ***Features:***

<table>
<tr><td>Age at Entry</td><td colspan="3">Minimum: 18 years (Age last birthday)
Maximum: 50 years (Age nearest birthday)</td></tr>
<tr><td>Maximum Maturity Age</td><td colspan="3">55 years (Age nearest birthday)</td></tr>
<tr><td>Policy Term</td><td colspan="3">One year renewable term</td></tr>
<tr><td>Sum Assured</td><td colspan="3">₹ 2,00,000 (Two lakhs only)</td></tr>
<tr><td rowspan="6">Premium Amount</td><td colspan="3">The annual premium is ₹ 330 (including administrative charges payable to Banks which is currently ₹ 41/- per subscriber per annum).
In the first year of enrolment the premium applicable will be as per the table below:</td></tr>
<tr><td>Month of enrolment</td><td>Premium payable for</td><td>Premium amount payable</td></tr>
<tr><td>June, July & August</td><td>Entire policy year i.e. 4 quarters</td><td>₹ 330/- plus applicable taxes, if any
(This includes administrative charges payable to Banks which is ₹ 41/- per subscriber per annum)</td></tr>
<tr><td>September, October & November</td><td>3 quarters</td><td>₹ 258/- plus applicable taxes, if any
(This includes administrative charges payable to Banks which is ₹ 33/- per subscriber for 3 quarters)</td></tr>
<tr><td>December, January & February</td><td>2 quarters</td><td>₹ 172/- plus applicable taxes, if any
(This includes administrative charges payable to Banks which is ₹ 22/- per subscriber for 2 quarters)</td></tr>
<tr><td>March, April & May</td><td>1 quarter</td><td>₹ 86/- plus applicable taxes, if any
(This includes administrative charges payable to Banks which is ₹ 11/- per subscriber for 1 quarter)</td></tr>
<tr><td>Lien Period</td><td colspan="3">45 days from the date of enrolment into the scheme (entry date/date of commencement of insurance cover)</td></tr>
</table>

- ***Maturity/ Surrender Benefit:*** There is no surrender or maturity benefit under this plan.

- ***Advantages:***
  - ***Security:*** Safeguard your family against financial difficulties
  - ***Simplicity:*** Fast enrollment and swift processing
    No medical examination required, acceptance is based on satisfactory health declarations in the consent form

- ***Affordability:*** Insure yourself for a cover of Rs.2 lakh at a nominal premium

B) Pradhan Mantri Suraksha Bima Yojana:

The Government of India has partnered with various insurance service providers to offer low-cost health insurance plans. Pradhan Mantri Suraksha Bima Yojana is one such low-cost scheme offered by various major players in the market. This is a government-backed insurance cover that offers protection against accidents and disabilities. This is a limited coverage plan that comes with a specific sum insured option. Following an unfortunate accident, the insured can claim the money as per the benefits listed in the policy schedule.

- ***Eligibility for Pradhan Mantri Suraksha Bima Yojana:***

People who wish to enroll themselves in Pradhan Mantri Suraksha Bima Yojana must meet the following eligibility criteria:

  - This scheme is available only for the savings account customers of participating banks.
  - Anyone between the age of 18 years and 70 years can avail this cover.
  - This cover starts from June 1 and ends on May 31 of every year.

- ***Premium Amount:***

Since this is a low-cost insurance scheme backed by the government, this policy is available to customers at an extremely low price of Rs.12 per annum.

- ***Features of Pradhan Mantri Suraksha Bima Yojana:***
  - Some of the key features of Pradhan Mantri Suraksha Bima Yojana can be listed as follows:
  - The sum insured amount available under this policy coverage is Rs.2 lakh.
  - Only one policy can be issued per customer. Customers cannot have multiple policies by opening multiple savings account in a bank (or different banks).
  - This policy cover is offered by various state-owned and private banks in the country including HDFC, ICICI, SBI, Axis Bank, Union Bank of India, Canara Bank, etc.
  - This policy will terminate after the insured reaches 70 years of age.
  - The sum insured amount up to Rs.1 lakh received following a claim is tax free.

- ***Benefits of Pradhan Mantri Suraksha Bima Yojana***

Benefits	**Extent of cover**
Death of Insured	Rs 2 lakh paid to nominee or legal heir
Permanent Total Disability (loss of both eyes or two limbs)	Rs 2 lakh
Partial Total Disability	Rs 1 lakh

(loss of one eye or loss of one limb)	
Temporary Total Disability	Upto Rs 5,000 per week for a maximum of 100 weeks

- ***Exclusions of Pradhan Mantri Suraksha Bima Yojana***
  - The exclusions that apply to Pradhan Mantri Suraksha Bima Yojana can be given as follows:
  - Any kinds of intentional self-injury, suicide, or attempted suicide
  - Injury or death caused while under the influence of drugs or alcohol
  - Any loss caused while breaking the law with criminal intent
  - Any kinds of medical expenses arising out of an accident
  - Injury or death caused while participating in extreme or adventure sports
  - Injury or death caused by act of war, invasion, riot, or warlike activities
  - Any loss caused by radiation, nuclear weapons, chemical weapons, etc.
  - Death or disability resulting from childbirth or pregnancy

C) Aayushman Bharat

Ayushman Bharat is a health protection scheme to provide health insurance to citizens. It provides insurance coverage of up to Rs.5 lakh on a family floater basis to beneficiaries every year in order to receive primary, secondary, and tertiary healthcare services. The scheme is mostly referred to as AB-NHPS as it is an initiative under the existing National Health Protection Scheme (NHPS).

The government plans to distribute the AB-NHPS scheme through national insurance companies. The scheme subsumes the existing senior citizen health insurance scheme as well as the Rashtriya Swasthya Bima Yojana.

- ***Features and benefits of the scheme:***
  - A cover of up to Rs.5 lakh is available for the beneficiary family every year.
  - The scheme can be utilised to get primary, secondary, and tertiary healthcare services.
  - The benefits of the scheme can be availed at any government hospital or empanelled private hospital.
  - The eligibility of beneficiaries targeted towards the poor, deprived rural families and identified occupational category of urban workers' families based on the Socio-Economic Caste Census (SECC) 2011 data.
  - Package model will be followed to make payments. The package will be defined by the government-in-charge in terms of total costs, specific services, and procedures.
  - An Ayushman Bharat National Health Protection Mission Council will be established for effective coordination between the Central and the state governments.
  - The Union Minister for Health and Family Welfare handles the affairs of the council.
  - The scheme covers about 40% of the country's population who are poor and vulnerable.
  - All expenses incurred by the beneficiary from his pocket during the hospitalisation will also be covered.

- The cost incurred for travel during the pre- and post-hospitalisation period will be covered.
- The insurance provides cashless hospitalisation facility.
- Daycare treatment expenses are covered by the scheme.
- Though there are a few exceptions, the insurance scheme covers most pre-existing health conditions.
  Follow-up medical examinations are also covered to ensure that the patients have recovered completely.

- ***Eligibility criteria for rural families:***

There are six deprivation criteria to identify the rural families that are eligible for the benefits of the scheme. They are:

- Families that do not have an earning adult member aged between 16 and 59 years.
- Households headed by female members having no adult male members aged between 16 and 59 years.
- Households with a single room having makeshift walls and roof.
- Households belonging to the Scheduled Castes and Scheduled Tribes categories.
- Households that have disabled members with no able members offering support.
- Landless households with manual labour as their basic source of income.

In addition, the following households are automatically eligible:

- Destitute families who rely on alms.
- Families of manual scavengers.
- Households without proper shelter.
- Families of bonded labour.
- Primitive and particularly vulnerable tribal groups.

- ***Eligibility criteria for rural families:***

An urban family must belong to one of the listed occupational categories to be eligible for the scheme:

- Street vendors, cobblers, and hawkers.
- Domestic workers.
- Rag pickers and beggars.
- Construction site workers, plumbers, masons, painters, welders, and security guards.
- Coolies.
- Sweepers, sanitation workers, and gardeners.
- Transport workers such as conductors, drivers, cart pullers, and others.
- Artisans, home-based workers, handicraft workers, and tailors.
- Washermen and watchmen.
- Electricians, mechanics, repair workers, and assemblers.
- Peons, helpers, shop workers, delivery assistants, attendants, and waiters.

All families that are eligible under the Annapurna and Antyodaya Anna schemes are also eligible for AB-NHPS.

5. Module 5: Entrepreneurship

5.1. Introduction

- **What is entrepreneurship?**

It is a process of identifying and starting a business venture, sourcing and organizing the required resources and taking both the risks and rewards associated with the venture.

- **Who is an entrepreneur?**
  - One who is willing to bear risk of a new venture-if there is a significant chance for profit.
  - An innovator who markets his innovation.
  - One who develops and processes those goods and services that the markets demands and are not currently supplied.
  - Entrepreneur is someone who actually search for change, responds to it, and exploits change as an opportunity.

- **Qualities and characteristics of an entrepreneur.**
  - Creativity
  - Dedication
  - Determination
  - Flexibility
  - Leadership
  - Passion
  - Self Confidence

- **Why people become entrepreneurs?**
  - Can’t have a boss
  - Easily bored
  - Too creative
  - Too impatient
  - Not too educated
  - Resourceful
  - Can’t keep a job
  - Can sell ice to eskimos
  - Want freedom above all
  - Too ambitious
  - Addicted to risk
  - Been through school of hard knocks
  - Has no other choice but to be an entrepreneur

5.2. Steps to become an entrepreneur

Step1: Idea Generation
Ways to look for an idea

- Read a lot
- Talk to people
- Consider questions such as
  - What limitations exist in current product and services?
  - Are there any other uses for new technology?
  - What would you like that is not available?
  - What are the innovative ways to use or provide existing products?
  - Is society changing?
  - What groups have unfulfilled demands?
  - What about people's perceptions?

Step 2: Develop Business Plan
A business plan is a written document that serves as a road map for your business. It includes items like how you plan to market your business, who you see as your competition, projected financial statements, and projected sales for your first two or three years. A business plan is essential if you plan to obtain financing from a lending institution.

Step 3: Choose Business Type
You'll need to identify the type of business you plan to operate. If you're on your own, you will likely be a sole proprietor where your profits and losses are part of your personal income tax return, or a limited liability company, which offers some protection from creditors in the event your business fails. Whatever method you chose, you'll need to register your business with the state and local government

Step 4: Obtain Financing
You may also need to obtain financing to get started. Financing options include dipping into personal savings or borrowing money from family and friends. Another alternative is to borrow the money from a bank or credit union. You can even obtain the funding from venture capitalist. As a last resort, you can use personal credit cards to obtain necessary cash or purchase equipment. Small business grants may also be available.

Step 5: Implementation
This event includes the incorporation of resources and arm the project to launch their new business to the market. The strategy and business plan begin to develop day by day, and the use of resources are invested in favour of building a successful company.

Step 6: Growth

The ideal event for any entrepreneur is to see how their company is constantly growing. The activities of the previous event, ideally lead the business to a stage of maturity to maximize profitability for better benefits. Growth is the stage of the entrepreneurial process in which time and effort spent by the entrepreneur is reflected.

5.3. Entry Strategies, Problems and Mistakes of New Enterprises

- **Entry strategies for new enterprise**
  - USP- Uniqueness in Idea.
  - Differentiation.
  - Niche Specification
  - Innovation

- **Problems of entrepreneurship:**
  - Uncertainty of Income
  - Risk of losing invested capital
  - Long hours & hard work
  - Lower quality of life until the business is established
  - High level of stress
  - Complete responsibility
  - Discouragement
  - Difficult to get finances from the investors
  - Entrepreneur lacks skills to run the business

- **Ten deadly mistakes of entrepreneurship:**
  - Management mistakes
  - Lack of experience
  - Poor financial control
  - Weak marketing efforts
  - Failure to develop a strategic plan
  - Uncontrolled growth
  - Poor location
  - Improper inventory control
  - Incorrect pricing
  - Inability to make entrepreneurial transition

- **Avoiding the pitfalls of business failure:**
  - Know your business in depth
  - Develop a solid business plan

- Manage financial resources
- Understands the financial statements
- Learn to manage people effectively
- Keep in tune with yourself.

5.4. Startup India

- **What is startup India?**

Startup India is a flagship initiative of the Government of India, intended to build a strong ecosystem that is conducive for the growth of startup businesses, to drive sustainable economic growth and generate large scale employment opportunities. The Government through this initiative aims to empower startups to grow through innovation and design.

Several programs have been undertaken since the launch of the initiative on 16th of January, 2016 by Hon’ble Prime Minister, to contribute to his vision of transforming India into a country of job creators instead of job seekers. These programs have catalyzed the startup culture, with startups getting recognized through the Startup India initiative and many entrepreneurs availing the benefits of starting their own business in India.

- **What are the benefits provided under startup scheme?**

The benefits provided to recognized startups under the Startup India initiative are:

- **Self-Certification:** Self-certify and comply under 3 Environmental & 6 Labour Laws
- **Tax Exemption:** Income Tax exemption for a period of 3 consecutive years and exemption on capital and investments above Fair Market Value
- **Easy Winding of Company:** In 90 days under Insolvency & Bankruptcy Code, 2016
- **Startup Patent Application & IPR Protection:** Fast track patent application with up to 80% rebate in filling patents
- **Easier Public Procurement Norms:** Exemption from requirement of earnest money deposit, prior turnover and experience requirements in government tenders
- **SIDBI Fund of Funds:** Funds for investment into startups through Alternate Investment Funds

5.5. Entrepreneurship and Finance:

Growing a business from the first seed of an idea is not a smooth linear journey and it’s not as simple as going from A to B. The destination is seldom decided as the business idea takes form, becomes a reality and then grows into a successful enterprise. The finance journey is continuous; there may never be an arrival point.

For any business to travel on a journey it needs at all points of that journey to be appropriately financed. Businesses need to make sure there is the finance to back their growth plans.

Businesses are often started on overdrafts or credit cards, or with help from friends or family or by using the family property as collateral. But soon after that the business will need to be financed so it can stand on its own two feet if it is to be a sustainably growing proposition.

This module will be invaluable for entrepreneurs who are starting a business, directors who are running growing businesses and established companies – of all sizes – as well as for business advisers and investors.

It explains how to approach the financing decision, the questions to ask and how to treat it as a business process, so that it is not as daunting as it can sometimes seem. And if it does get daunting, good advisers can provide further guidance.

Once a business is up and running on the growth journey, management will need to ensure that future plans for growth can be financed. If not, there is a chance the business will fail.

On the growth journey there will undoubtedly be ups and downs. Through the life of a business, as soon as plans are made, be they looking for growth or for survival or to batten down the hatches, the finance must be in place to support those plans.

The work to be done in getting a business to a position where it can take on additional capital need not be too daunting a task; however, nor should it be underestimated. **START** by looking at the business afresh, with a questioning mind, so that the answers to the questions a potential shareholder or lender will probably raise are immediately to hand.

- **S**tep out from your business
- **T**ake a fresh look at prospects and challenges
- **A**nalyse your opportunities
- **R**each for the future
- **T**hink about finance

Step out from your business: Entrepreneurs want to focus on doing business. For many, finance falls under the category of administration, which may not be their forte. But to make sure the business can move forward entrepreneurs must step out from the business and ask the questions that need answering.

Take a fresh look at prospects and challenges: Plans may have been made when the business was little more than an idea. Things change and circumstances move on. You need to make a fresh assessment of where the business is, what the opportunities are, how achievable they are and what new challenges there are to the business.

Analyse your opportunities: You need to make a detailed analysis of the prospects for the business in light of any changed circumstances. A review of the new upsides and the new downsides needs to be carried out and the impact of them assessed, together with the probability of different scenarios.

Reach for the future: On the basis of the above analysis, prepare a detailed forecast, looking at the forecast profit and loss (P+L) account and balance sheet and then, crucially, at the cash flow, which will highlight how much capital needs to be put into the business to finance your latest plans.

Think about finance: You then need to think about the financing options for the business, how appropriate and how attainable they may be. To secure debt financing and/or investment, you need to make your business proposition clear and understandable to your target audience – with a business plan. At this stage a business is likely to require outside advice and experienced resource to ensure that it is 'investment ready' for potential investors, giving it the best possible chance to secure funding. Be open-minded. The funding landscape has developed considerably over recent years and there are a lot of options available – some are new and some have been around for some time.

Business plan:

Preparing a solid business plan is the key to securing funding. A robust business plan helps potential lenders or investors understand the vision and goals of the business. It also brings focus to management's understanding of the business strategy. It helps them understand the risks inherent in the strategy and the impact of any deviations from their plan – particularly when it comes to funding.

Information will depend on the target audience, but it should incorporate:

- An executive summary, highlighting the main points, designed to grab the attention of potential lenders or investors;
- Details of key personnel, their responsibilities, skills and experience;
- Market analysis of the company, its products or services and its competitors;
- Details of current and intended client base;
- A marketing plan targeting new or existing customers;
- Historical financial information covering the last three years of trading (if available) – accounts (audited if available), and key accounting ratios;
- Cash-flow data, including information about standard payment terms and typical debt turn;
- Financial forecasts for the next three to five years, presented as the historical information, and highlighting the key underlying assumptions;
- Cash-flow forecasts covering the next two to three years (or in the case of a start-up or turnaround, until the business moves into profit), clearly highlighting the amount of funding required;
- How creditors, capital expenditure, debtors and stock will be managed over the forecast period;
- Additional 'flexed' forecasts showing the impact of key downside scenarios, such as sales targets not being met or cost savings taking longer to come on stream, may also be included, or if required, must be included; and
- How equity investors can exit or refinance the business, and realise their investment.

It must be clear how much of the existing owner's money is committed to the business. If a lender or investor thinks the existing owner does not have enough 'skin in the game', securing a loan or investment is likely to be more difficult, if not impossible. The business should consider whether investors would be eligible for tax reliefs and ensure that it communicates this in the business plan. The amount of any backing already received from other banks or investors must be clearly stated. This can demonstrate the attractiveness of the business as an investment.

If a business is looking for debt finance the plan needs to demonstrate how the business will be able to both meet interest payments and repay the capital element over the period of the loan. A repayment schedule linked to the forecasts will make this clear. And when looking for equity, the plan will need to show how the potential shareholder would receive dividends and how the value of the business and therefore their stake would grow.

Cash is king:

Before looking for external capital, businesses should make sure they are managing cash effectively. Some fairly simple steps can help maximise available cash. Being able to demonstrate good cash management also sends out the right signals to potential investors or lenders.

The only way cash flow can be kept under control is by understanding the ins and outs. A weekly cash-flow forecast is often essential, particularly in a growing business.

Management must have an understanding of the amount of cash and working capital required to operate the business. Then working capital needs to be carefully managed. For example:

- Stock and work-in-progress (WIP) levels must be reviewed, and excess stockholdings actively reduced;
- Sales invoices must be issued in a timely manner and through best-practice credit management procedures, with payments collected within those terms;
- Contractual agreements with suppliers should be reviewed to generate cash and suppliers paid to credit terms;
- Capital expenditure should be carefully assessed and consideration given to the cash-flow implications of outright purchase; and
- Automated payment methods should be used wherever possible – getting customers to pay by electronic transfer or through direct debit helps increase the speed and certainty of payment.

This approach to cash management is not just part of the preparation for taking on new investment or debt; it is a procedure that must be ongoing. With new stakeholders the scrutiny of cash flow will likely be even greater as the business’s journey proceeds.

5.6. Sources of Finance for an Enterprise

A) Equity Finance

You can look to equity investment as a way to finance many different stages of the business journey. Whether starting out or experiencing a high-growth phase, equity is an important part of finance arrangements for businesses and usually brings broader expertise with it.

Before seeking equity finance, consider these five questions:

- How much is required?
- What is it for?
- How long will the funds be needed for?
- What other skills does the business need?
- What level of control do existing shareholders want to retain?

The answers can be incorporated in a comprehensive business plan, which should incorporate realistic financial projections, a detailed marketing plan and, crucially, what the investor can expect in return.

At an early stage, businesses will need long-term backing to fund the business through to revenue and profit – this could be through business angels and/or venture capital and is commonly in different rounds with different parties. In the shorter term, equity investment can support an aggressive growth strategy.

In simple terms, equity financing is the raising of capital through the sale of shares in a business. Equity can be sold to third-party investors with no existing stake in the business. Alternatively, equity financing can be raised solely from existing shareholders, through a rights issue.

Founding shareholders will have put the initial equity into the business. Friends or family may have 'invested' in the early stage of a business's journey. **Venture capital** (VC) investors, (also known as venture capitalists), corporate venture capitalists or **private equity** (PE) investors tend to be an option at the growth phase. Financial institutions or the wider public may invest in equity through a **listing** of the company's shares. The public may also acquire equity stakes through equity **crowdfunding** platforms. As it progresses, a company's shareholder register will be a mix of investors who have taken stakes at different stages of its journey.

Unlike debt providers, or lenders, equity investors do not have rights to interest, or to have their capital repaid by a certain date. Shareholders' return is usually paid in dividends or realised through capital growth. Both are dependent on the business's growth in profitability, and its ability to generate cash. Because of the risk to their returns, equity investors will expect a higher return than debt providers. Where a project requires longerterm investment than conventional debt offers, equity will be the most suitable form of finance.

Types of Equity Finance:

- ***Venture Capitalists:***

Venture capitalists invest in businesses with the potential for high returns – those with products or services with a unique selling point, or competitive advantage. They invest in a portfolio where a significant number of businesses may fail, so those that succeed have to compensate for those losses. They also want proven track records, and so rarely invest at the start-up stage. Like angel investors, venture capitalists bring a wealth of experience to the business. They are unlikely to get involved in the day-to-day running of the business but will often help focus the business strategy.

Securing VC investment can be a complex, costly and time-consuming process. A detailed business plan is a must. And legal fees will be incurred through the deal negotiation, regardless of whether investment is ultimately secured.

Corporate venture capital (CVC) is another growing source of funding for small businesses. It describes a wide variety of equity investment undertaken by a corporation, or its investment entity, into a high-growth and high-potential, privately-held business. CVC performs the same economic role that private venture capital plays – the identification and nurturing of the innovative businesses of the future. This formal and direct relationship is usually three-fold: by making a financial investment in return for an equity stake in the business; by offering debt finance to fund growth activities for an agreed return; by offering non-financial support for an agreed return, such as providing access to established marketing or distribution channels, or knowledge transfer. It is important that the corporation's aims are aligned with those of the business.

- ***Private Equity:***

PE makes medium- to long-term investments in, or offers growth capital to, companies with high-growth potential. PE investors would usually improve the profitability of the business through operational improvements and aim to grow revenue through investment in product lines or new services, or expansion into new territories. They will also typically introduce corporate disciplines and a management structure to the business, to give it a platform on which it can grow further. The PE model of governance consists of the combination of strategic, financial and operational expertise. The provision of non-financial support includes facilitating access to established marketing or distribution channels. PE investors would actively manage their investment through a period of five to seven years on average. After this they would exit their investment, selling their shares, having seen the value of the invested company grow. A PE firm may sell their stake to another PE firm or a corporate trade buyer. Alternatively, it may publicly list the company.

- ***Equity Crowd funding:***

The use of equity crowdfunding by companies looking to raise equity finance is becoming increasingly common. In effect it is a means to connect companies with potentially hundreds of thousands of potential investors, some of whom may also be current or future customers. It does this by matching companies with would-be angels via an internet-based platform.

Raising equity finance through crowdfunding platforms can be an alternative to seeking angel or VC finance through more traditional routes – for start-up, early-stage and growth companies.

Before putting a pitch for equity investment on a crowdfunding platform, you would need to show that your business is investment-ready. As with attracting traditional angel or VC investment, you would need to produce a business plan and financial forecasts. A business might also include a video summarising the opportunity.

- ***Public Listing:***

The next stage of growth for a business may involve applying for a public listing of its shares. The process of listing is time-consuming and involves a range of advisers, but it is an opportunity for a company to critically examine itself. The decision to launch an IPO (initial public offering) or flotation must be based on a realistic assessment of the business, its management, where it is in the stage of its development and its prospects.

A listing may be used to raise money to:

- finance growth opportunities;
- finance acquisitions;
- rebalance the balance sheet;
- broaden the company's shareholder base; or
- provide liquidity at listing or when it comes to trading shares in the company.

In addition, a public listing will increase the profile of the company with a wide range of stakeholders, including customers, suppliers and peers, and allow it to incentivise key employees through share option plans more easily.

If your business has a trading track record and further growth plans, it would be in a position to raise equity capital through an IPO (flotation). A proportion of its shares would then be listed on a stock exchange and traded in the secondary market.

B) Debt Finance

Just as short-term capital should not be used to fund long-term plans, so the reverse is true. On the financing journey it is highly likely that you will need both, and the task is to get the mix right. Debt will undoubtedly be involved in growing a business. Debt comes in many different forms, each of which can be more or less appropriate to the type of business, the stage it is at in its development or the plans it has to grow. And often an established company will use a blend of different debt products from a range of providers.

Debt can be used for longer-term investment and/or to fund working capital. For the former, a loan, leasing arrangement or bond can be more appropriate and for the latter, some form of overdraft or asset-based finance is likely to be more appropriate. At any stage of its development a business is likely to need a mix of different forms of debt. All have their advantages for different aspects of a business's growth plans.

Debt, in its simplest terms, is an arrangement between borrower and lender. A capital sum is borrowed from the lender on the condition that the amount borrowed is paid back in full either at a later date (a bullet repayment), multiple dates, or over a period of time. Interest is accrued on the debt and the business's repayment usually has an element of capital repayment and interest.

Types of Debt Finance:

- ***Overdraft and Bank Loans:***

Overdrafts are often what a business uses to help finance working capital and to meet short-term requirements. Loans, leasing or hire purchase agreements are in most cases better suited to larger longer-term purchases, such as investment in plant and machinery, computers or transport.

While it is almost always the case that an entrepreneur will benefit from the knowledge, insight and network of advisers who deal day- to-day with banks and other finance providers, businesses themselves should cultivate relationships with banks and other finance providers, who may help meet future financing requirements rather than just the immediate needs.

To obtain a loan or overdraft, management must demonstrate to the lender that the business will generate the income and cash to both repay the facility according to the terms of the loan, and service the loan by meeting interest payments. Market conditions and regulatory requirements, such as those that mandate responsible lending to viable businesses, may also impact the ease with which a business can access a loan or overdraft.

- ***Inter Corporate Loan:***

A company can take a loan from another company for financial requirements. While taking such loan it has to comply with the provisions of the Companies Act.

- ***Asset Finance:***

Leasing and hire purchase are types of finance used by businesses to obtain a wide range of assets – everything from office equipment to vehicles – and could be the perfect solution if you need new equipment which would otherwise be unaffordable because of cash-flow constraints.

Because leases and hire-purchase agreements are secured wholly or largely on the asset being financed, the need for additional collateral is much reduced. There is more security for the user because the finance cannot be recalled during the life of the agreement, provided the business keeps up with payments.

A leasing company buys and owns the equipment, which the business then rents for a predetermined period. The business also has the option to replace or update the equipment at the end of the lease period. Typically, the lease will have a set interest rate, which fixes the outgoings on that asset.

If a business wants to own the equipment at the end of the agreement, but avoid the cash flow impact of buying outright, then hire purchase is an option. A finance company buys the equipment and the business repays the cash price plus interest through regular repayments. These agreements are also normally at fixed interest rates. At the end of the agreement there is usually a nominal fee to acquire title to the equipment.

- ***Trade Credit:***

Trade credit involves the purchase of the goods or raw materials at credit and payable later. It is a very common and preferable mode for startups. It fulfills the need for day to day capital requirement. Also, it is less expensive than a loan from a bank. There is no need to provide any security for such kind of credits. The entities with high goodwill will easily get a credit in the market.

- ***Bonds:***

A bond is simply a loan taken out by a company. Instead of going to a bank, the company gets the money from investors who buy its bonds. In exchange for the capital, the company pays an interest coupon—the annual interest rate paid on a bond, expressed as a percentage of the face value. The company pays the interest at predetermined intervals—usually annually or semi-annually—and returns the principal on the maturity date, ending the loan.