# FINANCIAL MARKETS AND INVESTMENT STRATEGIES

**FIRST EDITION**


**Authors**

**Dr. M. THAIYALNAYAKI**

**Dr. B. JANANEE**

**Dr. M. KOTTEESWARAN**



SRG
International
Publication

# TITLE OF THE BOOK:

# FINANCIAL MARKETS AND INVESTMENT STRATEGIES

**ISBN: 978-93-48151-43-8**

**Edition: First - 2025**



**Disclaimer**

The authors are solely responsible for the contents published in this text book. The publishers or editors do not take any responsibility for the same in any manner. Errors, if any, are purely unintentional and readers are requested to communicate such errors to the editors or publishers to avoid discrepancies in future.

**MRP: Rs.900 /-**

**PUBLISHER & PRINTER:**

**RG INTERNATIONAL PUBLICATION,**

**Email: editorrginternational@gmail.com**

**Website: www.rginternationalpublication.com**

| S.No. | Title | Pg.No. |
| --- | --- | --- |
| 1 | **INTRODUCTION TO FINANCIAL MARKETS** | 6 |
| 1.1 | Nature and Role of Financial System | 7 |
| 1.2 | Financial Markets as Components of Financial System | 10 |
| 1.3 | Financial System and Economic Growth | 13 |
| 1.4 | Financial System Designs | 15 |
| | 1.4.1 Bank-Based and Market Based | 15 |
| 1.5 | What is a market | 17 |
| | 1.5.1 The purpose of a market | 18 |
| | 1.5.2 Different styles of trading | 19 |
| | 1.5.3 Primary vs. secondary markets | 21 |
| 1.6 | Securities and Exchange Commission | 23 |
| | 1.6.1 Commodity Futures Trading Commission | 25 |
| | 1.6.2 Financial Industry Regulatory Authority | 26 |
| 1.7 | National Futures Association | 27 |
| | 1.7.1 How market regulators work | 28 |
| | 1.7.2 How market regulators make rules | 29 |
| 1.8 | Indian Financial System | 30 |
| | 1.8.1 Financial Institutions may be classified into three categories: | 33 |
| | 1.8.2 Functions of Indian Financial System | 34 |
| | 1.8.3 Importance of Indian Financial System | 34 |
| | 1.8.4 It aids in Financial Deepening and Broadening: | 35 |
| | 1.8.5 Financial Intermediaries/Intermediaries | 35 |

| | | |
|---|---|---|
| | in Indian Financial System | |
| 1.9 | Exploring the Benefits of Capital Market Integration | 35 |
| | 1.9.1 Trends and Implications | 38 |
| | 1.9.2 The Role of Regulatory Frameworks in Promoting Capital Market Integration | 40 |
| | 1.9.3 Successful Examples of Capital Market Integration | 49 |
| 1.10 | Challenges and Risks Associated with Capital Market Integration | 51 |
| 1.11 | Towards a More Integrated and Efficient Global Capital Market | 55 |
| 1.12 | Types of Financial Markets | 58 |
| 2 | **INVESTMENT FUNDAMENTALS AND ASSET CLASSES** | 60 |
| 2.1 | Investment Fundamentals | 60 |
| 2.2 | Purpose of Finance | 62 |
| 2.3 | Characteristics and Functions of Money Market | 63 |
| 2.4 | Role of the Reserve Bank in the Money Market | 66 |
| 2.5 | Intermediates in the Money Market | 71 |
| 2.6 | Development of Money Market in India | 74 |
| 2.7 | Money Market Instruments | 75 |
| | 2.7.1 Treasury Bills | 76 |
| | 2.7.2 Commercial Papers | 77 |
| | 2.7.3 Certificate of Deposit | 77 |

| | | |
|---|---|---|
| | 2.7.4 Commercial Bills | 79 |
| 2.8 | Collateralized Browsing and Lending Obligation | 79 |
| 2.9 | Call Money Market and Term Money Market | 81 |
| 2.10 | Diversification and Asset Allocation Strategies | 85 |
| | 2.10.1 Defining Diversification | 85 |
| | 2.10.2 Understanding Diversification | 87 |
| | 2.10.3 Diversification Strategies | 89 |
| | 2.10.4 Diversification Across Platforms | 93 |
| | 2.10.5 Diversification and Retail Investors | 95 |
| | 2.10.6 Pros and Cons of Diversification | 96 |
| | 2.10.7 Diversifiable vs. Non-Diversifiable Risk | 97 |
| | 2.10.8 Measuring Diversification | 99 |
| | 2.10.9 Standard Deviation | 99 |
| | 2.10.10 What Are the Benefits of Diversification? | 101 |
| 2.11 | What is a Collateralized Debt Obligation? | 102 |
| 2.12 | How does Collateralized Debt Obligation (CDO) Work? | 104 |
| | 2.12.1 Important Terms and Differentiation from Similar Products | 106 |
| | 2.12.2 CDOs and Subprime Mortgage Crisis 2008 | 108 |
| | 2.12.3 Collateralized Debt Obligations Vs Mortgage-Backed Securities | 109 |
| 3 | **INVESTMENT STRATEGIES AND MARKET ANALYSIS** | 125 |
| 3.1 | Statement Of Problem | 127 |

| | | |
|---|---|---|
| 3.2 | Objective Of The Study | 129 |
| 3.3 | What is investment strategy | 129 |
| | 3.3.1 Investment Styles | 131 |
| | 3.3.2 How Does It Help Investors | 133 |
| | 3.3.3 How does it help investors | 138 |
| 3.4 | Functions and Types of Capital Market | 143 |
| 3.5 | Reforms in the Capital Market | 150 |
| 3.6 | Issue Mechanisms | 154 |
| 3.7 | Types of Primary Issues | 155 |
| 3.8 | Public Rights and Private Placement | 156 |
| 3.9 | Resource Mobilization from International Capital Markets | 159 |
| | 3.9.1 ADRs | 161 |
| | 3.9.2 GDRs | 161 |
| | 3.9.3 ECBs | 162 |
| 3.10 | Primary Market | 164 |
| | 3.10.1 Scenario in India | 164 |
| 3.11 | Debt Market: Private Corporate | 166 |
| 3.12 | Role of SEBI in the Capital Market | 169 |
| 4 | **PORTFOLIO MANAGEMENT AND RISK MANAGEMENT** | 203 |
| 4.1 | Principles of Portfolio Construction | 203 |
| 4.2 | Functions of Secondary Market | 209 |
| 4.3 | Post Reforms Stock Market Scenario | 212 |
| 4.4 | Organization, Management and Membership | 215 |

| | | |
|---|---|---|
| | of Stock Exchange | |
| 4.5 | Listing of Securities | 217 |
| 4.6 | Trading Arrangements | 223 |
| 4.7 | Stock Market Index | 225 |
| 4.8 | Stock Exchanges in India | 227 |
| 4.9 | Characteristics of Financial Services | 228 |
| 4.10 | Evolution of Financial Services in India | 231 |
| 4.11 | Significance of Financial Services | 240 |
| 4.12 | Types of Financial Services | 247 |
| 5 | **EMERGING TRENDS AND FUTURE OF FINANCIALMARKETS** | 260 |
| 5.1 | Digital Transformation and FinTech Innovation | 262 |
| 5.2 | Fintech and Digital Transformation in Investing | 268 |
| 5.3 | Economic frictions and forces in financial services | 273 |
| 5.4 | The Impact of digital innovation on key economic frictions | 275 |
| 5.5 | Implications for the industrial organization of the financial sector | 278 |
| 5.6 | Decentralized Finance (DeFi) and Cryptocurrencies | 283 |
| 5.7 | ESG (Environmental, Social, Governance) and Eth Investing | 293 |
| 5.8 | Impact of Global Events and Economic Policies | 302 |
| 5.9 | Future Trends in Financial Markets and Investment Strategies | 318 |

# UNIT 1

## INTRODUCTION TO FINANCIAL MARKETS

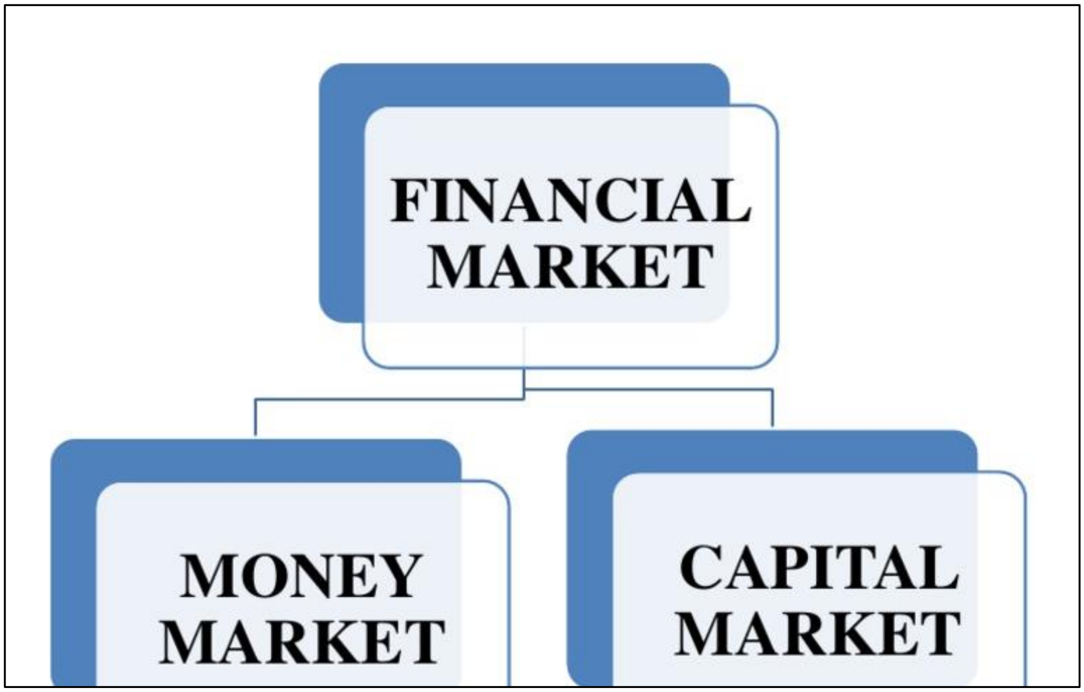
Financial markets play a crucial role in the global economy by facilitating the exchange of financial assets such as stocks, bonds, currencies, and commodities. These markets enable businesses to raise capital, investors to earn returns, and governments to manage economic policies effectively.

The study of financial market plays a significant role in the study of any management program. Considering the need and importance of this subject for the management students this subject has been introduced into this curriculum. In this block the readers would be briefed about the financial markets, money market and capital market. The functions and responsibilities of each of this market would be explained in very detail. Not only has this role do they play in the proper running of an economy been discussed here in very detail. After going through this block the readers would get sufficient idea about the Financial Market, Money Market and Capital Market. Block Objective After learning this block, you will be able to understand:

The concept and functions of financial markets

- The nature and importance of money market
- The nature and types of capital market
- Distinguish between capital market and money market
- The nature and functions of a stock exchange
- The advantages of stock exchanges from the points of view of companies,

- investors and society as a whole  The limitations of stock exchanges
- The concept of speculation and distinguish it from investment
- Outline the stock exchanges in India
- The nature of regulation of stock exchanges in India and the role of SEBI




**Structure of Market**

**1.1 Nature and Role of Financial System**

The financial system plays the key role in the economy by stimulating economic growth, influencing economic performance of the actors, affecting economic welfare. This is achieved by financial infrastructure, in which entities with funds allocate those funds to those who have potentially more productive ways to invest those funds. A financial system makes it possible a more efficient transfer of funds.

As one party of the transaction may possess superior information than the other party, it can lead to the information a symmetry problem and inefficient allocation of financial resources. By overcoming the information a symmetry problem the financial system facilitates balance between those with funds to invest and those needing funds.

According to the structural approach, the financial system of an economy consists of three main components:

1) Financial markets;

2) Financial intermediaries (institutions);

3) Financial regulators.

Each of the components plays a specific role in the economy. According to the functional approach, financial markets facilitate the flow of funds in order to finance investments by corporations, governments and individuals. Financial institutions are the key players in the financial markets as they perform the function of intermediation and thus determine the flow of funds.The financial regulators perform the role of monitoring and regulating theparticipants in the financial system.


**The structure of financial system**

Financial markets studies, based on capital market theory, focus on the financial system, the structure of interest rates, and the pricing of financial assets. An asset is any resource that is expected to provide future benefits, and thus possesses economic value. Assets are divided into two categories: tangible assets with physical properties and intangible assets. An intangible asset represents a legal claim to some future economic benefits. The value of an intangible asset bears no relation to the form, physical or otherwise, in which the claims are recorded. Financial assets, often called financial instruments, are intangible assets, which are expected to provide future benefits in the form of a claim to future cash. Some financial instruments are called securities and generally include stocks and bonds.

Any transaction related to financial instrument includes at least two parties: 1) The party that has agreed to make future cash payments and is called the issuer; 2) The party that owns the financial instrument, and therefore the right to receive the payments made by the issuer, is called the investor. Financial assets provide the following key economic functions.

- They allow the transfer of funds from those entities, who have surplus funds to invest to those who need funds to invest in tangible assets;
- They redistribute the unavoidable risk related to cash generation among deficit and surplus economic units.

The claims held by the final wealth holders generally differ from the liabilities issued by those entities who demand those funds. They role is performed by the specific entities operating in financial systems, called financial intermediaries. The latter ones transform the final liabilities into different financial assets preferred by the public.

## 1.2 Financial Markets as Components of FinancialSystem

A financial market is a market where financial instruments are exchanged ortraded. Financial markets provide the following three major economic functions:

1) Price discovery

2) Liquidity

3) Reduction of transaction costs

1) Price discovery function means that transactions between buyers and sellersof financial instruments in a financial market determine the price of thetraded asset. At the same time the required return from the investment offunds is determined by the participants in a financial market. The motivationfor those seeking funds (deficit units) depends on the required return thatinvestors demand. It is these functions of financial markets that signal howthe funds available from those who want to lend or invest funds will beallocated among those needing funds and raise those funds by issuingfinancial instruments.

2) Liquidity function provides an opportunity for investors to sell a financialinstrument, since it is referred to as a measure of the ability to sell an assetat its fair market value at any time. Without liquidity, an investor would beforced to hold a financial instrument until conditions arise to sell it or theissuer is contractually obligated to pay it off. Debt instrument is liquidatedwhen it matures, and equity instrument is until the company is either voluntarily or involuntarily liquidated. All financial markets provide someform of liquidity. However, different financial markets are characterized by the degree of liquidity.

3) The function of reduction of transaction costs is performed, when financial market participants are charged and/or bear the costs of trading a financial instrument. In market economies the economic rationale for the existence of institutions and instruments is related to transaction costs, thus the surviving institutions and instruments are those that have the lowest transaction costs.

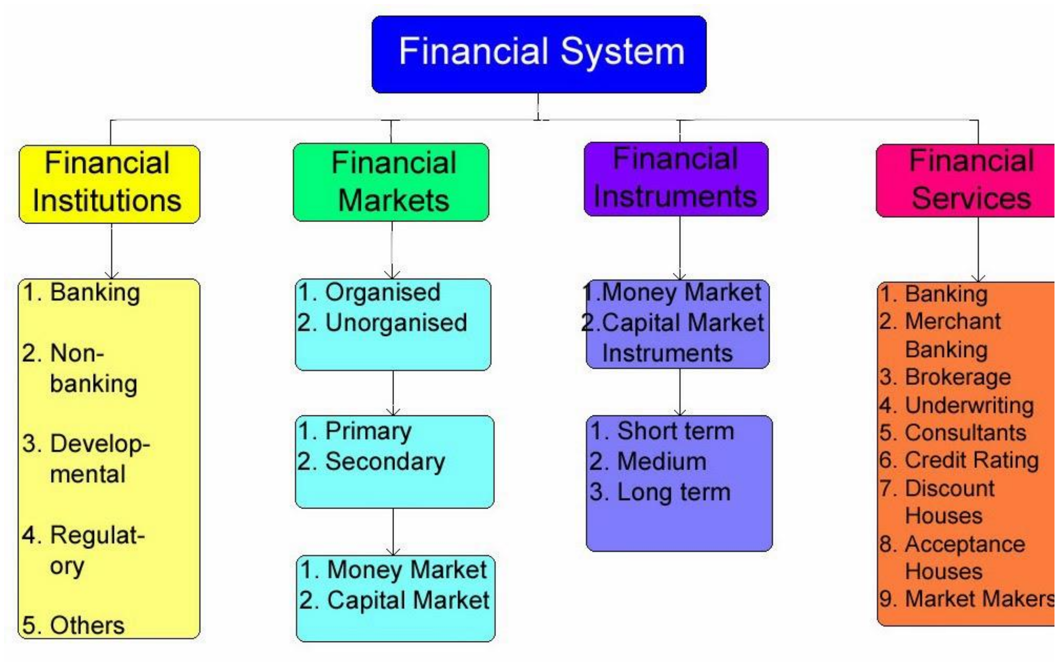
The key attributes determining transaction costs are

- Asset specificity,
- Uncertainty,
- Frequency of occurrence.

Asset specificity is related to the way transaction is organized and executed. It is lower when an asset can be easily put to alternative use, can be deployed for different tasks without significant costs.

Transactions are also related to uncertainty, which has (1) external sources (when events change beyond control of the contracting parties), and (2) depends on opportunistic behaviour of the contracting parties. If changes in external events are readily verifiable, then it is possible to make adaptations to original contracts, taking into account problems caused by external uncertainty. In this case there is a possibility to control transaction costs. However, when circumstances are not easily observable, opportunism creates incentives for contracting parties to review the initial contract and creates moral hazard problems. The higher the uncertainty, the more opportunistic behaviour may be observed, and the higher transaction costs may be born. Frequency of occurrence plays an important role in determining if a transaction should take place within the market or within the firm. A one-time transaction may reduce costs when it is executed in the market. Conversely, frequent transactions require detailed contracting and should take place within a firm in order to reduce the costs. When assets are specific, transactions are frequent, and there are significant uncertainties intra-firm transactions may be the least costly. And, vice versa, if assets are non-specific, transactions are infrequent, and there are no significant uncertainties least costly may be market transactions.

The mentioned attributes of transactions and the underlying incentive problems are related to behavioural assumptions about the transacting parties. The economists Coase (1932,1960, 1988), Williamson (1975, 1985), Akerlof (1971) and others) have contributed to transactions costs economics by analyzing behaviour of the human beings, assumed generally self-serving and rational in their conduct, and also behaving opportunistically. Opportunistic behaviour was understood as involving actions with incomplete and distorted information that may intentionally mislead the other party. This type of behaviour requires efforts of ex ante screening of transaction parties, and ex post safeguards as well as mutual restraint among the parties, which leads to specific transaction costs.

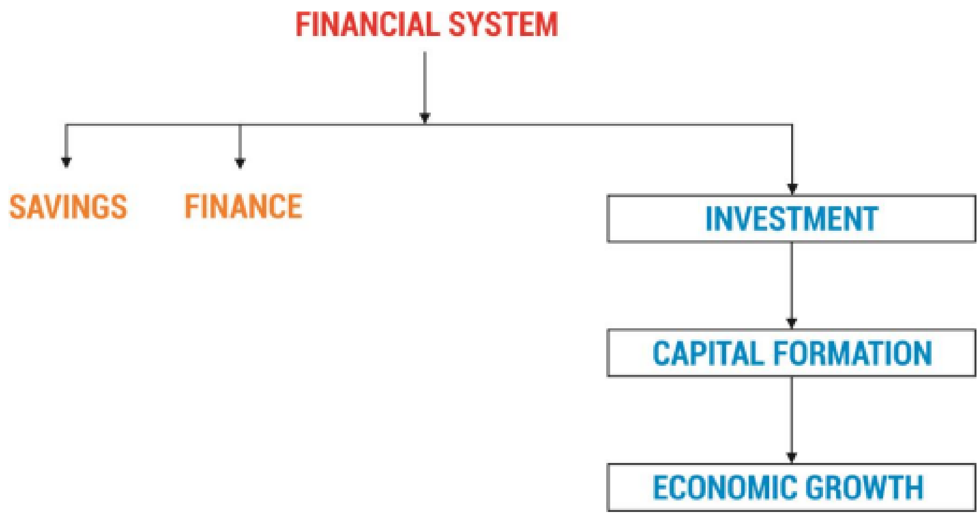



**Indian Financial System**

## 1.3 Financial System and Economic Growth

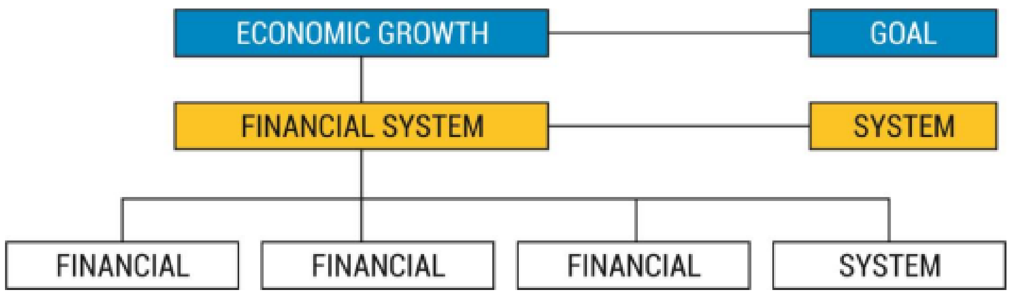
The term financial system is a set of inter-related activities/services working together to achieve some predetermined purpose or goal. It includes different markets, the institutions, instruments, services and mechanisms which influence the generation of savings, investment capital formation and growth. Van Horne defined the financial system as the purpose of financial markets to allocate savings efficiently in an economy to ultimate users either for investment in real assets or for consumption. Christy has opined that the objective of the financial system is to "supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequence of price level changes or unnecessary interference with individual desires."

According to Robinson, the primary function of the system is "to provide a link between savings and investment for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth." From the above definitions, it may be said that the primary function of the financial system is the mobilisation of savings, their distribution for industrial investment and stimulating capital formation to accelerate the process of economic growth.




**The Concept of the Financial System**

The process of savings, finance and investment involves financial institutions, markets, instruments and services. Above all, supervision control and regulation are equally significant. Thus, financial management is an integral part of the financial system. On the basis of the empirical evidence, Goldsmith said that "... a case for the hypothesis that the separation of the functions of savings and investment which is made possible by the introduction of financial instruments as well as enlargement of the range of financial assets which follows from the creation of financial institutions increase the efficiency of investments and raise the ratio of capital formation to national production and financial activities and through these two channels increase the rate of growth." The inter-relationship between varied segments of the economy is illustrated below:-




**Inter-relationship in the Financial System**

## 1.4 Financial System Designs

A financial system provides services that are essential in a modern economy. The use of a stable, widely accepted medium of exchange reduces the costs of transactions. It facilitates trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage saving in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use. Access to a variety of financial instruments enables an economic agent to pool, price and exchange risks in the markets. Trade, the efficient use of resources, saving and risk taking are the cornerstones of a growing economy. In fact, the country could make this feasible with the active support of the financial system. The financial system has been identified as the most catalyzing agent for growth of the economy, making it one of the key inputs of development.

### 1.4.1 Bank-Based and Market Based

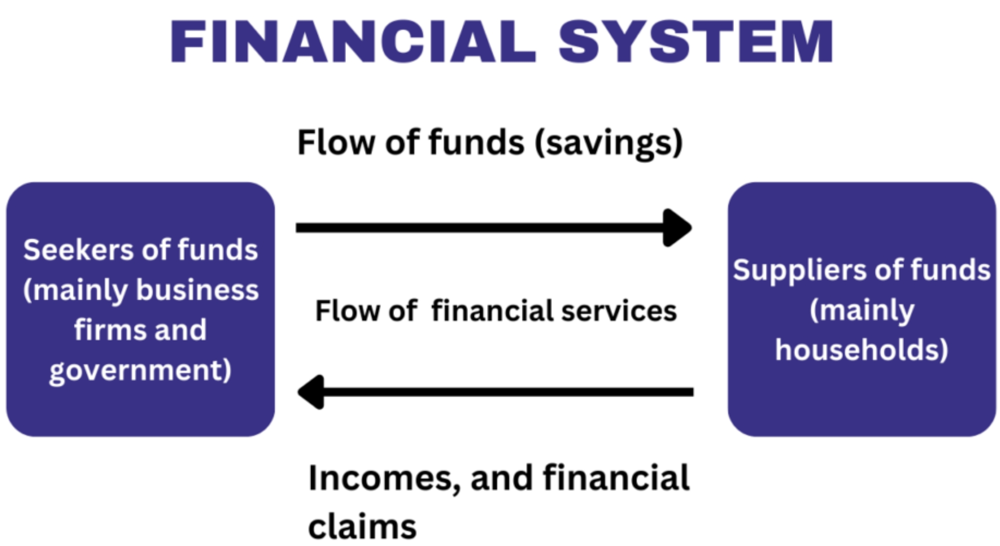
In countries such as Japan, France and Germany, where banks provide around 20% of the corporate financing, it is known that banks are making significant effort to develop a relationship banking culture, with long-term loans and preferential interest rates for clients with a „good history". These economies can be called Bank-Based Economies.


**Market in Finance**

There are also countries where the borrowing-lending activities take place through organized markets, such as London Stock Exchange, in the UK, or New York Stock Exchange in USA. These are known as Market-Based Economies. Although banks are present in these countries, they are highly competitive, the relationship with lenders and borrowers is purely limited to the transactions of granting loans or taking deposits and loans are usually granted on short-term.

Markets have been around for centuries as buyers and sellers came together to exchange goods. Originally, market participants traded in person, but today most financial trading is done electronically. Still, the concept remains the same: Two or more parties decide on the value of an asset and make an agreement to exchange a good for money or barter.

Markets can be as familiar as haggling over the price of apples at your local farmers market or bidding for an antique dresser on an auction website. They can also be difficult to understand, especially if you're new to the financial markets. Consider, for instance, all the recent hype around cryptocurrencies or the complexities of trading options.If a product exists, you can be almost certain it's traded in a market somewhere.




**Flow of Financial system**

### 1.5 What is a market?

Markets allow the exchange of goods, services, or other valuable assets between two or more parties. Most markets evolved as an exchange of goods for money at an agreed-upon price, but not all exchanges involve legal tender. Bartering remains common, with two parties agreeing to trade one good or service for another.

There are market parallels to everyday life. Negotiating is often part of markets, even informal ones.

- You might list a bicycle for sale on an online classified website or at a yard sale. A buyer can purchase your bike at the listed price or ask if you'll take less money.
- When a homeowner puts a house up for sale, prospective buyers may offer the listed price or go above/below the ask.
- At outdoor markets and bazaars, negotiating is sometimes expected, and savvy buyers often wait until closing time to try to get what they think is the best price.

### 1.5.1 The purpose of a market

Markets help establish the price of goods, services, and other assets. At least two parties are needed to trade, and three or more parties help to spur competition. Competition helps with price discovery, which is the process of determining the price for an asset. When more people participate in a market, it's considered more liquid, and the determined price will have more influence.For instance, crude oil futures that are electronically traded at CME Group's (CME) NYMEX by thousands of participants each day set the accepted benchmark price for U.S. crude oil. That benchmark is used as a reference point for crude oil that's changing hands in local markets across North America and the world—from drilling operations and refineries, all the way to the gas prices at your local station.

Supply and demand—and expectations for future supply and demand—have always been and remain the basic price-setting principles. Sellers supply an asset, whether it's corn, cars, stocks, or bonds. Buyers create demand by bidding for the supply. High supply often leads to lower prices, while tight supply usually means higher prices. If, for instance, floods ruin millions of acres of corn, prices tend to rise amid short supplies. If it's a perfect year for the corn crop and more bushels end up in grain elevators than the market needs for processing, the price is likely to fall.

For instance, crude oil futures that are electronically traded at CME Group's (CME) NYMEX by thousands of participants each day set the accepted benchmark price for U.S. crude oil. That benchmark is used as a reference point for crude oil that's changing hands in local markets across North America and the world—from drilling operations and refineries, all the way to the gas prices at your local station.

Supply and demand—and expectations for future supply and demand—have always been and remain the basic price-setting principles. Sellers supply an asset, whether it's corn, cars, stocks, or bonds. Buyers create demand by bidding for the supply. High supply often leads to lower prices, while tight supply usually means higher prices. If, for instance, floods ruin millions of acres of corn, prices tend to rise amid short supplies. If it's a perfect year for the corn crop and more bushels end up in grain elevators than the market needs for processing, the price is likely to fall.

### 1.5.2 Different styles of trading

Just as there are many assets to trade, from corn to crude to antique dressers, there are lots of ways to trade them. Here's a rundown of some types of markets where price discovery takes place.

Auction markets. In auction markets, buyers and sellers meet to exchange money for goods in a structured exchange. Listed financial exchanges, such as stock markets or commodities markets, use the auction process to match the bids and offers of buyers and sellers. The U.S. Treasury also has daily and weekly auctions to sell government notes and bonds to fixed-income buyers. Wall Street is probably the first place you think of when it comes to “auction” markets; legend has it that trading there began under a buttonwood tree in 1792.

Outside of financial markets, there are other auction markets, such as those for art, wine, livestock, foreclosed homes, or a number of other assets sold at a central location, either a physical space or online. In the 20th century, Chicago became the center of the world for agricultural futures trading in a system that allowed farmers and processing companies to offset (i.e., hedge) their price risk on future prices for crops and livestock. Nowadays, a high percentage of futures market activity is in financial products such as stock indexes, Treasury securities, and foreign exchange.

Over-the-counter (OTC) markets. Unlike structured markets, OTC markets use broker-dealer networks that exist outside of an exchange to trade securities. Dealers quote prices at which they will buy or sell securities to other dealers or customers. Deals can be negotiated by phone, email, messaging services, or through electronic bulletin boards.

Several types of securities are available OTC, including stocks, bonds, currencies, cryptocurrencies, and derivatives (whose value is based on an underlying asset).

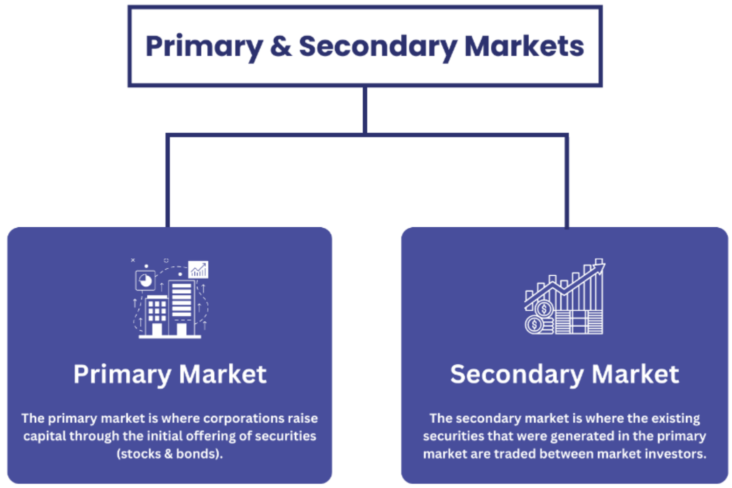
But most trades in stocks, bonds, commodities, and crypto are matched on exchanges or other trade execution platforms—a modern but much faster version of an auction market. A few decades ago, before the advent of electronic trading, trades were matched on exchange floors through an “open outcry” process. While some exchange trading still occurs via open outcry, the vast majority of transactions are done electronically.


**Source of Consumer Protection**

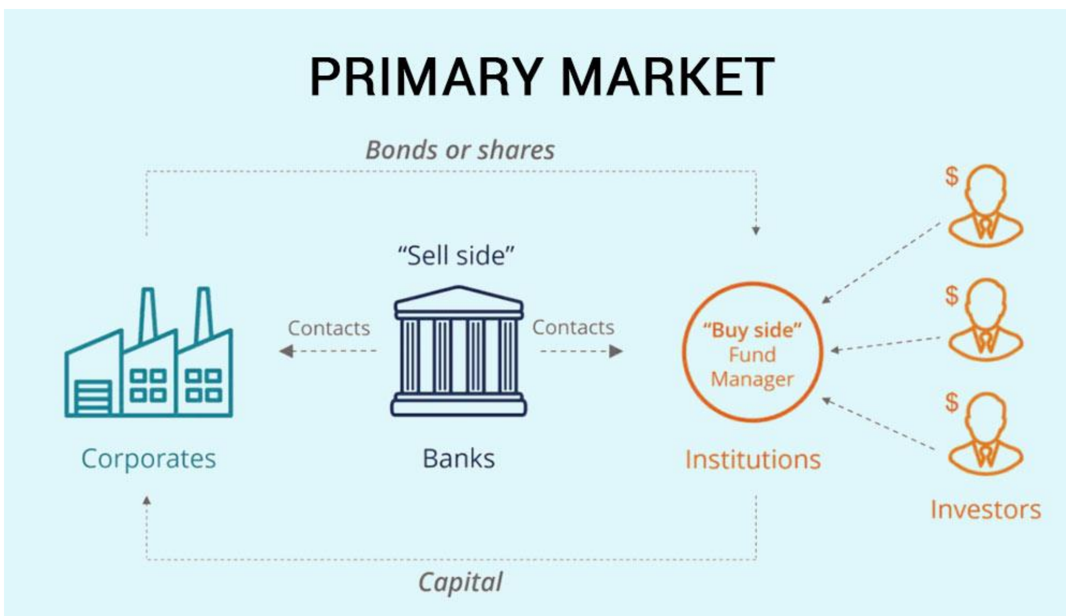
### 1.5.3 Primary vs. secondary markets

Stocks and bonds trade through both primary and secondary markets. For stocks, the best-known example of a primary market is when a private company goes public with an initial public offering (IPO). This is the first time the company offers stock to outside investors, and it's a chance for investors to buy securities from the bank that completed the initial underwriting of the stock.

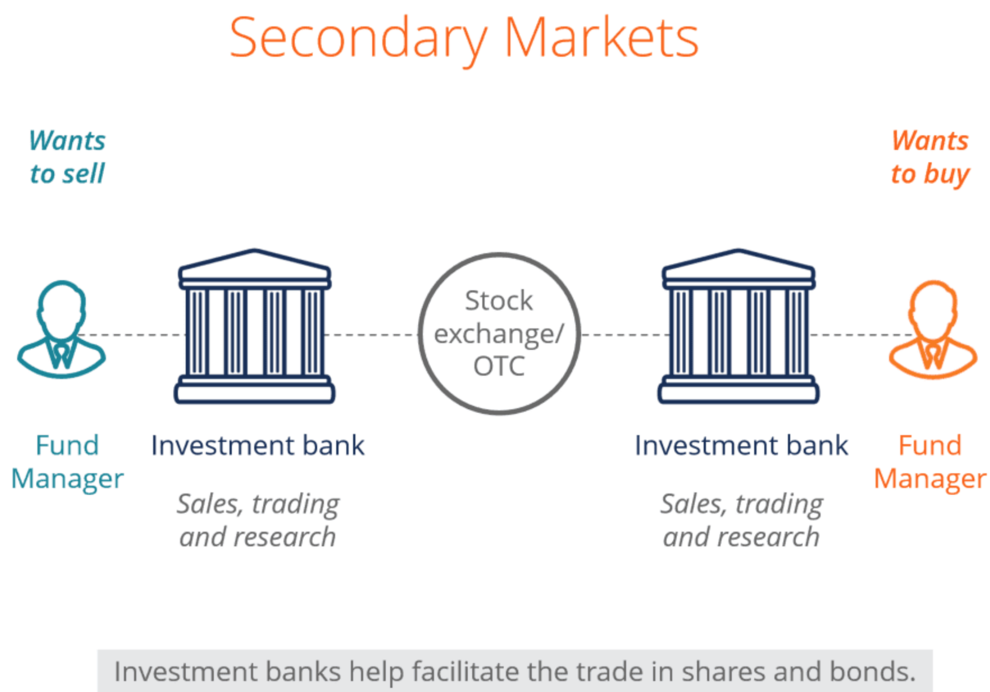
Bonds are also available on the primary market. New debt issuance offered directly from a company or a government is considered a primary market offering.




**View of Market in Finance**




**Primary Market**

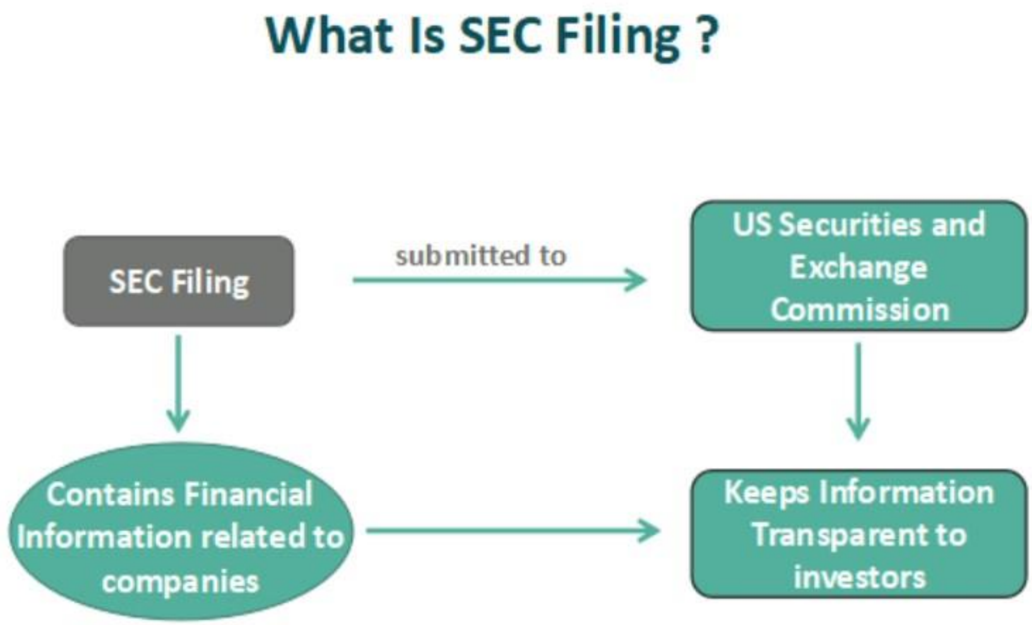



**Secondary Market**

Once a company issues stock, the shares trade in the secondary market between investors on a listed exchange. A secondary market is also available for bonds. Bond holders can hang onto their debt instruments and receive par value at maturity (if there is no default), or they can sell the bonds to other investors.

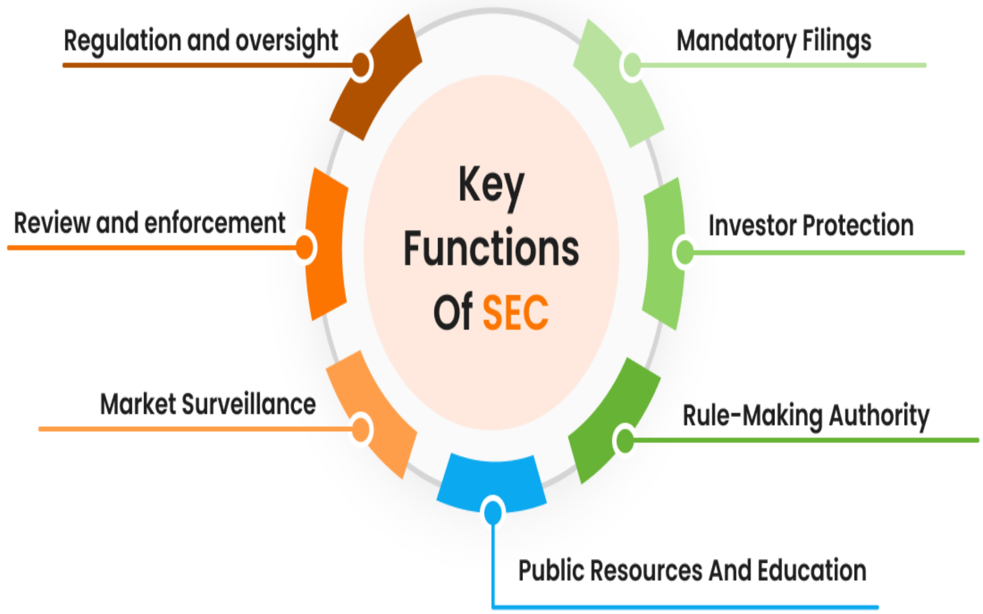
### 1.6 Securities and Exchange Commission

The U.S. Securities and Exchange Commission, or SEC, oversees the U.S. bond and equity markets. It enforces securities laws related to public companies, fund and asset managers, investment professionals, and other market participants. The SEC has three main goals:




**Definition of SEC**

- Protect investors. The SEC requires that public companies selling securities must be honest about their businesses, the securities being sold, and the investment risks. Those who trade securities and offer advice must treat investors fairly and honestly. Information must be timely, accurate, and complete.
- Facilitate capital formation. The SEC helps businesses large and small ensure access to U.S. capital markets, in addition to creating financial opportunities for those who invest in these companies.
- Maintain fair, orderly, and efficient markets. The agency monitors market environments as technology and economic conditions change, and it modernizes its rules, regulations, and oversight tools as needed.




**Key Function of SEC**

### 1.6.1 Commodity Futures Trading Commission

The Commodity Futures Trading Commission, or CFTC, is in charge of regulating derivatives, which include futures, options, and over-the-counter markets. Entities that want to trade in the derivatives markets must register with the CFTC.

In addition to the two government agencies that oversee equities and derivatives trading, there are self-regulatory organizations (SROs) that provide market oversight. These agencies are needed because they help to regulate certain professions or industries. The benefits of SRO oversight include field expertise and ensuring members follow a certain standard of conduct. These organizations are funded by the industries they oversee.


**Finance Account based Statement**

### 1.6.2 Financial Industry Regulatory Authority

The Financial Industry Regulatory Authority (FINRA) is a government-authorized, not-for-profit organization that oversees U.S. broker-dealers and was authorized by Congress to make sure the industry remains fair and honest.

- Brokers are qualified to handle client assets. As part of this responsibility, FINRA administers licensing exams. FINRA also runs the BrokerCheck site, which allows you to look into your broker or financial advisor's history, background, and experience, including any disciplinary actions taken against them.
- Security products are suitable for an investor's needs. Different types of advisors are held to different standards.

- Securities product ads are truthful. Because each investor is different, ads and content created for general consumption must not be promissory or advisory. Whenever investment returns are mentioned, the investment risks must balance them out.
- Investors receive full disclosure about the investment products they're buying. If you've seen the boilerplate disclaimers about past performance not guaranteeing future returns, or how securities products aren't FDIC insured, these are among the FINRA requirements.

**Financial Statement Footnote**

**NOTE 6. INVENTORIES, INCLUDING DEFERRED INVENTORY COSTS**

| December 31 | | 2020 | | 2019 |
|---|---|---|---|---|
| Raw materials and work in process | $ | 7,937 | $ | 8,771 |
| Finished goods | | 5,654 | | 5,333 |
| Deferred inventory costs(a) | | 2,299 | | 3,111 |
| **Inventories, including deferred inventory costs** | $ | 15,890 | $ | 17,215 |

(a) Represents cost deferral for shipped goods (such as components for wind turbine assemblies within our Renewable Energy segment) and labor and overhead costs on time and material service contracts (primarily originating in Power and Aviation) and other costs for which the criteria for revenue recognition has not yet been met. This was previously recorded in Contract and other deferred assets.

**Note for Financial Statement**

## 1.7 National Futures Association

The SRO for the derivatives industry is the National Futures Association (NFA), which was designated by the CFTC. NFA registers any entity wishing to conduct business in the derivatives industry on behalf of the CFTC. The organization determines industry best practices and enforces compliance to those rules among its members. It also:

- Protects investors.
- Creates member education, resources, and outreach programs.

- Offers arbitration for customers and members over disputes related to futures and foreign exchange.
- Can take disciplinary action against members that break rules.

### 1.7.1 How market regulators work

The regulators have committees and divisions to help distribute and enforce their regulatory powers.

Five commissioners head the SEC; they are appointed by the U.S. president. The SEC has six divisions tasked with carrying out the regulator's work, including:

  - Corporate finance. This division provides investors with material information to make informed investment decisions and helps companies understand SEC rules.
  - Economic and risk analysis. The department was created after the 2008 global financial crisis to integrate financial economics and rigorous data analytics into the core mission of the SEC.
  - Enforcement. This staff conducts investigations into possible federal securities laws violations and prosecutes the SEC's civil suits.
  - Examinations. This division conducts the SEC's national exam program.
  - Investment management. The staff oversees the regulatory policy for investment companies and advisers.
  - Trading and markets. This division regulates the major securities market participants.

There are also five CFTC commissioners appointed by the president. The CFTC has 13 operating divisions and offices. Some of those are similar to the SEC divisions, but some are different. These offices include:

- ✓ Clearing and risk. This department oversees the unique clearing aspect of derivatives markets.
- ✓ Enforcement. This division investigates and prosecutes violations of the commission regulations and the Commodity Exchange Act.
- ✓ Office of International Affairs. The office advises the agency regarding international regulatory issues and initiatives.

The SRO regulators have more narrowly defined tasks for their individual industry. FINRA's board of directors includes 22 members who are industry and public representatives. It also has four main committees that handle FINRA's functions, including an advisory committee with 13 subcommittees, plus regional committees made up of five subcommittees. These subcommittees provide feedback on rules and regulatory issues.

As the SRO for the derivatives industry, the NFA has a board of directors, including a chair, vice chair, members of the different groups it oversees, and public representatives. It has 14 committees, which oversee the NFA's several roles.

### 1.7.2 How market regulators make rules

As market conditions change and become more sophisticated, new types of products are created, so regulators need to stay on top of these changes to adjust or adopt rules as needed.

To create new regulations, the SEC or the CFTC generally propose a rule and ask for public comment. The organization may tweak the proposal based on the feedback. If the regulator seeks to continue with the proposed rule, it will publish a Notice of Proposed Rulemaking to address the issues or concerns with the initial proposed rule. The organization allows another round of public comment, usually 30 to 60 days. After the second comment period, the organization may issue a final rule that may reflect the agency's thoughts on the public's feedback.

Once approved, the final rule is published in the Federal Register with an effective date, and typically a date by which market participants must comply.

Regulatory agencies are in charge of enforcing their rules, which are legally binding. Enforcement may include fines and in some cases jail time for federal enforcement actions from the SEC and CFTC. The FINRA and NFA can ban members for life and levy heavy fines, depending on which rules were broken, and to what degree.

Both the SEC and CFTC have whistleblower programs to help them uncover wrongdoing. These programs provide monetary incentives for people who come forward and anti-retaliation protections for whistleblowers.

## 1.8 Indian Financial System

The financial system of a country is an important tool for economic development of the country, as it helps in creation of wealth by linking savings with investments. It facilitates the flow of funds form the households (savers) to business firms (investors) to aid in wealth creation and development of both the parties.

The financial system of a country is concerned with:

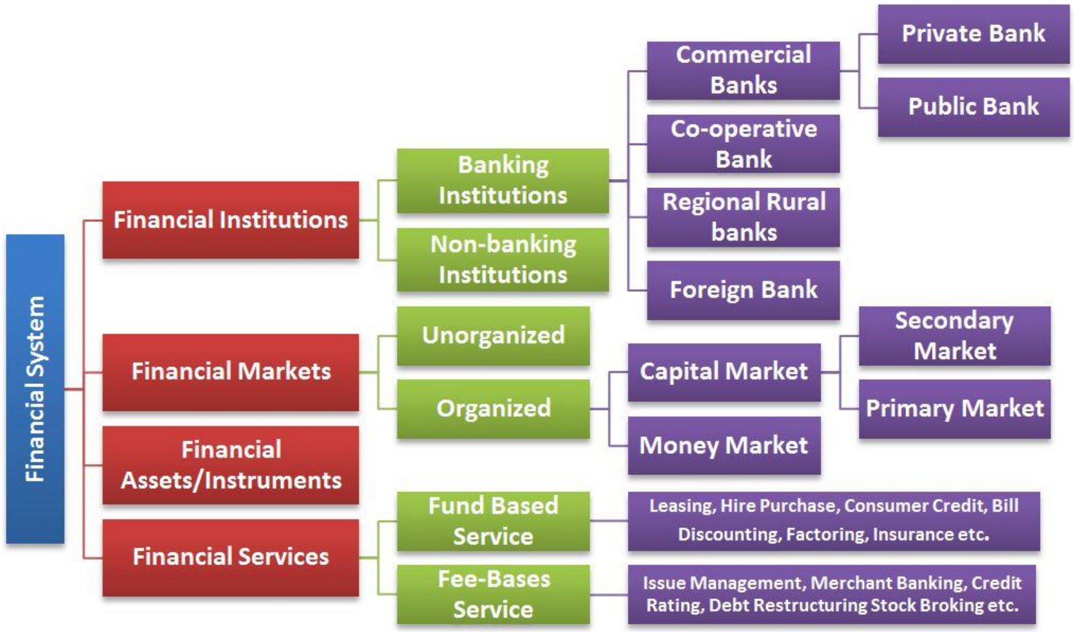
- ❖ Allocation and Mobilization of savings
- ❖ Provision of funds
- ❖ Facilitating the Financial Transactions
- ❖ Developing financial markets
- ❖ Provision of legal financial framework
- ❖ Provision of financial and advisory services

According to Robinson, the primary function of a financial system is “to provide a link between savings and investment for creation of wealth and to permit portfolio adjustment in the composition of existing wealth”

A Financial System consists of various financial Institutions, Financial Markets, Financial Transactions, rules and regulations, liabilities and claims etc.

**Features of Financial System**:

- ❖ It plays a vital role in economic development of a country
- ❖ It encourages both savings and investment
- ❖ It links savers and investors
- ❖ It helps in capital formation
- ❖ It helps in allocation of risk
- ❖ It facilitates expansion of financial markets
- ❖ It aids in Financial Deepening and Broadening




**Structure of Indian Financial System**

(1)Financial Institutions – Financial institutions are intermediaries of financial markets which facilitate financial transactions between individuals and financial customers. It simply refers to an organization (set-up for profit or not for profit) that collects money from individuals and invests that money in financial assets such as stocks, bonds, bank deposits, loans etc.

There can be two types of financial institutions:

- Banking Institutions or Depository institutions – These are banks and credit unions that collect money from the public in return for interest on money deposits and use that money to advance loans to financial customers.
- Non- Banking Institutions or Non-Depository institutions – These are brokerage firms, insurance and mutual funds companies that cannot

collect money deposits but can sell financial products to financial customers.

### 1.8.1 Financial Institutions may be classified into three categories:

- Regulatory – It includes institutions like SEBI, RBI, IRDA etc. which regulate the financial markets and protect the interests of investors.
- Intermediaries – It includes commercial banks such as SBI, PNB etc. that provide short term loans and other financial services to individuals and corporate customers.
- Non – Intermediaries – It includes financial institutions like NABARD, IDBI etc. that provide long-term loans to corporate customers.

(2) Financial Markets – It refers to any marketplace where buyers and sellers participate in trading of assets such as shares, bonds, currencies and other financial instruments. A financial market may be further divided into capital market and money market. While the capital market deals in long term securities having maturity period of more than one year, the money market deals with short-term debt instruments having maturity period of less than one year.

(3) Financial Assets/Instruments – Financial assets include cash deposits, checks, loans, accounts receivable, letter of credit, bank notes and all other financial instruments that provide a claim against a person/financial institution to pay either a specific amount on a certain future date or to pay the principal amount along with interest.

(4) Financial Services – Financial Services are concerned with the design and delivery of financial instruments and advisory services to individuals and businesses within the area of banking and related institutions, personal financial planning, leasing, investment, assets, insurance etc.

It involves provision of a wide variety of fund/asset based and non-fund based/advisory services and includes all kinds of institutions which provide intermediate financial assistance and facilitate financial transactions between individuals and corporate customers.

### 1.8.2 Functions of Indian Financial System

- It bridges the gap between savings and investment through efficient mobilization and allocation of surplus funds
- It helps a business in capital formation
- It helps in minimising risk and allocating risk efficiently
- It helps a business to liquidate tied up funds
- It facilitates financial transactions through provision of various financial instruments
- It facilitate trading of financial assets/instruments by developing and regulating financial markets

### 1.8.3 Importance of Indian Financial System

- It accelerates the rate and volume of savings through provision of various financial instruments and efficient mobilization of savings
- It aids in increasing the national output of the country by providing funds to corporate customers to expand their respective business

- It protects the interests of investors and ensures smooth financial transactions through regulatory bodies such as RBI, SEBI etc.
- It helps economic development and raising the standard of living of people
- It helps to promote the development of weaker section of the society through rural development banks and co-operative societies
- It helps corporate customers to make better financial decisions by providing effective financial as well as advisory services

### 1.8.4 It aids in Financial Deepening and Broadening:

- ❖ Financial Deepening – It refers to the increase in financial assets as a percentage of GDP
- ❖ Financial Broadening – It refers to increasing number of participants in the financial system.

### 1.8.5 Financial Intermediaries/Intermediaries in Indian Financial System

- ❖ Commercial Banks
- ❖ Cooperative Banks
- ❖ Regional Rural Banks
- ❖ Development Banks
- ❖ Non-banking Financial Companies
- ❖ Mutual Fund companies
- ❖ Insurance Companies

## 1.9 Exploring the Benefits of Capital Market Integration

1. Diversification of Investment Opportunities: One of the key benefits of capital market integration is the increased access to a wide range of

investment opportunities. When investors are no longer limited to their domestic market, they can explore and invest in various assets across different countries and regions. This diversification can help reduce risks and potentially increase returns by spreading the investments across different markets and industries. For example, an investor in the United States can easily invest in emerging markets like Brazil or India, providing exposure to industries and sectors that may not be available domestically.

2. Enhanced Liquidity: Capital market integration can also lead to increased liquidity in financial markets. As more investors participate in a market, the buying and selling of assets become more frequent, resulting in higher trading volumes and improved market liquidity. This liquidity can benefit investors by reducing transaction costs and making it easier to buy or sell assets at fair prices. An excellent example of this is the integration of European stock markets through the creation of the Eurozone, which facilitated cross-border trading and increased liquidity in European equity markets.

3. Access to Specialized Expertise: When capital markets are integrated, investors gain access to specialized expertise and knowledge from a broader pool of market participants. This can be particularly beneficial for investors seeking exposure to niche sectors or specific regions. For instance, a technology-focused investor in Germany can tap into the expertise of Silicon Valley venture capitalists by investing in global technology funds, potentially benefiting from their insights and experience.

4. Improved Capital Allocation: capital market integration promotes efficient capital allocation by allowing funds to flow to the most productive and promising investment opportunities. As investors have a wider range of choices, capital can be

directed towards companies and projects with the highest potential for growth and profitability. This allocation of capital based on market forces helps drive economic development and innovation. A notable case study is the liberalization of China's capital markets, which has attracted significant foreign investment and facilitated the growth of Chinese companies.

5. Risk Sharing: Integrating capital markets can also enhance risk-sharing mechanisms. When investors can diversify their portfolios across different countries, the impact of adverse events in one market can be mitigated by the performance of other markets. This risk-sharing aspect can be particularly crucial for smaller or less developed markets that may be more susceptible to economic shocks. For example, during the global financial crisis of 2008, countries with more integrated capital markets were better able to withstand the impact of the crisis through diversification.

6. lower Cost of capital: Capital market integration can potentially lower the cost of capital for issuers. When markets are open to a broader pool of investors, the increased competition can result in lower borrowing costs for companies and governments. This can stimulate investment, economic growth, and job creation. An example of this can be seen in the European Union, where the integration of capital markets has led to increased cross-border investment and reduced borrowing costs for member states.

Capital market integration brings numerous benefits to investors, issuers, and economies as a whole. From diversification and increased liquidity to access to specialized expertise and improved capital allocation, the advantages are substantial. By embracing and encouraging capital market integration, countries can challenge home bias and tap into the opportunities presented by a globalized world.

### 1.9.1 Trends and Implications

1. Globalization of Capital Markets: Breaking Down Barriers :In today's interconnected world, the globalization of capital markets has become a defining feature of the global economy. With advancements in technology, communication, and transportation, financial markets have become more integrated than ever before. This phenomenon has brought about numerous trends and implications that shape the way investors and businesses operate on a global scale.

2. Market Access and Investment Opportunities :One of the key trends resulting from the globalization of capital markets is the increased accessibility to investment opportunities worldwide. In the past, investors were limited to their domestic markets, but now they can easily invest in foreign securities. For instance, through the use of online trading platforms, individuals can buy shares of companies listed on international stock exchanges with just a few clicks.

3. diversification and Risk management: Capital market globalization has also facilitated diversification of investment portfolios. By investing in assets across different countries and regions, investors can reduce their exposure to country-specific risks and enhance their risk-adjusted returns. For example, a portfolio comprising stocks from various countries may exhibit lower volatility compared to one concentrated solely in a single market.

4. Increased Competition and Efficiency :As capital markets become more globalized, competition among market participants intensifies. This increased competition fosters greater efficiency in the allocation of capital. For instance, a

company seeking funding can tap into a global pool of investors, allowing for more efficient pricing of securities and a wider range of funding options.

5. Regulatory Challenges and Harmonization :While the globalization of capital markets brings numerous benefits, it also presents challenges in terms of regulatory frameworks. Different countries have varying rules and regulations governing their financial markets, which can create complexities for international investors and issuers. To address this, efforts have been made to harmonize regulations across jurisdictions, such as the adoption of international Financial Reporting standards (IFRS) for financial reporting.

6. Case Study: The European Union and the Eurozone : The European Union (EU) and the Eurozone provide a compelling case study on the globalization of capital markets. With the establishment of the EU and the introduction of the euro as a common currency, member countries have experienced increased integration of their capital markets. This integration has allowed for the free movement of capital, harmonization of regulations, and the creation of a single market for financial services.

7. Tips for Navigating global Capital markets

For investors looking to navigate the global capital markets, here are a few tips to consider:

- Stay informed: Keep abreast of global economic and market developments to identify investment opportunities and potential risks.

- Diversify intelligently: diversify your investment portfolio across different asset classes, sectors, and regions to mitigate risk.

- Understand local regulations: Familiarize yourself with the regulatory frameworks of the countries in which you plan to invest to ensure compliance and avoid any legal pitfalls.

The globalization of capital markets has revolutionized the way investments are made and businesses operate in today's globalized world. The trends and implications discussed above highlight the opportunities and challenges that arise from this integration. As investors and businesses embrace this interconnectedness, it becomes crucial to adapt strategies and stay informed to navigate the dynamic landscape of global capital markets.

### 1.9.2 The Role of Regulatory Frameworks in Promoting Capital Market Integration

1. Regulatory frameworks play a crucial role in promoting capital market integration, as they provide a set of rules and guidelines that govern the functioning of financial markets. These frameworks help to create a level playing field for market participants, enhance transparency and investor protection, and facilitate cross-border investments. In this section, we will explore the various ways in which regulatory frameworks contribute to capital market integration.

2. Harmonization of regulations: One of the key aspects of regulatory frameworks is the harmonization of rules and regulations across different jurisdictions. By aligning their regulatory frameworks, countries can remove barriers to cross-border investments and foster greater integration. For example, the European Union has implemented the markets in Financial Instruments directive (MiFID), which harmonizes regulations for investment services across member states. This has facilitated the integration of european capital markets, enabling investors to access a wider range of investment opportunities.

3. Investor protection: Regulatory frameworks also play a crucial role in safeguarding the interests of investors. Robust regulations ensure that market participants adhere to high standards of conduct and provide adequate disclosures. This instills confidence among investors and encourages them to participate in capital markets. For instance, the securities and Exchange commission (SEC) in the United States enforces regulations that protect investors from fraudulent practices and ensure fair and transparent markets.

4. Cross-border market access: Regulatory frameworks can enable cross-border market access by setting out rules for foreign investments and facilitating the entry of foreign market participants. For example, the qualified Foreign Institutional investor (QFII) program in China allows qualified foreign investors to access the Chinese capital markets. This program has helped to integrate China's capital markets with global markets, attracting foreign investments and promoting capital market integration.

5. Regulatory cooperation and information sharing: Collaboration between regulatory authorities is essential for promoting capital market integration. Regulatory frameworks often include provisions for cooperation and information sharing between jurisdictions. This enables regulators to exchange important market-related information, coordinate their efforts, and address cross-border challenges effectively. The international Organization of Securities commissions (IOSCO) is a prime example of a global organization that facilitates regulatory cooperation and sets international standards for securities regulation.

6. Case study: The European Union's capital Markets union (CMU) initiative provides a notable case study of the role of regulatory frameworks in promoting capital market integration. The CMU aims to create a single market for capital

within the EU by removing barriers and harmonizing regulations. It encompasses various regulatory measures, such as the Prospectus Regulation and the European long-Term investment Funds (ELTIF) Regulation, which aim to simplify access to capital markets and increase cross-border investments. The CMU initiative demonstrates how regulatory frameworks can be instrumental in fostering capital market integration within a regional bloc.

7. Tips for effective regulatory frameworks: To promote capital market integration, regulatory frameworks should prioritize harmonization of rules, ensure robust investor protection, facilitate cross-border market access, encourage regulatory cooperation, and promote information sharing. Additionally, it is crucial for regulatory frameworks to strike a balance between promoting integration and maintaining financial stability.

Regulatory frameworks play a pivotal role in promoting capital market integration. By harmonizing regulations, protecting investors, facilitating cross-border market access, and promoting regulatory cooperation, these frameworks create an environment conducive to the seamless flow of capital across borders. Through initiatives like the European Union's CMU, countries and regions can leverage regulatory frameworks to overcome home bias and create more integrated and globally connected capital markets.

***1. Performance Comparison***

A) Active vs. Passive Strategies: Passive strategies, such as index fund investing, generally outperformed many activelymanaged funds over the long term, primarily due to lower costs and the difficulty of consistently beating the market. However,some active managers were able to achieve superior returns, particularly in specific market conditions or niches.

B) Value vs. Growth Investing: Value investing strategies showed resilience and outperformance during market downturns,capitalizing on undervalued assets. Conversely, growth investing thrived during bull markets, benefiting from high-growthpotential companies.

***2. Risk Management***

A) Diversification Benefits: Diversified portfolios, incorporating a mix of asset classes (stocks, bonds, real estate),consistently demonstrated reduced volatility and improved risk-adjusted returns compared to concentrated portfolios.

B) Modern Portfolio Theory (MPT): Portfolios constructed using MPT principles achieved better balance between risk andreturn, emphasizing the importance of asset allocation and diversification.

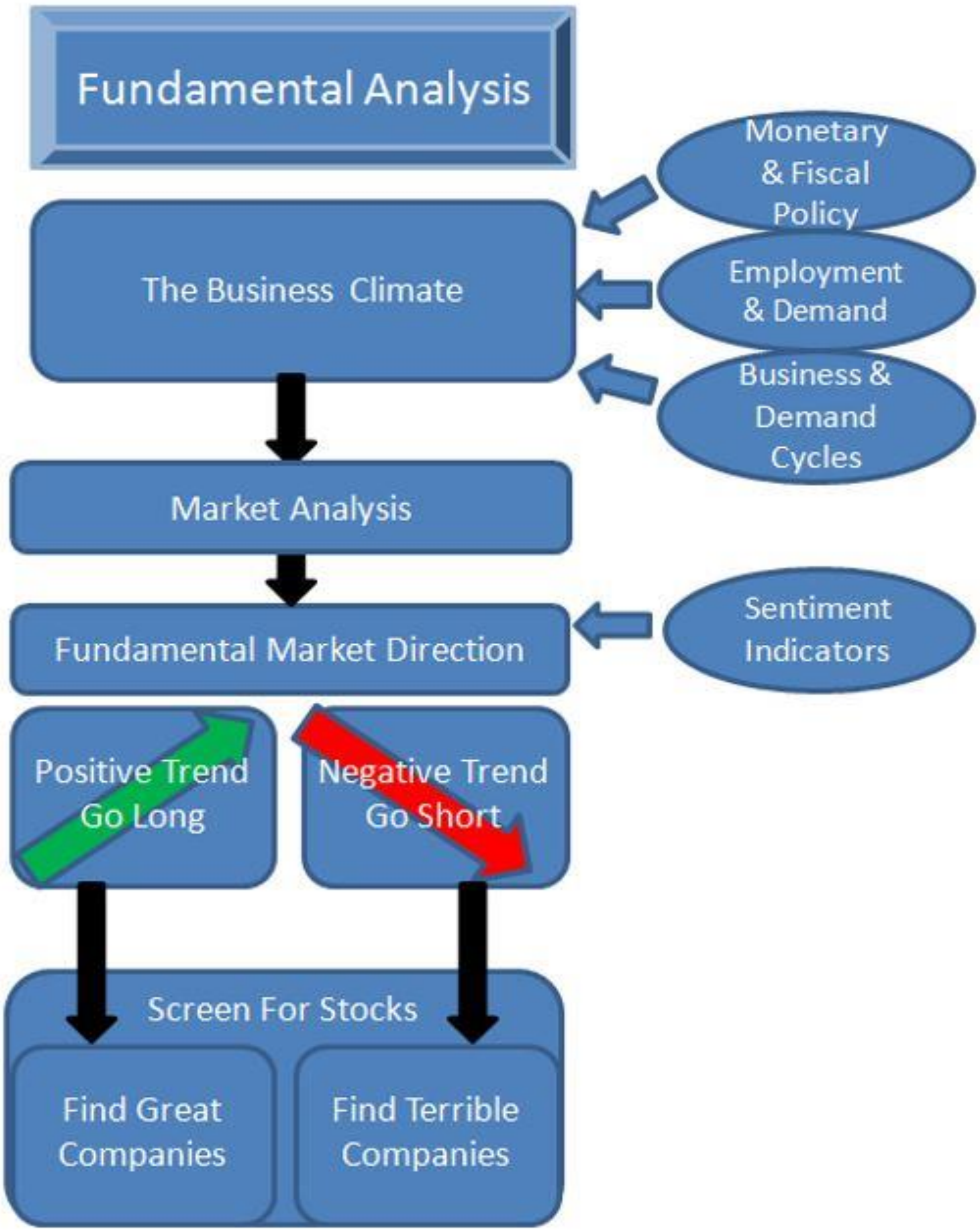
***3. Investor Behavior***

Behavioral Biases: Common biases such as overconfidence, herd behavior, and loss aversion significantly impactedinvestment decisions, often leading to suboptimal outcomes. Educating investors about these biases helped improve decisionmaking.

***4. Emerging Trends***

A) Sustainable Investing: Strategies incorporating environmental, social, and governance (ESG) criteria gained popularity,with evidence suggesting that ESG-focused portfolios can achieve competitive returns while contributing to positive societalimpact.

B) Technological Advancements: The use of artificial intelligence and machine learning in investment strategies providedenhanced data analysis and predictive capabilities, leading to more informed and potentially profitable investment decisions.




**Stock Market Success**

1. Balancing Active and Passive Strategies

While passive investing offers cost efficiency and consistent market returns, active investing can provide opportunities foroutperformance in specific sectors or market conditions. A blended approach, utilizing both strategies, may offer a balancedpath to achieving investment goals.

2. Importance of Diversification

The benefits of diversification are clear, underscoring the need for investors to construct well-diversified portfolios. Thisapproach not only reduces risk but also enhances the potential for stable, long-term returns.

3. Behavioral Finance

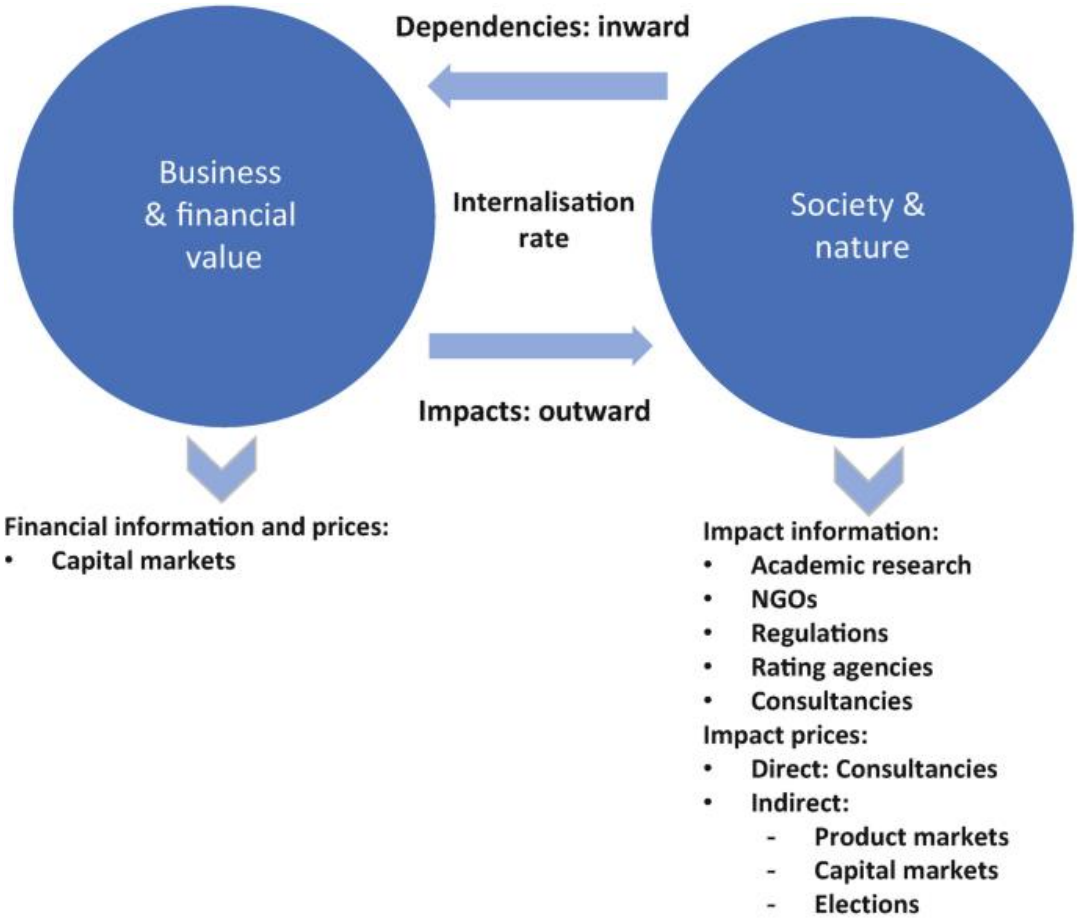
Understanding and mitigating behavioral biases is crucial for improving investment outcomes. Financial education andawareness programs can play a significant role in helping investors recognize and counteract these biases.

4.Adapting to Market Trends

The growing importance of sustainable investing and technological advancements presents new opportunities and challenges.Investors need to stay informed and adapt their strategies to incorporate these trends, leveraging ESG criteria and advancedanalytics for better decision-making.

5. Long-term Perspective

The study reinforces the value of maintaining a long-term perspective in investing. Short-term market fluctuations areinevitable, but a long-term approach, guided by sound investment principles and strategies, tends to yield better outcome .




### Capital Market Adaptability

The study's findings provide valuable insights into the effectiveness of various investment strategies in capital markets. Bybalancing active and passive approaches, emphasizing diversification, addressing behavioral biases, and staying attuned toemerging trends, investors can enhance their potential for achieving financial success. Continuous research and adaptation areessential to navigate the ever-evolving landscape of capital markets.

Investment strategies in capital markets encompass a wide array of approaches aimed at maximizing returns while managing risk. As an essential component of the financial ecosystem, these strategies guide investors in making informed decisions about allocating their capital. From value investing, which focuses on undervalued stocks, to growth investing, which targets companies with high potential for future expansion, each strategy offers unique benefits and challenges. By understanding and applying these strategies, investors can better navigate the complexities of the market, adapt to changing economic conditions, and achieve their financial goals. This introduction delves into the fundamental principles and diverse tactics that underpin successful investment strategies, providing a foundation for both novice and seasoned investors to build and refine their market approaches.

It also encompass a range of methodologies designed to optimize returns and mitigate risks within financial portfolios. These strategies are fundamental to the decision-making processes of individual investors, institutional investors, and financial advisors. The dynamic nature of capital markets, characterized by volatility and diverse asset classes, necessitates a thorough understanding of various investment approaches to navigate effectively. Active management strategies involve a hands-on approach, with frequent buying and selling of securities to outperform market benchmarks.


**Investment Types**

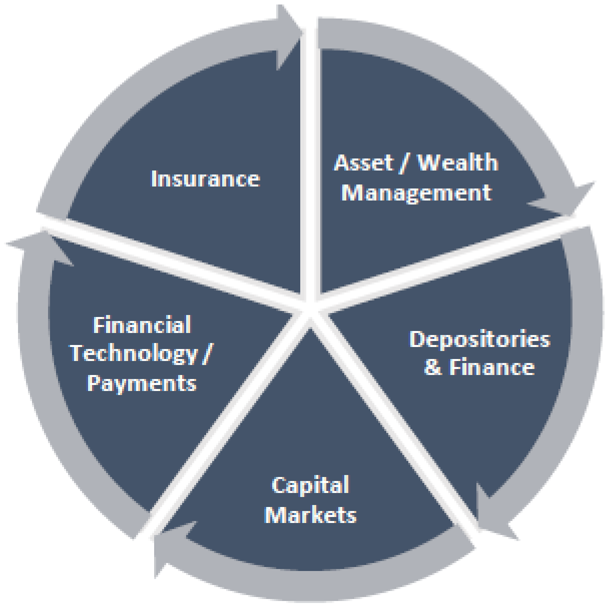
This strategy demands in-depth research, technical analysis, and often relies on market timing. Conversely, passive management strategies, such as index fund investing, focus on long-term market participation with minimal trading, aiming to mirror the performance of specific market indices like the S&P 500. Among the myriad strategies, value investing identifies and invests in undervalued stocks that are perceived to be trading below their intrinsic value. Growth investing, on the other hand, targets companies exhibiting strong potential for future growth, often reflected in high earnings growth rates. Income investing seeks to generate a steady cash flow through investments in dividend-paying stocks and bonds, appealing to investors seeking regular income. Modern portfolio theory (MPT) and asset allocation form the backbone of many investment strategies.

MPT advocates for portfolio diversification to optimize returns for a given level of risk, while asset allocation involves distributing investments across various asset classes, such as stocks, bonds, and real estate, to balance risk and reward according to the investor’s goals and risk tolerance. In recent years, sustainable investing, which integrates environmental, social, and governance (ESG) criteria into investment decisions, has gained prominence. Additionally, advancements in technology, particularly the application of artificial intelligence and machine learning, are revolutionizing traditional investment strategies by providing enhanced data analysis and predictive capabilities.

### 1.9.3Successful Examples of Capital Market Integration

1. The success of capital market integration in challenging home bias in a globalized world is evident through various case studies. These examples highlight the benefits of cross-border investment and the potential for increased returns and diversification. In this section, we will explore some successful case studies that demonstrate the positive impact of capital market integration.

2. Case Study 1: The European Union's Single Market :The European Union's single market is a prime example of successful capital market integration. The removal of barriers to cross-border investment and the harmonization of regulations have facilitated the free movement of capital within the EU. As a result, investors have been able to diversify their portfolios and access a broader range of investment opportunities. The integration of capital markets within the EU has also led to increased competition and efficiency, ultimately benefiting both investors and issuers.




**Financial Service Focus**

3. Case Study 2: ASEAN Linkage :The Association of Southeast Asian Nations (ASEAN) has made significant progress in integrating its capital markets through initiatives such as the ASEAN Linkage. This initiative aims to connect the stock exchanges of ASEAN member countries, allowing investors to trade securities across borders. The ASEAN Linkage has not only increased market liquidity but has also facilitated the flow of capital within the region. This integration has attracted foreign investors and enhanced the region's attractiveness as an investment destination.

4. Case Study 3: The shanghai-Hong Kong Stock connect: The Shanghai-Hong Kong Stock Connect is a landmark program that enables cross-border trading between the Shanghai Stock exchange and the hong Kong Stock exchange. This initiative has allowed international investors to access China's A-share market and Chinese investors to invest in Hong Kong-listed stocks. The integration of these

two markets has not only provided investors with greater investment opportunities but has also contributed to the internationalization of the Chinese capital market.

5. tips for Successful capital Market Integration:Harmonize regulations: Streamlining regulations across different markets can remove barriers to cross-border investment and facilitate capital market integration.

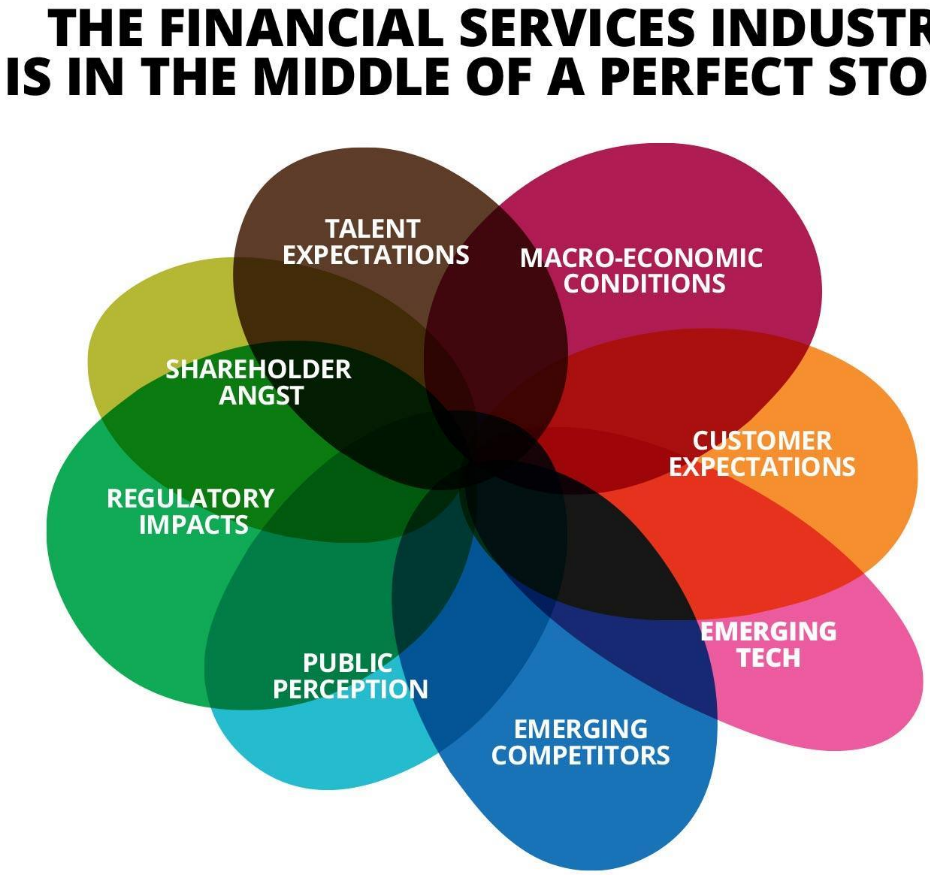
- Enhance market infrastructure: Investing in modern and efficient market infrastructure can improve liquidity and attract more investors.

- Foster collaboration: Encouraging collaboration between market participants, regulators, and policymakers can help overcome challenges and promote integration.

- Promote investor education: Educating investors about the benefits and risks of cross-border investment can increase their confidence and participation in integrated markets.

**1.10 Challenges and Risks Associated with Capital Market Integration**

1. Regulatory challenges: One of the key challenges associated with capital market integration is the need for harmonization of regulatory frameworks across different jurisdictions. Each country may have its own set of rules and regulations governing capital markets, which can create barriers to cross-border investment. For instance, differences in disclosure requirements, accounting standards, and investor protection regulations can make it difficult for investors to assess and compare investment opportunities in different markets. Harmonizing these regulations is crucial to ensure a level playing field and promote fair and transparent capital market integration.




**Financial Services Strategic**

2. Market volatility and systemic risks: Capital market integration can also increase market volatility and systemic risks. When markets are interconnected, a shock or crisis in one market can quickly spread to other markets, amplifying the impact and potentially leading to a global financial contagion. The 2008 global financial crisis is a prime example of how interconnectedness can magnify risks. Therefore, robust risk management frameworks and effective coordination among regulators are essential to mitigate these risks and maintain stability in integrated capital markets.

3. currency risk: Currency risk is another significant challenge associated with capital market integration. When investing in foreign markets, investors are exposed to fluctuations in exchange rates, which can affect the returns on their investments. For instance, a strengthening of the investor's home currency against the currency of the foreign market can erode the value of their investments. Hedging strategies, such as using derivatives or currency swaps, can help mitigate this risk, but they also come with their own complexities and costs.

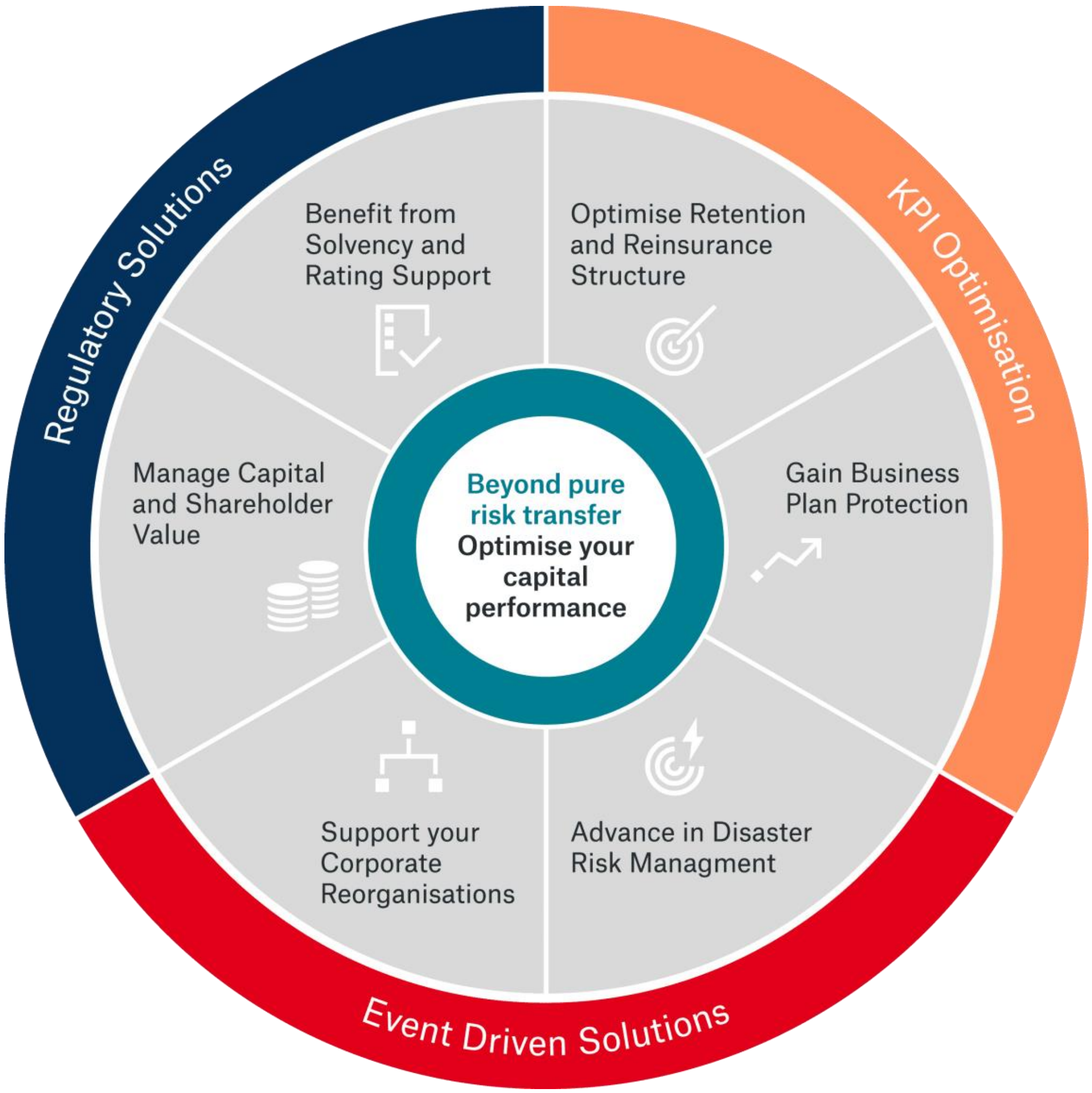
4. Information asymmetry: Capital market integration can exacerbate information asymmetry between investors and issuers. In integrated markets, investors may face challenges in accessing accurate and timely information about foreign companies, particularly those with different reporting standards and language barriers. This can lead to mispricing of securities and hinder efficient capital allocation. To address this, regulators and market participants must work towards enhancing transparency and facilitating the flow of information across borders.

5. Home bias and cultural barriers: Despite the benefits of capital market integration, investors often exhibit a home bias, preferring to invest in their domestic markets. This bias can stem from familiarity with local companies, cultural factors, or perceived risks associated with foreign investments. Overcoming this bias requires education and awareness campaigns to encourage investors to diversify their portfolios and take advantage of the opportunities offered by integrated capital markets. case studies showcasing successful cross-border investments can serve as inspiration for investors to overcome their biases.

6. Market manipulation and fraud: With increased cross-border transactions, the risk of market manipulation and fraud also rises. Fraudulent activities, such as insider trading or accounting fraud, can undermine investor confidence and hinder

the development of integrated capital markets. Effective regulatory enforcement, surveillance systems, and cooperation among regulatory authorities are crucial to detect and deter such activities. Examples of high-profile cases, such as the Enron scandal, highlight the importance of robust regulatory oversight in maintaining market integrity.

Capital market integration presents numerous challenges and risks that need to be addressed for successful global financial integration. Harmonizing regulations, managing market volatility, mitigating currency risk, improving information flow, overcoming home bias, and combating fraud are key areas that require attention from regulators, market participants, and investors. By effectively addressing these challenges, the potential benefits of capital market integration can be fully realized, fostering economic growth and facilitating efficient allocation of capital in a globalized world.




**Challenges and Risks Of Market Integration**

## 1.11Towards a More Integrated and Efficient Global Capital Market

In this blog series on capital market integration, we have explored the challenges posed by home bias in a globalized world and the potential benefits of a more integrated and efficient global capital market. Throughout our discussions, we have highlighted the importance of overcoming barriers to cross-border investment and the need for increased diversification and risk management strategies. As we conclude this series, let us summarize some key takeaways and discuss the way forward.

1. Home Bias: A Barrier to Global Integration

Home bias refers to the tendency of investors to allocate a significant portion of their portfolios to domestic assets, despite the availability of global investment opportunities. This bias can limit the benefits of diversification and hinder the efficient allocation of capital across borders. Overcoming home bias requires a shift in mindset and the adoption of a more global perspective when making investment decisions.

2. Benefits of Integration

A more integrated global capital market offers numerous benefits for investors, businesses, and economies as a whole. It facilitates access to a wider range of investment opportunities, enhances liquidity, reduces transaction costs, and promotes efficient pricing of assets. Integration also promotes competition among market participants, leading to increased efficiency and innovation.

3. Overcoming Barriers to Integration

To achieve a more integrated and efficient global capital market, it is crucial to address the barriers that hinder cross-border investment. These barriers can include regulatory differences, legal complexities, tax implications, and cultural differences. Harmonizing regulations, simplifying legal processes, and providing clearer tax frameworks can encourage greater cross-border investment flows.


**Overview of Financial Sector**

4. Tips for Investors

For individual investors looking to overcome home bias and take advantage of a more integrated global capital market, several tips can be helpful. Firstly, diversify your portfolio by investing in a mix of domestic and international assets. This diversification can reduce risk and enhance returns. Secondly, stay informed about global market trends, economic developments, and regulatory changes that may impact your investments. Finally, consider seeking professional advice from financial advisors who have expertise in global markets.

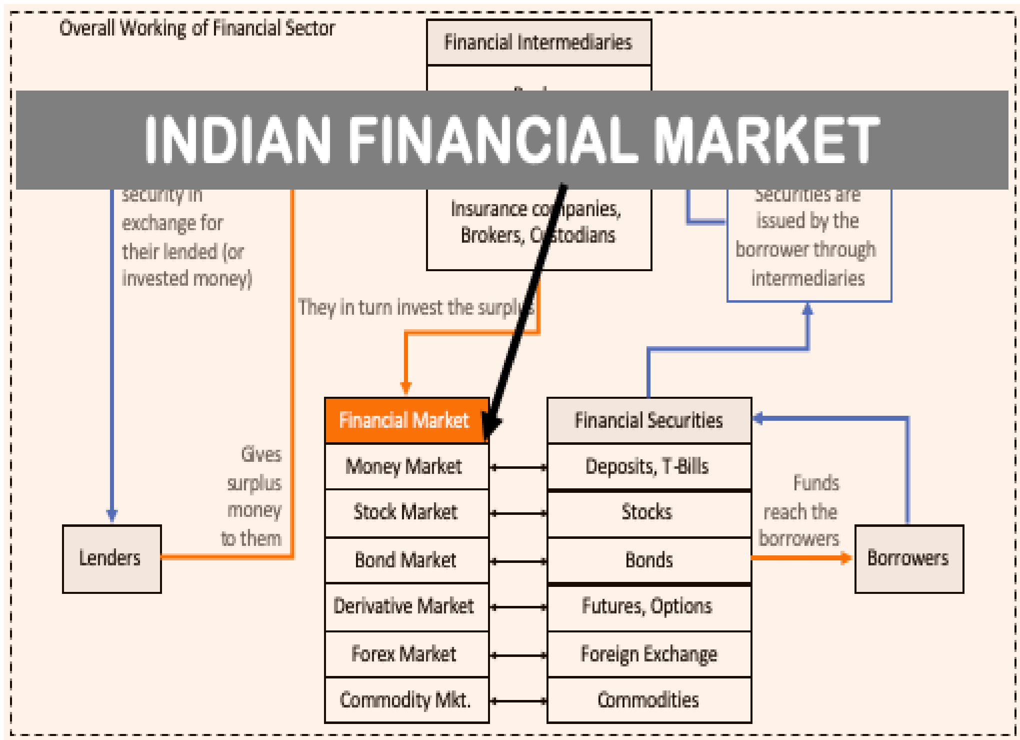
5. Case Study: European Union and the Eurozone

The European Union (EU) and the Eurozone provide an excellent case study of capital market integration. The EU has made significant efforts to harmonize regulations and remove barriers to cross-border investment within its member countries. The introduction of the euro as a common currency has further facilitated capital flows and enhanced market integration. While challenges remain, the EU experience demonstrates the potential benefits of deeper integration in a regional context.

A more integrated and efficient global capital market holds great potential for investors and economies worldwide. Overcoming home bias, addressing barriers to integration, and adopting a global perspective are crucial steps towards realizing these benefits. As we navigate an increasingly interconnected world, it is essential for investors to embrace the opportunities offered by a global capital market and make informed decisions that optimize their portfolios. By doing so, we can contribute to the growth and stability of the global economy.

## 1.12 Types of Financial Markets

- Stock Market – Allows companies to raise funds by issuing shares, which investors buy and sell. Major stock exchanges include the New York Stock Exchange (NYSE) and Nasdaq.
- Bond Market – Governments and corporations issue bonds to borrow money, offering fixed interest payments to investors.
- Forex Market – The foreign exchange (Forex) market deals with the trading of global currencies, influencing international trade and investments.
- Commodity Market – Trades raw materials like oil, gold, and agricultural products, impacting global supply chains.
- Derivatives Market – Involves contracts such as futures and options based on the value of underlying assets, helping in risk management.




**Financial Market in India**

***Importance of Financial Markets***

- Capital Allocation – Directs funds to productive businesses and sectors.
- Liquidity – Ensures assets can be easily bought or sold.
- Risk Management – Offers instruments like derivatives to hedge against uncertainties.
- Economic Stability – Helps in regulating money supply and interest rates.
- Financial markets drive economic growth by efficiently distributing capital, fostering investment, and supporting financial stability worldwide.

# UNIT 2

# INVESTMENT FUNDAMENTALS AND ASSET CLASSES

Investing is the process of allocating money into assets with the expectation of generating returns over time. Understanding investment fundamentals and different asset classes is essential for making informed financial decisions.

## 2.1. Investment Fundamentals

- Risk and Return – Higher potential returns usually come with higher risks. Investors must balance their risk tolerance with their financial goals.
- Diversification – Spreading investments across different assets to reduce overall risk.
- Time Horizon – The length of time an investor plans to hold an investment, affecting risk and return expectations.
- Liquidity – The ease with which an asset can be converted into cash without significant loss in value.

Major Asset Classes

- Equities (Stocks) – Ownership shares in companies, offering high return potential but also higher risk.
- Fixed-Income Securities (Bonds) – Debt instruments issued by governments or corporations, providing regular interest payments with lower risk than stocks.
- Cash and Cash Equivalents – Highly liquid assets such as savings accounts, Treasury bills, and money market funds with low risk but modest returns.

- Real Estate – Investments in properties, offering income from rent and potential appreciation in value.
- Commodities – Physical goods like gold, oil, and agricultural products, often used as a hedge against inflation.
- Alternative Investments – Includes hedge funds, private equity, and cryptocurrencies, often requiring specialized knowledge and higher risk tolerance.

Understanding these fundamentals and asset classes helps investors create a balanced portfolio that aligns with their financial objectives and risk appetite.

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is up to one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement. Money market does not imply to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to borrowers. Most of the money market transactions are taken place on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

## 2.2 Purpose of Finance

The purpose of money markets is facilitate the transfer of short-term funds from agents with excess funds (corporations, financial institutions, individuals, government) to those market participants who lack funds for short-term needs. They play central role in the country"s financial system, by influencing it through the country"s monetary authority. For financial institutions and to some extent to other non-financial company"s money markets allow for executing such functions as:

- Fund raising
- Cash management
- Risk management
- Speculation or position financing
- Signaling
- Providing access to information on prices.

Money markets are wholesale markets with very large amounts of transactions, e.g. with transactions from 500 million Euro to 1 billion Euro or even larger ones. This is the most active financial market in terms of volumes of trading.

From the start of emergence the traditional money markets performed the role of monetary policy. In order to influence the supply side, governments have employed methods of direct regulation and control of the savings and investment behaviour of individuals and companies. However due to fast technological advances, internationalization and liberalization of financial markets, possibilities to carry out policy objectives through such measures have diminished. Current policy through market oriented measures is aimed primarily at demand side. Thus money markets serve the interface between execution of monetary policy and the national economies.

Another role of domestic money markets is to serve public policy objectives, i.e. financing public sector deficits and managing the accumulated government deficits. Government public debt policy is an important determinant of the money markets operations, since government debt typically forms a key part of the country‟s money markets (as well as debt markets). The scope and measures of monetary policy are also linked to the government‟s budget and fiscal policies. Thus the country‟s money market shifts are dependent upon the goals of national public policy and tools used to reach these goals.

Changes in the role and structure of money markets were also influenced by financial deregulation, which evolved as a result of recognition that excessive controls are not compatible with efficient resource allocation, with solid and balanced growth of economies. Money markets went through passive adaptation as well as through active influence from the side of governments and monetary authorities.

Finally, money markets were influenced by such international dimensions as increasing capital mobility, changing exchange rate arrangements, diminishing monetary policy autonomy. The shifts in European domestic money markets were made by the European integration process, emergence and development of European monetary union.

**2.3 Characteristics and Functions of Money Market**

The money market is a market for financial assets that are close substitutes for money. It is a market for overnight short-term funds and instruments having a maturity period of one or less than one year. It is not a place (like the Stock market), but an activity conducted by telephone. The money market constitutes a very important segment of the Indian financial system.

## Characteristics of Money Market

1. It is not a single market but a collection of markets for several instruments.

2. It is wholesale market of short term debt instruments.

3. Its principal feature is honour where the creditworthiness of the participants is important.

4. The main players are: Reserve bank of India (RBI), Discount and Finance House of India (DFHI), mutual funds, banks, corporate investor, nonbanking finance companies (NBFCs), state governments, provident funds and primary dealers. Securities Trading Corporation of India (STCI), public sector undertaking (PSUs), non-resident Indians and overseas corporate bodies.

5. It is a need based market wherein the demand and supply of money shape the market.

## Functions of Money Market

A well-developed money market is essential for a modern economy. Though, historically, money market has developed as a result of industrial and commercial progress, it also has important role to play in the process of industrialization and economic development of a country. Importance of a developed money market and its various functions are discussed below:

1.Financing Trade:

Money Market plays crucial role in financing both internal as well as international trade. Commercial finance is made available to the traders through bills of exchange, which are discounted by the bill market. The acceptance houses and discount markets help in financing foreign trade.

2.Financing Industry:

Money market contributes to the growth of industries in two ways:

(a) Money market helps the industries in securing short-term loans to meet their working capital requirements through the system of finance bills, commercial papers, etc.

(b) Industries generally need long-term loans, which are provided in the capital market. However, capital market depends upon the nature of and the conditions in the money market. The short-term interest rates of the money market influence the long-term interest rates of the capital market. Thus, money market indirectly helps the industries through its link with and influence on long-term capital market.

3. Profitable Investment:

Money market enables the commercial banks to use their excess reserves in profitable investment. The main objective of the commercial banks is to earn income from its reserves as well as maintain liquidity to meet the uncertain cash demand of the depositors. In the money market, the excess reserves of the commercial banks are invested in near-money assets (e.g. short-term bills of exchange) which are highly liquid and can be easily converted into cash. Thus, the commercial banks earn profits without losing liquidity.

4.Self-Sufficiency of Commercial Bank:

Developed money market helps the commercial banks to become selfsufficient. In the situation of emergency, when the commercial banks have scarcity of funds, they need not approach the central bank and borrow at a higherinterest rate. On the other hand, they can meet their requirements by recalling their old short-run loans from the money market.

5. Help to Central Bank:

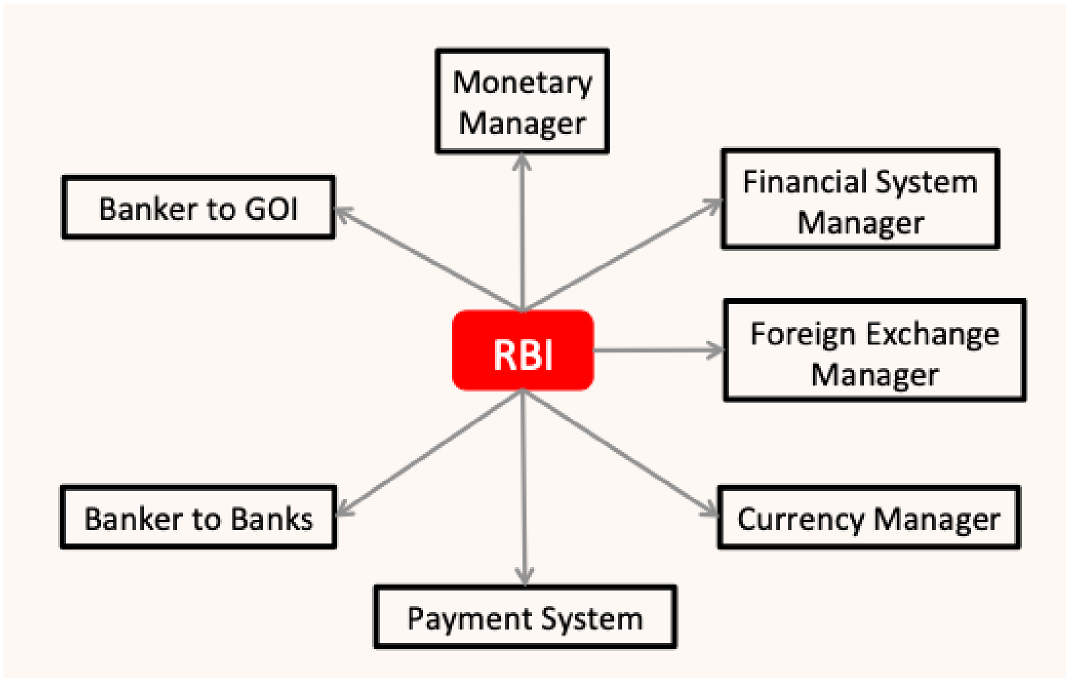
Though the central bank can function and influence the banking system in the absence of a money market, the existence of a developed money market smoothens the functioning and increases the efficiency of the central bank. Money market helps the central bank in two ways:

(a) The short-run interest rates of the money market serves as an indicator of the monetary and banking conditions in the country and, in this way, guide the central bank to adopt an appropriate banking policy,

(b) The sensitive and integrated money market helps the central bank to secure quick and widespread influence on the sub-markets, and thus achieve effective implementation of its policy.

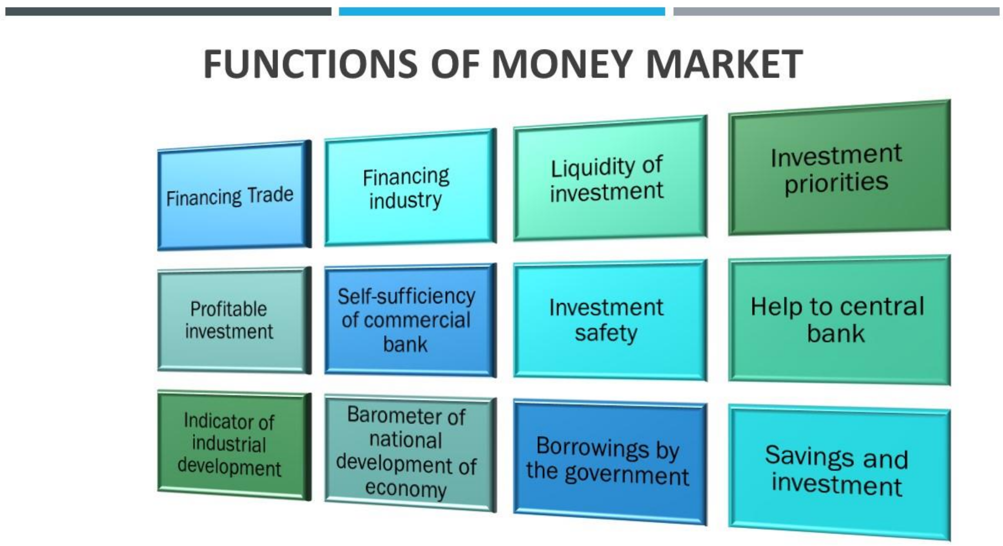
**2.4 Role of the Reserve Bank in the Money Market**

The Reserve Bank of India (RBI) has always been playing the major role in regulating and controlling the India money market. The intervention of RBI is varied - curbing crisis situations by reducing the cash reserve ratio (CRR) or infusing more money in the economy.




**Functions of RBI**

Having talked about financial sector and the on-going reform process in the sector, let us now turn our attention to what exact role RBI is playing for thefinancial sector in general and the financial reform process in particular. As all of you know, RBI is the central bank of the country. Central banks are very old institutions. The Bank of England was set up way back in 1694, the Bank of France is more than 200 years old and the Federal Reserve Bank was set up in 1913. As aptly stated by our Governor, Dr. Bimal Jalan, although RBI, set up in 1935, may appear a „toddler or at most a young adult", it is one of the oldest central banks among the developing world. Traditionally, central banks have performed roles of currency authority, banker to the Government and banks, lender of last resort, supervisor of banks and exchange control (now it would be more appropriate to call it exchange management) authority. Generally, central banks in developed economies have price or financial stability as their prime objective. The RBI has the twin objectives of maintaining price stability and promoting growth. The objectives are the following:




**Function of Money Market**

- Provision of adequate liquidity to meet credit growth and support investment demand in the economy while continuing a vigil on movements in the price level. In line with the above to continue the present stance on interest rates including preference for soft interest rates.
- To impart greater flexibility to the interest rate structure in the mediumterm. In developing economies, however, the growth objective assumes greater importance. Recent experience has shown

that during recessionary or deflationary conditions achievement of higher growth becomes the dominant objective of central banks, both in developing and developed economies.

Let us now look at the evolution of RBI and its changing role and strategy over time. RBI was set up to regulate the issue of currency and keep reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage (RBI Act, 1934). Within these overall objectives, RBI performs a wide range of promotional functions, which are designed to support the country‟s efforts to accelerate the pace of economic development with social justice. In keeping with the overall logic of reforms that market based allocation rather than directed allocation of resources led to greater efficiency, the functions of the RBI have undergone a strategic shift under the current reforms. The strategy shifted from controlling institutions and markets to facilitation of efficient functioning of markets and strengthening of the supporting institutional infrastructure. The pre-emptions in the form of CRR and SLR have been progressively reduced. The scope of priority sector has been expanded. The interest rate has been deregulated both on deposits and advances. Allowing DFIs and banks to lend in the short as well as the longend of the market has reduced segmentation of credit market. From conservation of foreign exchange through control of transactions, the focus has shifted to facilitation of foreign exchange transactions. Intervention in the foreign exchange market has shifted from fixing of exchange rate to merely curbing speculative volatility.

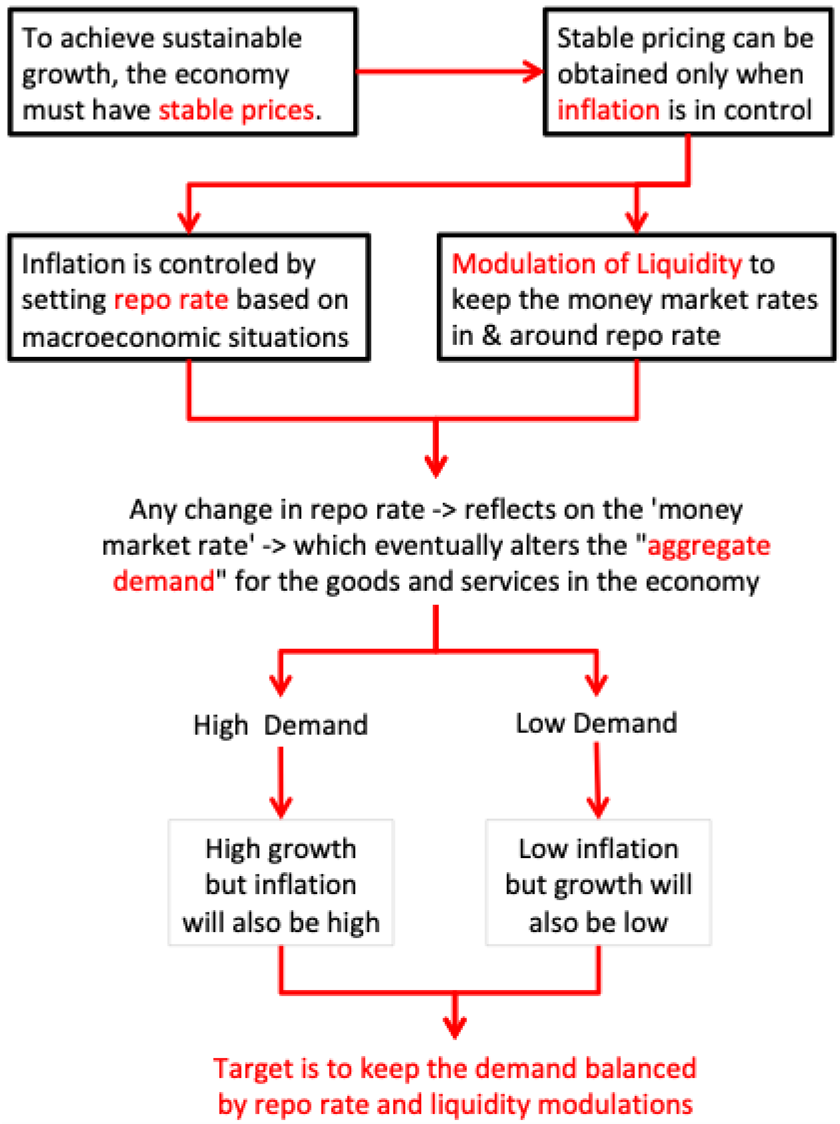

**Money Market**

Stability issues came to the fore especially after the crises in South East Asian countries in late 1990s. The RBI progressively strengthened prudential regulation relating to capital adequacy, income recognition, asset classification, provisioning, disclosures and transparency. Sequencing of reforms among various segments of the financial sector (banks, DFIs, co-operative banks, NBFCs, money market, debt market and forex market) was determined by the importance of each segment, extent of regulatory powers enjoyed by the RBI and the evolving situation. Furthermore, institutional strengthening was undertaken to ensure the progressive development and integration of the securities, money and forex markets. The RBI has made significant improvements in the quality of performance of regulatory and supervisory functions. Our standards are comparable to the best in the world. Attention is being paid to several contemporary issues such as, relative roles of onsite and off-site supervision, functional versus institutional regulation, relative stress on internal management, market discipline and regulatory prescriptions, consolidated approach to supervision, etc. Several legislative initiatives have also been taken up with Government, covering procedural law, debt recovery systems, Credit Information Bureau, Deposit Insurance, etc. Progress in these is critical for effectiveness of RBI in the regulatory sphere. A recent important legislative development, which will improve the momentum of recovery of dues, is the enactment of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act. Under this Act RBI has been entrusted with the role of stipulating suitable norms for registration of securitisation or reconstruction companies, prescribing prudential norms, recommending proper and transparent accounting and disclosure standards and framing appropriate guidelines for the conduct of asset reconstruction and securitization.

## 2.5 Intermediates in the Money Market

Money market participants include mainly credit institutions and other financial intermediaries, governments, as well as individuals (households). Ultimate lenders in the money markets are households and companies with a financial surplus which they want to lend, while ultimate borrowers are companies and government with a financial deficit which need to borrow. Ultimate lenders and borrowers usually do not participate directly in the markets. As a rule they deal through an intermediary, who performs functions of broker, dealer or investment banker.

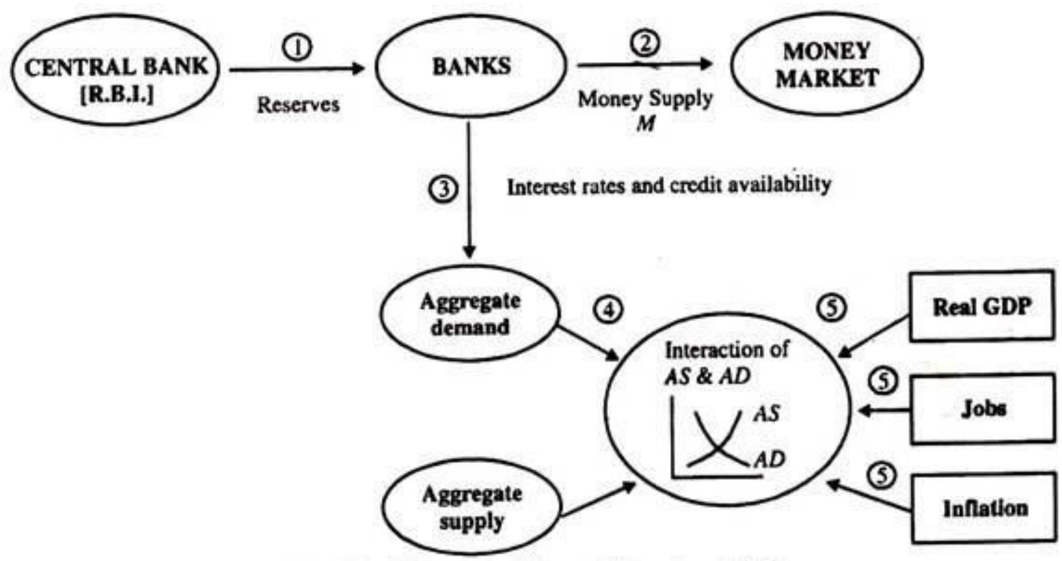
Important role is played by government, which issue money market securities and use the proceeds to finance state budget deficits. The government debt is often refinanced by issuing new securities to pay off old debt, which matures. Thus it manages to finance long term needs through money market securities with short-term maturities.




**Flow Chart of RBI**

Central bank employs money markets to execute monetary policy. Through monetary intervention means and by fixing the terms at which banks are provided with money, central banks ensure economy‟s supply with liquidity.

Credit institutions (i.e. banks) account for the largest share of the money market. They issue money market securities to finance loans to households and corporations, thus supporting household purchases and investments of corporations. Besides, these institutions rely on the money market for the management of their short-term liquidity positions and for the fulfilment of their minimum reserve requirements.



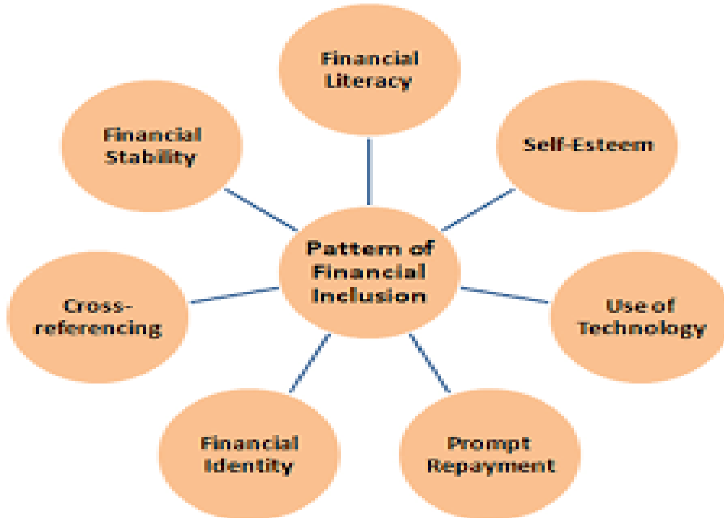

**Role of Bank**

Other important market participants are other financial intermediaries, such as money market funds, investment funds other than money-market funds, insurance companies and pension funds. Large non-financial corporations issue money market securities and use the proceeds to support their current operations or to expand their activities through investments.

In general issuance of money market securities allow market participants to increase their expenditures and finance economic growth.Money market securities are purchased mainly by corporations, financial intermediaries and government that have funds available for a short-term period. Individuals (or households) play a limited role in the market by investing indirectly through money market funds. Apart from transactions with the central bank, money-market participants trade with each other to take positions dependent upon their short-term interest rate expectations, to finance their securities trading portfolios (bonds, shares, etc.), to hedge their longer-term positions with shortterm contracts, and to reduce individual liquidity imbalances.

### 2.6 Development of Money Market in India

While the need for long term financing is met by the capital or financial markets, money market is a mechanism which deals with lending and borrowing of short term funds. Post reforms age in India has witnessed marvellous increase of the Indian money markets. Banks and other financial institutions have been able to meet the high opportunity of short term financial support of important sectors like the industry, services and agriculture. It performs under the regulation and control of the Reserve Bank of India (RBI). The Indian money markets have also exhibit the required maturity and flexibility over the past two decades. Decision of the government to permit the private sector banks to operate has provided much needed healthy competition in the money markets resulting in fair amount of improvement in their performance.




**Pattern of Financial Inclusion**

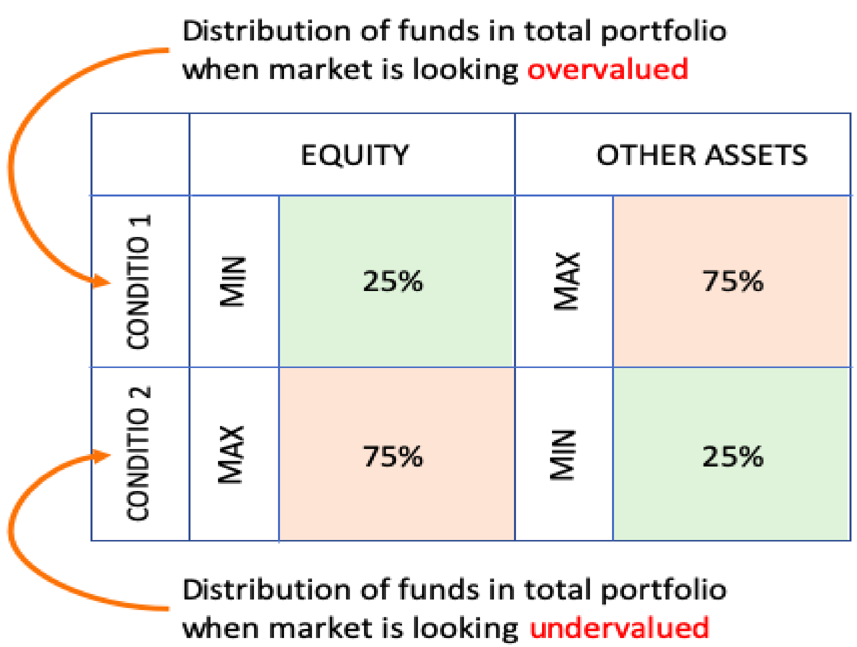
Till 1935, when the RBI was set up the Indian money market remained highly disintegrated, unorganized, narrow, shallow and therefore, very backward. The planned economic development that commenced in the year 1951 market is an important beginning in the annals of the Indian money market. The nationalization of banks in 1969, setting up of various committees such as the Sukhmoy Chakraborty Committee (1982), the Vaghul working group (1986), the setting up of discount and finance house of India ltd. (1988), the securities trading corporation of India (1994) and the commencement of liberalization and globalization process in 1991 gave a further fillip for the integrated and efficient development of India money market.

### 2.7 Money Market Instruments

Money Market is the part of financial market where instruments with high liquidity and very short-term maturities are traded. It's the place where large financial institutions, dealers and government participate and meet out their shortterm cash needs. They usually borrow and lend money with the help of instruments or securities to generate liquidity. Due to highly liquid nature of securities and their short-term maturities, money market is treated as safe place.

### 2.7.1 Treasury Bills

A treasury bill is a promissory note issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments that mean, at any time the holder of treasury bills can transfer of or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference between the issue price and the face value of the Treasury bill represents the interest on the investment. These bills are secured instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play major role in the Treasury bill market.




**Investment Diversification**

### 2.7.2 Commercial Papers

Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. The CP is an unsecured instrument issued in the form of promissory note. This instrument was introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market. The aim of its issuance is to provide liquidity or finance company‟s investments, e.g. in inventory and accounts receivable. The major issuers of commercial papers are financial institutions, such as finance companies, bank holding companies and insurance companies. Financial companies tend to use CPs as a regular source of finance. Non-financial companies tend to issue CPs on an irregular basis to meet special financing needs. Thus commercial paper is a form of short-term borrowing. Its initial maturity is usually between seven and forty-five days. In US, the advantage of issuing CPs with maturities less than nine months is that they do not have to register with the Securities Exchange Commission (SEC) as a public offering. This reduces the costs of registration with SEC and avoids delays related to the registration process. CPs can be sold directly by the issuer, or may be sold to dealers who charge a placement fee (e.g. 1/8 percent). Since issues of CPs are heterogeneous in terms of issuers, amounts, maturity dates, there is no active secondary market for commercial papers. However, dealers may repurchase CPs for a fee.

### 2.7.3 Certificate of Deposit

Certificates of Deposit (CDs) are short-term instruments issued by Commercial Banks and Special Financial Institutions (SFIs), which are freely transferable from one party to another. The maturity period of CDs ranges from 91 days to one year. These can be issued to individuals, co-operatives and companies.

Certificate of deposit (CD) states that a deposit has been made with a bank for a fixed period of time, at the end of which it will be repaid with interest.

Thus it is, in effect, a receipt for a time deposit and explains why CDs appear in definitions of the money supply such as M4. It is not the certificate as such that is included, but the underlying deposit, which is a time deposit like other time deposits. An institution is said to „issue‟ a CD when it accepts a deposit and to „hold‟ a CD when it itself makes a deposit or buys a certificate in the secondary market. From an institution‟s point of view, therefore, issued CDs are liabilities; held CDs are assets.

The advantage to the depositor is that the certificate can be tradable. Thus though the deposit is made for a fixed period, he depositor can use funds earlier by selling the certificate to a third party at a price which will reflect the period to maturity and the current level of interest rates.

The advantage to the bank is that it has the use of a deposit for a fixed period but, because of the flexibility given to the lender, at a slightly lower price than it would have to pay for a normal time deposit.

The minimum denomination can be 100 000USD, although the issue can be as large as 1million USD. The maturities of CDs usually range from two weeks to one year. Non-financial corporations usually purchase negotiable CDs. Though negotiable CD denominations are typically too large for individual investors, they are sometimes purchased by money market funds that have pooled individual investors‟ funds. Thus money market funds allow individuals to be indirect investors in negotiable CDs. This way the negotiable CD market can be more active. There is also a secondary market for these securities, however its liquidity is very low.


**Managing investment risk**

### 2.7.4 Commercial Bills

Normally the traders buy goods from the wholesalers or manufactures on credit. The sellers get payment after the end of the credit period. But if any seller does not want to wait or in immediate need of money, he/she can draw a bill of exchange in favour of the buyer. When buyer accepts the bill it becomes a negotiable instrument and is termed as bill of exchange or trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawer i.e., the buyer of goods. When trade bills are accepted by Commercial Banks it is known as Commercial Bills. So trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

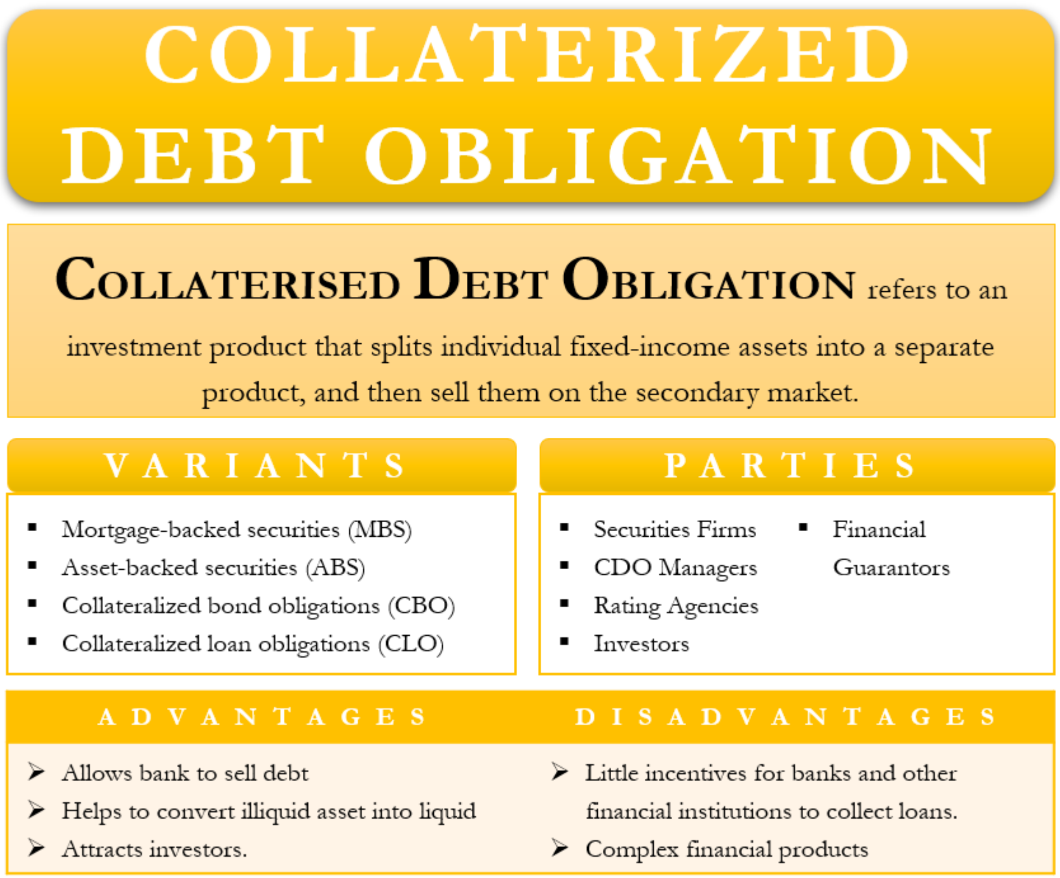
## 2.8 Collateralized Browsing and Lending Obligation

"Collateralized Borrowing and Lending Obligation (CBLO)", as the name implies is a fully collateralized and secured instrument for borrowing / lending money. CBLO as a product is conceived and developed by CCIL for the facilitating deployment in a collateralized environment. As a product, CBLO aims to benefit those entities who have been phased out of Call/ Notice money market and / or those entities on restrictions have been placed on the borrowing / lending in call / notice money market. CBLO Dealing system is hosted and maintained by Clear corp Dealing Systems (India) Ltd, a fully owned subsidiary of CCIL. CCIL becomes Central Counterparty to all CBLO trades and guarantees settlement of CBLO trades. CBLO is an RBI approved money market instrument which can be issued for a maximum tenor of one year. CBLO is a discounted instrument traded on Yield Time priority. CBLO instrument that are generally made available for trading are those with maturity of next seven business days and three month end dates. The balances are maintained in electronic book entry. The access to CBLO Dealing system for NDS Members is made available through INFINET and for non NDS Members through Internet. The Funds settlement of members in CBLO segment is achieved in the books of RBI for members who maintain an RBI Current Account and are allowed to operate that current account for settlement of their secondary market transactions. In respect of other members, CBLO Funds settlement is achieved in the books of Settlement Bank.

**Collateralized Borrowing and Lending**

## 2.9 Call Money Market and Term Money Market

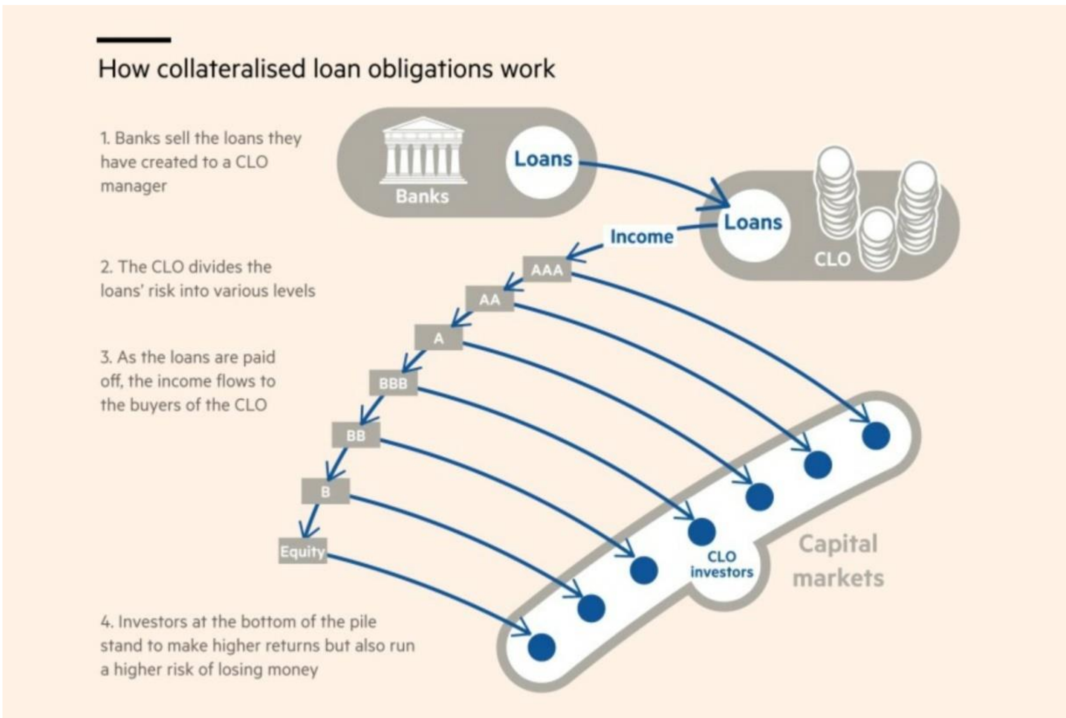
The call money market deals in short term finance repayable on demand, with a maturity period varying from one day to 14 days. S.K. Muranjan commented that call loans in India are provided to the bill market, rendered between banks, and given for the purpose of dealing in the billion market and stock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




**Collateralized Debt Obligation**

The money market is a market for short-term financial assets that are close substitutes of money. The most important feature of a money market instrument is that it is liquid and can be turned over quickly at low cost and provides an opportunity for balancing the short-term surplus funds of lenders and the requirements of borrowers. By convention, the term "Money Market" refers to the market for short-term requirement and deployment of funds. Money market instruments are those instruments, which have a maturity period of less than one year. The most active part of the money market is the market for overnight call and term money between banks and institutions and repo transactions.

Call Money / Repo are very short-term Money Market products. There is a wide range of participants (banks, primary dealers, financial institutions, mutual funds, trusts, provident funds, etc.) dealing in money market instruments. Money Market Instruments and the participants of money market are regulated by RBI and SEBI.As a primary dealer SBI DFHI is an active player in this market and widely deals in Short Term Money Market Instruments.




**Work flow of Collateralized loan obligations**

The below mentioned instruments are normally termed as money market instruments:

- Call/ Notice/ Term Money
- Repo/ Reverse Repo
- Inter Corporate Deposits
- Commercial Paper
- Certificate of Deposit
- T-bills
- Inter Bank Participation Certificate


**Portfolio Diversification**

### 2.10 Diversification and Asset Allocation Strategies

Diversification and asset allocation are key investment strategies that help manage risk and optimize returns. **Diversification** involves spreading investments across different asset classes, industries, and geographic regions to reduce exposure to any single risk. This minimizes potential losses if one asset underperforms. **Asset allocation** is the process of distributing investments among various asset classes (such as stocks, bonds, and real estate) based on an investor's financial goals, risk tolerance, and time horizon. A well-balanced portfolio combines both strategies to enhance stability and achieve long-term financial growth.

#### 2.10.1 Defining Diversification

Asset allocation alone is not enough to effectively manage risk. After all, allocating 100 percent of your assets into security in one asset class won't offer up much protection. Instead, it will expose you to concentration risk. That's where diversification comes in.

Diversification reduces the risk of major losses that can result from over-emphasizing a single security or single asset class, however resilient you might expect that asset or asset class to be. This is especially true if your assets are "uncorrelated," meaning they react to economic events in ways independent of other assets in your portfolio. Stocks and bonds, for instance, often move in different directions from each other, which is why holding both of these asset classes (and others) can help manage risk. Learn more in this Smart Investing Course: Playing the Field: Diversification.

Financial experts tend to recommend diversification among and within asset classes. For example, when it comes to stocks, diversification increases when you own multiple stocks. It increases further when those stocks are made up of different sized companies (small, medium and large companies), include different sectors (technology, consumer, healthcare and more) and are diversified geographically (domestic and international).

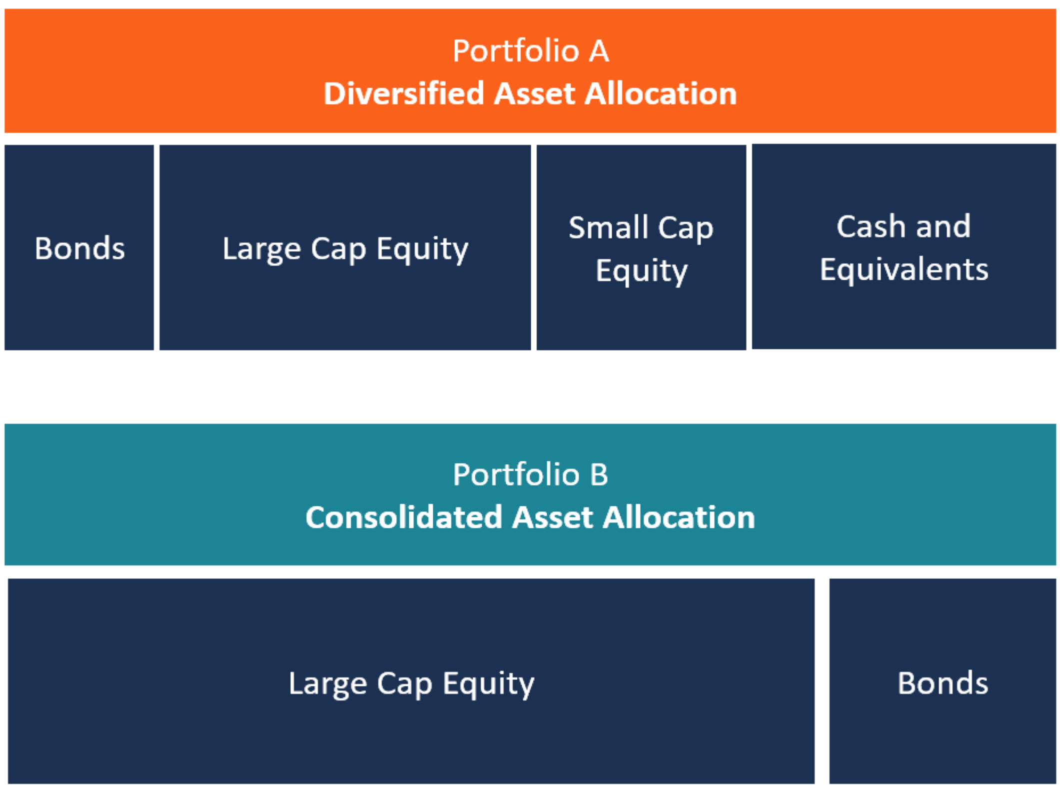
Similarly, if you're buying bonds, you might choose bonds from different issuers—the federal government, state and local governments and corporations—as well as those with different terms and different credit ratings.

Building a diversified portfolio is one of the reasons many investors turn to pooled investments—such as mutual funds and exchange-traded funds. Pooled investments typically include a larger number and variety of underlying investments than you're likely to assemble on your own, so they help spread out your risk. You do have to make sure, however, that even the pooled investments you own are diversified. For example, owning two mutual funds that invest in the same subclass of stocks won't help you to diversify.

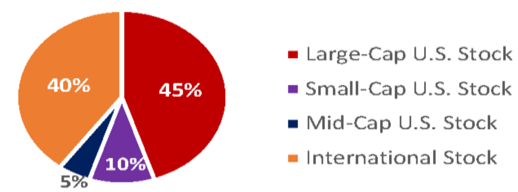
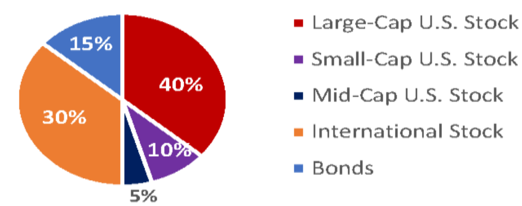
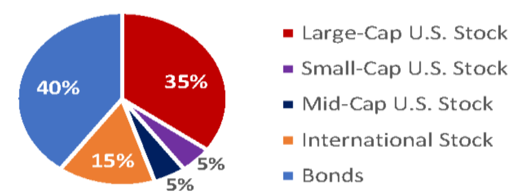
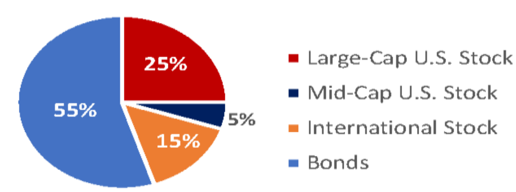
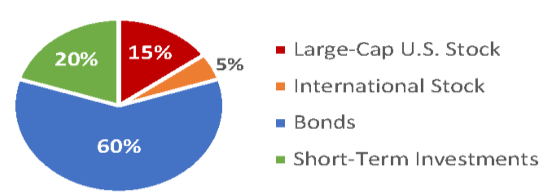
- Diversification is a strategy that mixes a wide variety of investments within a portfolio in an attempt to reduce portfolio risk.
- Diversification is most often done by investing in different asset classes such as stocks, bonds, real estate, or cryptocurrency.
- Diversification can also be achieved by purchasing investments in different countries, industries, sizes of companies, or term lengths for income-generating investments.
- The quality of diversification in a portfolio is most often measured by analyzing the correlation coefficient of pairs of assets.
- Investors can diversify on their own by investing in select investments or can hold diversified funds.

### 2.10.2 Understanding Diversification

Studies and mathematical models have shown that maintaining a well-diversified portfolio of 25 to 30 stocks yields the most cost-effective level of risk reduction. Investing in more securities generates further diversification benefits, but it does so at a substantially diminishing rate of effectiveness.Diversification strives to smooth out unsystematic risk events in a portfolio, so the positive performance of some investments neutralizes the negative performance of others. The benefits of diversification hold only if the securities in the portfolio are not perfectly correlated—that is, they respond differently, often in opposing ways, to market influences.




**Asset Allocation**

<table>
<tr><th>INVESTOR TYPE</th><th>SAMPLE ASSET ALLOCATION</th></tr>
<tr><td>AGGRESSIVE<br>For investors who have a long-term investing time horizon and are willing to assume stock market volatility in exchange for potentially higher growth over time.</td><td>
</td></tr>
<tr><td>MODERATELY AGGRESSIVE<br>For investors who have a long-term investing time horizon and are willing to absorb a fair amount of stock market volatility but also temper their exposure to stocks with less volatile investments.</td><td>
</td></tr>
<tr><td>MODERATE<br>For investors who seek to balance moderate growth potential with lower volatility investments.</td><td>
</td></tr>
<tr><td>MODERATELY CONSERVATIVE<br>For investors willing to accept modest investment growth and modest stock market volatility.</td><td>
</td></tr>
<tr><td>CONSERVATIVE<br>For investors unwilling or unable to accept volatility and are concerned with preserving their account balance with little growth potential.</td><td>
</td></tr>
</table>

### 2.10.3 Diversification Strategies

As investors consider ways to diversify their holdings, there are dozens of strategies to implement. Many of the methods below can be combined to enhance the level of diversification within a single portfolio.

***Asset Classes***

Fund managers and investors often diversify their investments across asset classes and determine what percentages of the portfolio to allocate to each. Each asset class has a different, unique set of risks and opportunities. Classes can include:

- Stocks: Shares or equity in a publicly traded company
- Bonds: Government and corporate fixed-income debt instruments
- Real estate: Land, buildings, natural resources, agriculture, livestock, and water and mineral deposits
- Exchange-traded funds (ETFs): A marketable basket of securities that follow an index, commodity, or sector
- Commodities: Basic goods necessary for the production of other products or services
- Cash and short-term cash-equivalents (CCE): Treasury bills, certificate of deposit (CD), money market vehicles, and other short-term, low-risk investments

The theory holds that what may negatively impact one asset class may benefit another. For example, rising interest rates usually negatively impact bond prices as yield must increase to make fixed income securities more attractive. On the other hand, rising interest rates may result in increases in rent for real estate or increases in prices for commodities.

### *Industries/Sectors*

There are tremendous differences in the way different industries or sectors operate. As investors diversify across various industries, they become less likely to be impacted by sector-specific risk.Investors can diversify across industries by coupling investments that may counterbalance different businesses. For example, consider two major means of entertainment: travel and digital streaming. Investors hoping to hedge against the risk of future major pandemic impacts may invest in digital streaming platforms (positively impacted by more shutdowns). At the same time, they may consider simultaneously investing in airlines (positively impacted by fewer shutdowns). In theory, these two unrelated industries may minimize overall portfolio risk.

### *Corporate Lifecycle Stages (Growth vs. Value)*

Public equities tend to be broken into two categories: growth stocks and value stocks. Growth stocks are stocks in companies that are expected to experience profit or revenue growth greater than the industry average. Value stocks are stocks in companies that appear to be trading at a discount based on the current fundamentals of a company.

Growth stocks tend to be more risky as the expected growth of a company may not materialize. For example, if the Federal Reserve constricts monetary policy, less capital is usually available (or it is more expensive to borrow), creating a more difficult scenario for growth companies. However, growth companies may tap into seemingly limitless potential and exceed expectations, generating even greater returns than expected.

On the other hand, value stocks tend to be more established, stable companies. While these companies may have already experienced most of their potential, they usually carry less risk. By diversifying into both, an investor would capitalize on the future potential of some companies while also recognizing the existing benefits of others.

***Market Capitalizations (Large vs. Small)***

Investors may want to consider investing across different securities based on the underlying market capitalization of the asset or company. Consider the vast operational differences between Apple and Newell Brands Inc. In July 2023, both companies were in the S&P 500, with Apple representing 7.6% of the index and Newell Brands representing 0.0065%.

Each company will have a considerably different approach to raising capital, introducing new products to the market, brand recognition, and growth potential. Lower cap stocks have more room to grow, though higher cap stocks tend to be safer investments.

***Risk Profiles***

Across almost every asset class, investors can choose the underlying risk profile of the security. For example, consider fixed-income securities. An investor can choose to buy bonds from the top-rated governments in the world or from nearly defunct private companies raising emergency funds. There are considerable differences between several 10-year bonds based on the issuer, their credit rating, future operational outlook, and existing level of debt.

The same can be said for other types of investments. Real estate development projects with more risk may carry greater upside than established operating properties. Meanwhile, cryptocurrencies with longer histories and greater adoption, such as Bitcoin, carry less risk relative to smaller market cap coins or tokens.

### *Physical Locations (Foreign vs. Domestic)*

Investors can reap further diversification benefits by investing in foreign securities. For example, forces depressing the U.S. economy may not affect Japan's economy in the same way. Therefore, holding Japanese stocks gives an investor a small cushion of protection against losses during an American economic downturn.

Alternatively, there may be a greater potential upside (with associated higher degrees of risk) when diversifying across developed and emerging countries. Consider Pakistan's current classification as a frontier market participant (recently downgraded from an emerging market participant).

Investors willing to take on higher levels of risk may want to consider the higher growth potential of smaller yet-to-be-fully established markets such as Pakistan.

### *Tangibility*

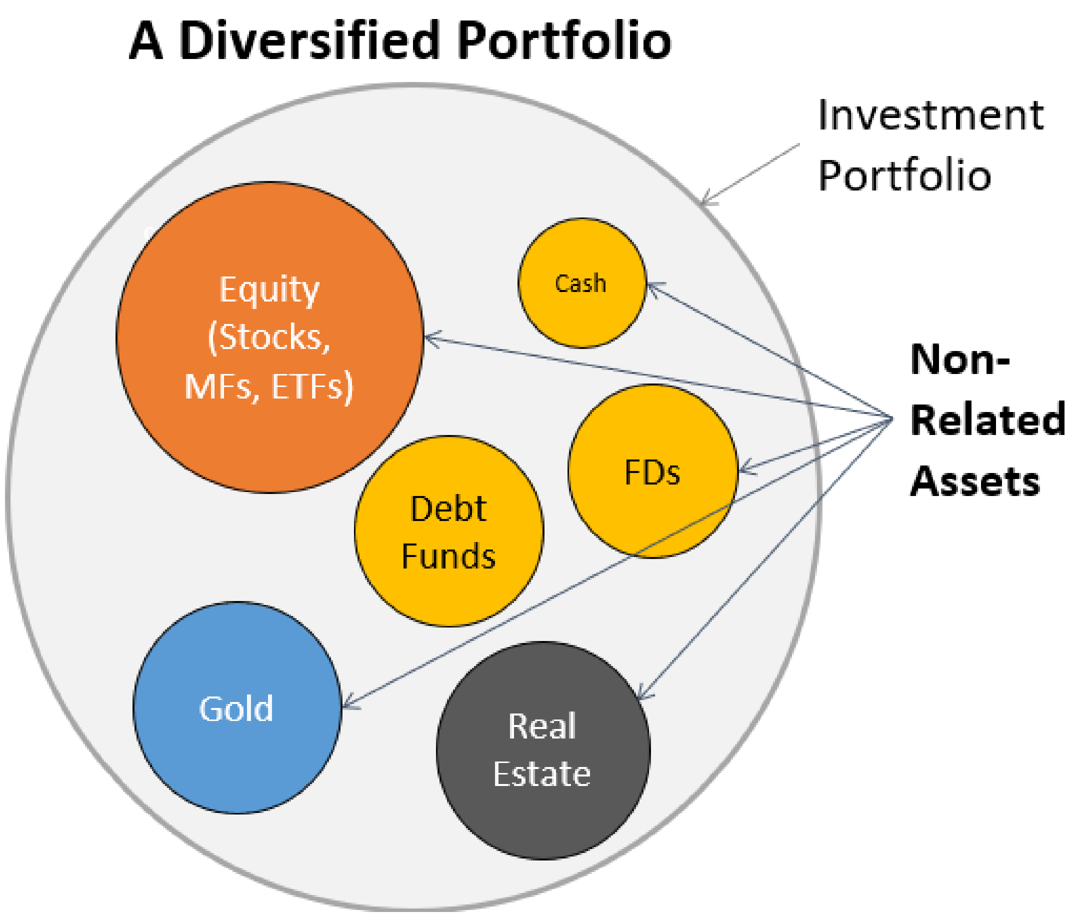
Financial instruments such as stocks and bonds are intangible investments; they can not be physically touched or felt. On the other hand, tangible investments such as land, real estate, farmland, precious metals, or commodities can be touched and have real-world applications. These real assets have different investment profiles as they can be consumed, rented, developed, or treated differently than intangible or digital assets.

There are also unique risks specific to tangible assets. Real property can be vandalized, physically stolen, damaged by natural conditions, or become obsolete.

Real assets may also require storage, insurance, or security costs to carry. Though the revenue stream differs from financial instruments, the input costs to protect tangible assets are also different.

### 2.10.4Diversification Across Platforms

Regardless of how an investor considers building their portfolio, another aspect of diversification relates to how those assets are held. Though this is not an implication of the investment's risk, it is an additional risk worth considering as it may be diversifiable.




**Investment Diversification**

For example, consider an individual with $400,000 of U.S. currency. In all three of the situations below, the investor has the same asset allocation. However, their risk profile is different:

- ❖ The individual may deposit $200,000 at one bank and $200,000 at a second bank. Both deposits are under the FDIC insurance limit per bank and are fully insured.
- ❖ The individual may deposit $400,000 at a single bank. Only a portion of the deposit is covered by insurance. In addition, should that single bank experience a bank run, the individual may not have immediate access to cash.
- ❖ The individual may physically store $400,000 of cash in their home. Though immediately accessible, the individual will not yield any interest or growth on their cash. In addition, the individual may lose capital in the event of theft, fire, or by misplacing it.
- ❖ The same concept above relates to almost every asset class. For example, Celsius Network filed for bankruptcy in July 2022.

Investors holding cryptocurrency with the exchange experienced the inability to withdraw or transfer funds. Had investors diversified across platforms, the risk of loss would have been spread across different exchanges.


**Asset Allocation Strategies**

### 2.10.5 Diversification and Retail Investors

Time and budget constraints can make it difficult for noninstitutional investors—i.e., individuals—to create an adequately diversified portfolio. This challenge is a key to why mutual funds are so popular with retail investors. Buying shares in a mutual fund offers an inexpensive way to diversify investments.

While mutual funds provide diversification across various asset classes, exchange-traded funds (ETFs) afford investor access to narrow markets, such as commodities and international plays, that would ordinarily be difficult to access. An individual with a $100,000 portfolio can spread the investment among ETFs with no overlap.

There are several reasons why this is advantageous to investors. First, it may be too costly for retail investors to buy securities using different market orders. In addition, investors must then track their portfolio's weight to ensure proper diversification. Though an investor sacrifices a say in all of the underlying companies being invested in, they simply choose an easier investment approach that prioritizes minimizing risk.

### 2.10.6 Pros and Cons of Diversification

The primary purpose of diversification is to mitigate risk. By spreading your investment across different asset classes, industries, or maturities, you are less likely to experience market shocks that impact every single one of your investments the same.

There are other benefits to be had as well. Some investors may find diversification makes investing more fun as it encourages exploring different unique investments. Diversification may also increase the chance of hitting positive news. Instead of hoping for favorable news specific to one company, positive news impacting one of dozens of companies may benefit your portfolio.

However, there are drawbacks to diversification. The more holdings a portfolio has, the more time-consuming it can be to manage—and the more expensive, since buying and selling many different holdings incurs more transaction fees and brokerage commissions. More fundamentally, diversification's spreading-out strategy works both ways, lessening the risk and the reward.

For instance, imagine you've invested $120,000 equally among six stocks, and one stock doubles in value. Your original $20,000 stake is now worth $40,000. You've made a lot, sure, but not as much as if your entire $120,000 had been invested in that one company. By protecting you on the downside, diversification limits you on the upside—at least in the short term.

***Pros***

- ✓ Reduces portfolio risk
- ✓ Hedges against market volatility
- ✓ Offers potentially higher returns long-term
- ✓ May be more enjoyable for investors to research new investments

***Cons***

- ✓ Limits gains short-term
- ✓ Time-consuming to manage
- ✓ Incurs more transaction fees, commissions
- ✓ May be overwhelming for newer, unexperienced investors

### 2.10.7 Diversifiable vs. Non-Diversifiable Risk

The idea behind diversification is to minimize (or even eliminate) risk within a portfolio. However, there are certain types of risks you can diversify away, and certain types of risks exist regardless of how you diversify. These types of risks are called unsystematic and systematic risks.

Consider the impact of COVID-19. Due to the global health crisis, many businesses stopped operating. Employees across many industries were laid off, and consumer spending across all sectors declined. On one hand, the economic slowdown negatively impacted almost every sector. On the other, nearly every sector then benefited from government intervention and monetary stimulus. The impact of COVID-19 on financial markets was systematic.

In general, diversification aims to reduce unsystematic risk. These are the risks specific to an investment that are unique to that holding. Examples of diversifiable, non-systematic risks include:

- ✓ Business risk: The risk related to a specific company based on the nature of its company and what it does in the market.
- ✓ Financial risk: The risks related to a specific company or organization's financial health, liquidity, and long-term solvency.
- ✓ Operational risk: The risk related to breakdowns in manufacturing or goods distribution processes.
- ✓ Regulatory risk: The risk that legislation may adversely impact the asset.

Through diversification, investors strive to reduce the risks above, which are controllable based on the investments held.

### 2.10.8 Measuring Diversification

It can become complex and cumbersome to measure how diversified a portfolio is. In reality, it is impossible to calculate the actual degree of diversification; there are simply too many variables to consider across too many assets to truly quantify a single measure of diversification. Still, analysts and portfolio managers use several measurements to get a rough idea of how diversified a portfolio is.

***Correlation Coefficient***

A correlation coefficient is a statistical measurement that compares the relationship between two variables. This statistical calculation tracks the movement of two assets and whether the assets tend to move in the same direction. The correlation coefficient result varies from -1 to 1, with interpretations ranging from:

- ❖ Closer to -1: There is strong diversification between the two assets, as the investments move in opposite directions. There is a strong negative correlation between the two variables being analyzed.
- ❖ Closer to 0: There is moderate diversification between the two assets, as the investments have no correlation. The assets sometimes move together, while other times, they don't.
- ❖ Closer to 1: There is a strong lack of diversification between the two assets, as the investments move in the same direction. There is a strong positive correlation between the two variables being analyzed.

### 2.10.9 Standard Deviation

Standard deviation (SD) measures how often and far an outcome occurs away from the mean. For investments, standard deviation measures how far away from an asset's average return other returns fall. Analysts use SD to estimate risk based on return frequency.

For example, imagine two investments, each with an average annual return of 5%. One has a high standard deviation, which means the investment returns can vary greatly. The other investment has a low standard deviation, meaning its returns have been closer to 5%. The higher the standard deviation, the more risk there is—but there is a chance for higher returns.

A portfolio full of investments with high standard deviations may have higher earning potential. However, these assets may be more likely to experience similar risks across asset classes.

***Smart Beta***

Smart beta strategies offer diversification by tracking underlying indices but do not necessarily weigh stocks according to their market cap. ETF managers further screen equity issues on fundamentals and rebalance portfolios according to objective analysis, not just company size. While smart beta portfolios are unmanaged, the primary goal becomes the outperformance of the index itself.

***Count/Weighting***

In its most basic form, a portfolio's diversification can be measured by counting the number of assets or determining the weight of each asset. When counting the number of assets, consider the number of each type for the strategies above. For example, an investor can count that of the 20 equities they hold, 15 are in the technology sector.

Alternatively, investors can measure diversification by allocating percentages to what they are invested in. So, in this view, the investor with 15 equities in tech has 75% of their equity holdings in a single industry.

On a broader portfolio basis, investors more often compare equity, bonds, and alternative assets to create their diversification targets. For example, traditional portfolios tended to skew towards 60% equities and 40% bonds—though some strategies call for different diversification based on age. Other theories claim that holding alternative assets has added benefits (for example, 60% equities, 20% bonds, and 20% alternatives).

***Example of Diversification***

Imagine an aggressive investor, who can assume a higher risk level, wishes to construct a portfolio composed of Japanese equities, Australian bonds, and cotton futures. They could purchase stakes in the iShares MSCI Japan ETF, the Vanguard Australian Government Bond Index ETF, and the iPath Bloomberg Cotton Subindex Total Return ETN.

With this mix of ETF shares, due to the specific qualities of the targeted asset classes and the transparency of the holdings, the investor ensures true diversification in their holdings. Also, with different correlations, or responses to outside forces, among the securities, they can slightly lessen their risk exposure.

### 2.10.10 What Are the Benefits of Diversification?

In theory, holding investments that are different from each other reduces the overall risk of the assets you're invested in. If something bad happens to one investment, you're more likely to have assets that are not impacted if you were diversified. Diversification may result in a larger profit if you are extended into asset classes you wouldn't otherwise have invested in. Also, some investors find diversification more enjoyable to pursue as they research new companies, explore different asset classes, and own different types of investments.

### *What Are the Methods of Diversification?*

There are many different ways to diversify; the primary method of diversification is to buy different types of asset classes. For example, instead of putting your entire portfolio into public stock, you may consider buying some bonds to offset some market risk of stocks.

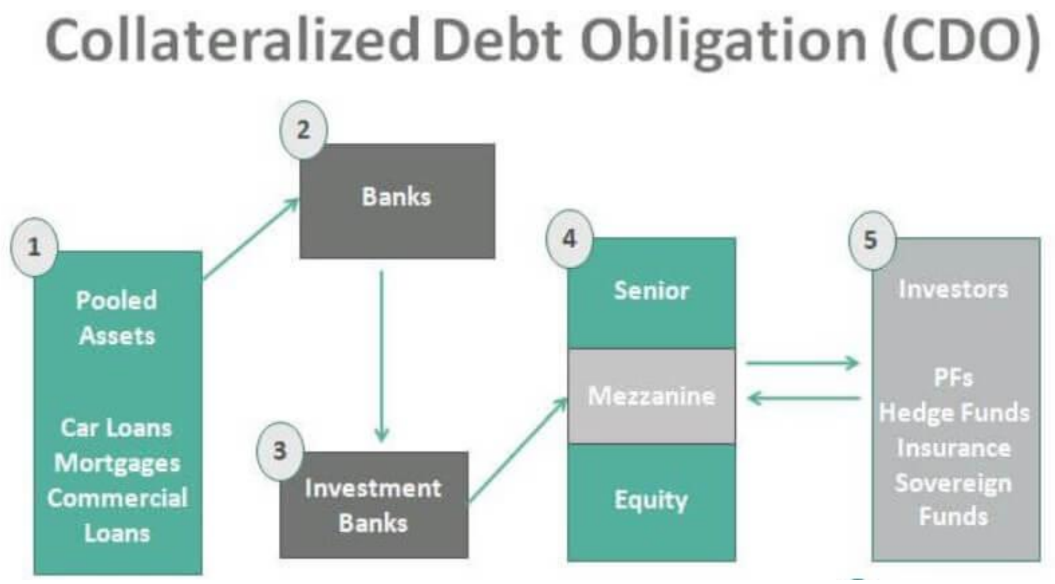
In addition to investing in different asset classes, you can diversify into different industries, geographical locations, term lengths, or market caps. The primary goal of diversification is to invest in a broad range of assets that face different risks.

### *Is Diversification a Good Strategy?*

For investors seeking to minimize risk, diversification is a strong strategy. That said, diversification may minimize returns, as the goal of diversification is to reduce the risk within a portfolio. By reducing risk, an investor is willing to take less profit in exchange for the preservation of capital.

## 2.11 What is a Collateralized Debt Obligation?

Collateralized debt obligation (CDO) is a Structured product used by banks to unburden themselves of risk, and this is done by pooling all debt assets (including loans, corporate bonds, and mortgages) to form an investable instrument (slices/trances) which are then sold to investors ready to assume the underlying risk.




**Steps for CDO**

The rise and demise Collateralized Debt Obligation assets turned out to be a cyclical process, initially reaching the top because of its inherent benefits, but ultimately collapsing and leading to one of the largest financial crises. CDOs are considered highly astute financial instruments that created cheap credit market infused liquidity, and freed up capital for lenders but ultimately collapsed because of a lack of comprehensive understanding of the systemic risk it may cause.

**Key Takeaways**

- ❖ A Collateralized Debt Obligation (CDO) is a structured financial product that combines various debt instruments, such as bonds, loans, and credit assets.

- ❖ CDOs provide investors with a diversified portfolio of debt instruments across different risk levels. Tranches are structured to prioritize repayment, allowing investors to choose risk and return levels that suit their preferences.
- ❖ CDOs often employ credit enhancement mechanisms, such as over-collateralization or credit default swaps, to improve the credit quality of lower-rated tranches.

**2.12 How does Collateralized Debt Obligation (CDO) Work?**

Synthetic Collateralized Debt Obligations or the general CDO creation can be understood as a 5-step process:

- ❖ Step #1 - Pooled Assets

Banks prepare a list of all the pooled assets (secured and unsecured) like car loans, mortgage loans, commercial loans, etc. that can be included a part of CDOs

- ❖ Step #2 - Banks form a diversified portfolio

Once the list of pooled assets is prepared, than the Bank started with an aggregation of various debt assets, such as Loans issued corporates and individuals, Corporate bonds invested in, Mortgages, and other debt instruments like credit card receivables.

- ❖ Step #3 - Investment Banks

A Bank may rope in an investment bank to sell this diversified portfolio.

- ❖ Step #4 - Formation of Tranches

The cash inflows from the portfolio created are sliced into the number of investable tranches. These tranches are characterized by a degree of riskiness. The tranches created are classified as

- “super senior,” the safest and first one to receive the payouts. But, have the lowest interest rate
- “mezzanine financing,” moderate risk, and a bit higher interest rate
- “equity”/ ”toxic waste,” junior tranche, most risky and offers the highest interest rate. The payouts are made after all payouts are made for super senior and mezzanine tranches.
- ❖ Step #5 - Selling of Tranches to Investors.

Depending on the risk appetite of various investor groups, these tranches are offered. The most senior tranche is often sold to institutions looking for highly-rated instruments, such as pension funds. The lowest rated tranches are often retained by the CDO (Collateralized Debt Obligations) issuers. This gives the bank an incentive to monitor the loan.

- ❖ Mezzanine tranches are often bought by other banks and financial institutions.

This entire process of aggregation of assets and slicing them and selling it off to appropriate investors is known as securitization. The bank or the institution assuming the role of CDO issuer is known as Originating Institution. And this entire model is known as the originate-to-distribute model.

***Example #1***

Michael, an investor with a high risk appetite. He is eyeing an investment opportunity and comes across a CDO. It is a mixed bag of debt securities like mortgages, bonds, and the likes. Michael perceives potential in the real estate market and decides to invest in a CDO filled with mortgage-backed securities.

By purchasing a tranche of this CDO, Michael essentially owns a slice of the bundled mortgages. The risk and return associated with his investment are based on the performance of these underlying mortgages. If homeowners make timely payments, Michael stands to gain returns. However, if economic winds shift unfavorably, leading to mortgage defaults, Michael could face losses.

***Example #2***

In 2020, JP Morgan, Nomura, and BNP Paribas were in a race to re-launch the first managed synthetic collateralized debt obligation (CDO) since the 2008 financial crisis. This initiative marked a significant milestone in the rehabilitation of this controversial category of structured credit investment, often linked to the excessive financial engineering that precipitated the 2008 crisis.

The credit default swap (CDS) market, a key component in CDOs, experienced a staggering fourfold expansion in just two years, reaching its peak at US $58 trillion in 2007, as reported by the Bank for International Settlements. However, it subsequently contracted, shrinking to US $8 trillion by mid-2019.

### 2.12.1 Important Terms and Differentiation from Similar Products

CDOs are part of a large set of financial instruments that sound and operate similarly. However, there are differences in their fundamentals and implications.

***#1 - CDOs and CMOs***

Collateralized Mortgage Obligation, as the name suggests, is a structured product that pools in mortgage loans and slice them into tranches of different risk profiles, as explained in the previous section. CDOs, on the other hand, can have loans (home/student/auto, etc.), corporate bonds, mortgages, and credit card receivables, thereby expanding the choice of instruments for forming the portfolio.

CMOs are issued by REMICs (Real Estate Mortgage Investment Conduit). CDOs are issued by SPEs (Special purpose entities) created by banks which are separately capitalized to assume a high Credit rating for issuing CDOs.

CMOs may have different classes of securities depending on the quantum of risk associated with the mortgages and are created by breaking down coupons and principal payment. CDOs, on the other hand, have tranches created by slicing down the groups of cash flows from various instruments. And there have to be at least three classifications.

### *#2 - CDOs and MBS*

MBS or the Mortgage-backed securities are the earliest form of structured products, formally introduced in the early 80s. Structurally MBS and CDOs are similar to CDO being more complex. MBS have repackaging of mortgages into investable instruments. Based on the type of mortgage repackaged, MBS are of majorly two types: RMBS (Residential MBS) and CMBS (Commercial MBS)

### *#3 - CDOs and ABS*

ABS or the Asset-backed Security, is similar to MBS, with the only difference that the pool of assets comprises of all debt assets other than Mortgages. CDO is a type of ABS which includes mortgages as well in the pool of assets.

### *#4 - CLOs and CBOs*

CLOs and CBOs are subclassifications of CDO. CLOs are collateralized loan obligations that are made using bank loans. CBOs are a collateral bond obligation which is made using corporate bonds.

There are lesser-known CDO classifications as well, Structured finance back CDOs having ABS/RMBS/CMBS as underlying and Cash CDOs with cash market debt instruments.

### 2.12.2 CDOs and Subprime Mortgage Crisis 2008

The financial crisis of 2007 and 2008, often called the subprime crisis, had several factors, ultimately leading to a collateral failure of financial systems. Among various causes, CDOs played an important role. The crisis started with a housing bubble1, which majorly proliferated because of the availability of cheap credit and widespread use of the Originate-to-distribute model, burst around 2006 and 2007, and led to a liquidity squeeze.

The originate-to-distribute model and securitization, i.e., use of CDOs/ CMOs, etc. became popular for the following reasons:

A low-interest rate on mortgages: Originating institutions were in a position to issue mortgages at a low-interest rate by slicing it off and spreading the risk among willing investors

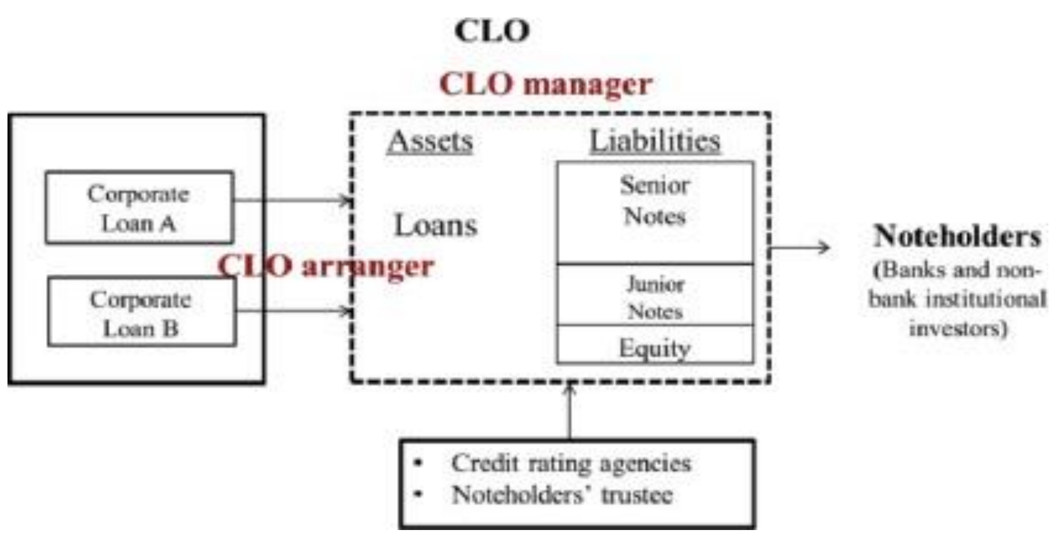
A high rating of CDOs helped banks to meet lower capital charge requirements of Basel I and II without affecting the risk profile.

Commercial papers were issued, and short term repurchase agreements (both of which are ideally short-term instruments) were done to fund the investments in structured products. The months of July and August 2007 were specifically important as most of the commercial papers were maturing in this period. Banks tried Repos and issuance of Commercial papers to meet the liquidity requirements at redemptions, but the impact was so widespread as all major banks were facing the same problem, that the dollar lending rates rose as high as 6/7 %.

Faced with huge losses, banks and financial institutions with heavy investments in structured products were forced to liquidate their assets at very low prices. This further led to bankruptcies filed by prominent banks like Lehman Brothers and American Home Mortgage Investment Corp. etc., and leading to intervention and financial restructuring by the International Monetary Fund in October 2009.

### 2.12.3 Collateralized Debt Obligations Vs Mortgage-Backed Securities

We saw the differences between collateralized debt obligation assets and mortgage-backed securities in one of the sections above. However, let us understand the differences between the two concepts in detail through the comparison below.




**Portfolio performance manipulation**

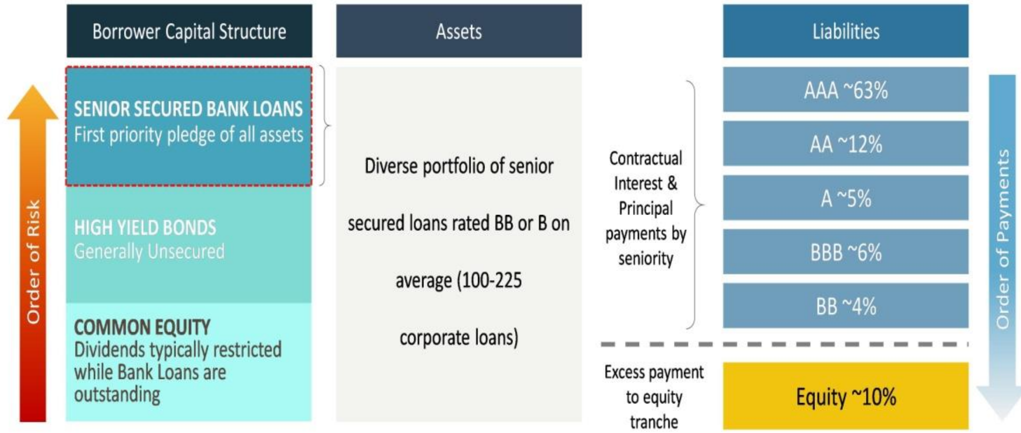
***CDOs***

- CDOs are complex financial instruments that bundle various debt securities, such as mortgages, bonds, and loans, into a single package.
- They comprise diverse assets and are typically divided into tranches with varying risk and return profiles.
- Investors in CDOs are exposed to the performance of the underlying assets, and returns are contingent on the success or failure of the bundled securities.
- CDOs include various debt instruments like loans, corporate bonds, and mortgages.
- They expose investors to a broader spectrum of risks, given their diverse asset pool.

**Basic CLO structure**

The CLO structure is made up of two parts: Collateral, which is also known as pool of assets, and tranches which forms liabilities. The tranching mechanism is one of the important features where a specific order of seniority exists. Each tranche is a piece of the CLO and represents the order of repayment. It also dictates the risks associated with the investments.

These tranches are classified as debt tranche with different ratings along with the equity tranche or non-rated tranche. Each tranche is protected from the loss by the tranches which are below that particular tranche. Both risks and returns usually increases from the senior most tranche down to the equity tranche. The equity tranche absorbs the first losses arising out of the total collateral and the senior most tranche is affected only after the tranches below it have borne the losses.




**CLO Structure**

**CLO lifecycle**

Each CLO has a defined lifecycle - from the purchase of the first asset to the repayment of all assets and tranches.

- ✓ Warehouse phase:

At this stage, warehouse investors earn the carry (income from bank loans less the cost of financing) and CLO managers begin acquiring assets several months before the launch. Key features of the deal are determined at this stage and warehouse investors also typically gain the right to invest in the equity of the new CLO at economics not available in the secondary market.

- ✓ Pricing date:

Arranger prices the notes by computing the issuance spreads and prices. Tranche terms such as prices and coupons are finalized. Pricing occurs 2 to 4 weeks before the closing date.

- ✓ Closing date:

This is the date on which CLO transactions come into legal existence. Assets in the warehouse are transferred to SPV. Tranches are issued as investors pay and their interest starts to accrue.

- ✓ Ramp-up period:

Managers do not acquire the full portfolio at the time of pricing. The manager purchases the remainder of the loans portfolio after the closing date when CLO is issued. In this phase, the portfolio of assets are fully ramped by the effective date.

- ✓ Effective date:

It occurs after 3 to 6 months of closing date with rating agencies confirms their ratings.

- ✓ Non-Call Period:

This period typically lasts 2 years. During this period equity holders cannot ask for liquidation of the portfolio or refinancing of the debt tranches. Investors can exercise their right to terminate a deal or reset or refinance the debt tranches after completion of non-call period.

- ✓ Reinvestment period:

The CLO managers actively manages the loan portfolio during this period (typically for 4-5 years). Principal repayments and prepayments from the assets are used by collateral manager to purchase new assets.

- ✓ Amortization period:

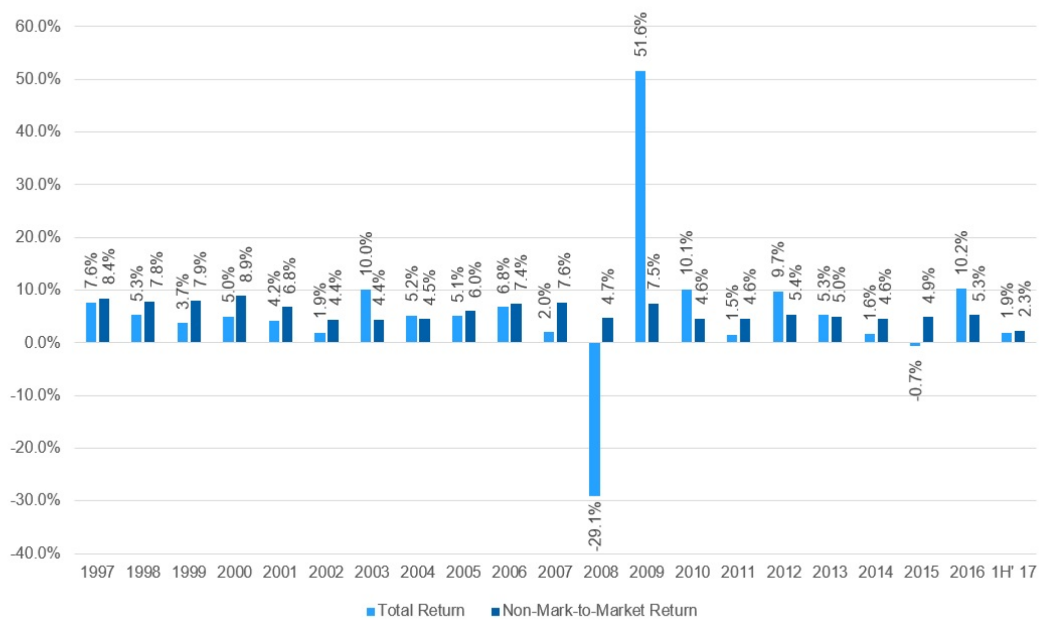
This period commences at the end of reinvestment period if the CLO is not called by the majority of the equity holders. During the amortization period, the manager uses the repayments from the assets to pay down outstanding CLO debt in order of seniority. This period lasts until the legal maturity of the deal or until the deal is called by a majority of equity investors.

***CLO characteristics***

Focus on longer term financing: Unlike a typical finance company, the entirity of a CLO's assets are loans, of which more than 90%-95% are senior secured or first lien. Since a CLO borrows for the long term, once the transaction closes, it does not have to borrow again and does no face forced liquidations due to unavailibity of financing in difficult market conditions. Long term investors like asset-managers, insurance companies and pension funds have also increased their allocation to CLOs. According to research by Citigroup, asset managers comprised 17.9% of the US AAA CLO market at the end of 2016, a significant increase from 4.4% in 2013.

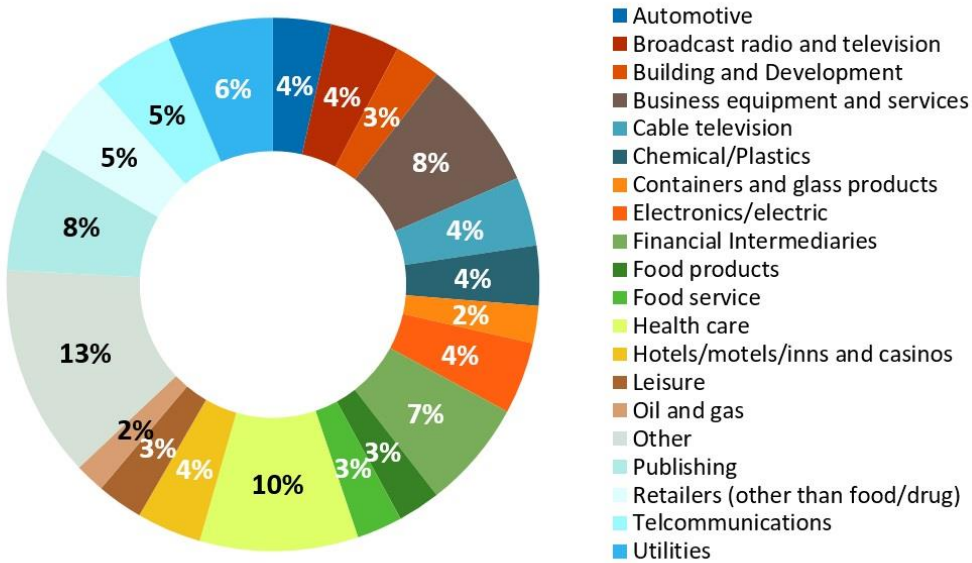
Non-mark to market: CLOs are not subject to a mark-to-market triggers. They can actually take advantage of volatility during times of market distress. In an environment of spread widening, collateral managers can acquire cheaper assets with previously locked-in, non-recourse, non-mark-to-market financing. This creates additional opportunities to build par by purchasing collateral at a discount and through trading. A decline in Senior Secured Loan prices similar to 2008 and

August 2011 did not impact CLOs directly, but provided CLOs an opportunity to acquire Senior Secured Loans at discounted prices.




**Source: S&P/LSTA Index: Total Returns (%)**

***Diversification:*** Most private equity strategies tend to be very concentrated, whereas CLO equity provides much more diversified exposure. A CLO's underlying collateral pool is subject to industry concentration limits, which minimize each CLO's exposure to any one industry. In fact, the underlying CLO collateral pool typically consists of loans from 150–200 issuers, offering exposure to companies that span a wide variety of industries and sectors. S&P also found that CLO managers avoided potential losses amounting to just under 2% of US CLO 2.0 portfolios during the oil- and gas-related stress in Q4 2015 and Q1 2016.

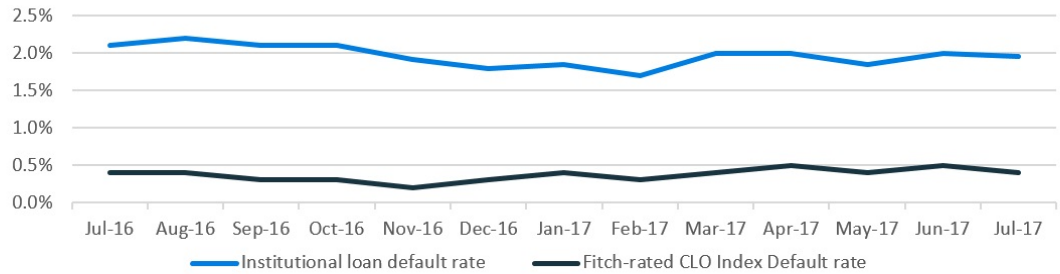



**Highly diversified portfolio across industry**

Active management: CLOs are actively managed vehicles; i.e., they have a reinvestment period during which the manager can reposition the portfolio within the parameters set forth by the governing documents. Managers add value by reinvesting and repositioning portfolios to increase returns and protect against downside risk during weaker economic times. In general, CLO managers have been able to add value by avoiding defaults and managing around portfolio constraints to keep the cash fully invested, thereby increasing the return on equity.

Moreover, research has shown that the overall credit performance in actively managed CLOs has outperformed static transactions, especially during periods of volatility. For example, S&P Global Market Intelligence showed that manager trades during the 2008–2009 credit crisis reduced potential losses by 10% on average4. Even though CLO managers tend to add value, the variability in their performance, especially during periods of distress, is significant. Selecting the right

CLO manager could be a differntiating factor for clocking in higher returns and maintaining risk while investing in the similar vintage CLO.




**Fitch-Rated CLO Index**

| | Payment Year | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Vintage | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| 2004 | 14.90% | 17.60% | 19.60% | 1.70% | 12.10% | 13.90% | 7.00% | 13.00% | - | - | - | - |
| 2005 | 15.30% | 20.40% | 22.20% | 4.90% | 18.20% | 26.60% | 24.10% | 16.50% | 18.30% | - | - | - |
| 2006 | - | 16.00% | 23.70% | 6.50% | 19.20% | 29.20% | 31.90% | 25.70% | 17.40% | 14.60% | 2.90% | - |
| 2007 | - | - | 22.10% | 5.50% | 20.40% | 31.70% | 35.20% | 34.90% | 24.50% | 18.30% | 14.00% | 4.00% |
| 2008 | - | - | - | 3.90% | 8.00% | 18.30% | 17.30% | - | - | - | - | - |
| 2010 | - | - | - | - | - | 1.90% | 3.10% | 2.40% | 28.60% | 7.30% | 34.20% | - |
| 2011 | - | - | - | - | - | 11.10% | 26.20% | 27.30% | 21.30% | 19.70% | 61.70% | 14.90% |
| 2012 | - | - | - | - | - | - | 5.80% | 21.00% | 18.30% | 17.70% | 16.30% | 30.20% |
| 2013 | - | - | - | - | - | - | - | 9.20% | 20.60% | 21.80% | 18.60% | 13.30% |
| 2014 | - | - | - | - | - | - | - | - | 9.30% | 22.10% | 18.10% | 12.80% |
| 2015 | - | - | - | - | - | - | - | - | - | 9.60% | 20.00% | 13.80% |
| 2016 | - | - | - | - | - | - | - | - | - | - | 7.60% | 12.80% |
| 2017 | - | - | - | - | - | - | - | - | - | - | - | 6.20% |

**Median US CLO Equity Distributions by Vintage**

***CLOs benefit over other Fixed Income instruments***

CLOs offer investors multiple advantages, both on their own and in comparison to other fixed income products such as corporate and government bonds.

- ✓ Better returns:

CLOs provide an opportunity to investors to earn excess return as compared to other fixed income securities and bonds over a period of time. Spread difference between average CLO spreads and comparable rated bonds is typically positive across different rating in IG and HY, wider as we move down the tranche.

- ✓ Diversified risk profile:

CLO structure is made up of different tranches ranging from senior to equity, with risks varying as per the seniority of the tranches. Different CLO tranches have the potential to meet the needs of a wide range of investors such as pension fund and insurance.

- ✓ Managers incentives are aligned:

Managers are paid senior and subordinated management fees. Subordinated fees is only paid if CLO is in good health. Further incentive fees are due if equity investors recevie more than a predetermined IRR.

- ✓ Floating rate and shorter duration:

CLO liabilities are floating rate in nature which reduces interest rate sensitivity and results in shorter duration. LIBOR's sensitivity to changing market interest rate ensures each of the tranche's return are reflective of market returns. This reduces the overall cost of adjusting the portfolio to achieve the target returns of the investor.

- ✓ Low correlation to other Asset Classes:

CLO correlations versus other fixed income categories are relatively low, meaning that CLOs can provide effective diversification in a broader portfolio. It is negatively corelated to US Treasury bonds and has low correlation to US investment grade corporate bonds and equities.

CLOs have historically experienced lower default rates, higher recovery rates, and lower credit volatility relative to high yield corporate bonds. According to S&P 2, AAA and AA-rated CLO tranches have never incurred a default (data back to 1994). Over this 23-year period, cumulative default rates further down the capital structure were 0.41% in US. A separate Moody's study estimated the cumulative impairment rate for global CLOs for 1993-2009 of only 1.36%

***Mortgage-Backed Securities***

- MBS are financial products backed by a pool of mortgages, where the cash flow from the underlying mortgages is used to pay investors.
- MBS are specifically tied to mortgages, representing an ownership interest in a pool of loans.
- Investors in MBS bear the risk associated with mortgage payments, prepayments, and potential defaults within the underlying mortgage pool.
- They are solely tied to mortgages.
- MBS focuses on the risks inherent in the mortgage repayment scheme of things.

***CLO Control Equity – Favorable economics and cheap optionality***

CLOs are bankruptcy-remote vehicles that issue equity and borrow funds (CLO liabilities) to invest in bank loans (CLO assets). CLOs receive interest income from bank loans and pay interest on CLO liabilities. The residual income after certain expenses is then paid to CLO equity. CLO liabilities offer long term, non-mark to market funding to CLOs. These characteristics allow CLOs to benefit from volatility and asset price dislocations in the bank loan market.

CLO equity generates a high cash-on-cash return with a target of generating a low-mid teens IRR after accounting for potential defaults on bank loans. New issue CLO equity provides for longer cash flows, cheap optionality embedded in the structure and a longer timeframe to benefit from the volatility in the bank loan market.

Anchoring the new issue transaction creates a strong negotiating position and helps capture best possible economics. Invaluable control rights provide ability to refinance and restructure the transaction as well as capture opportunities for investing in the debt tranches.

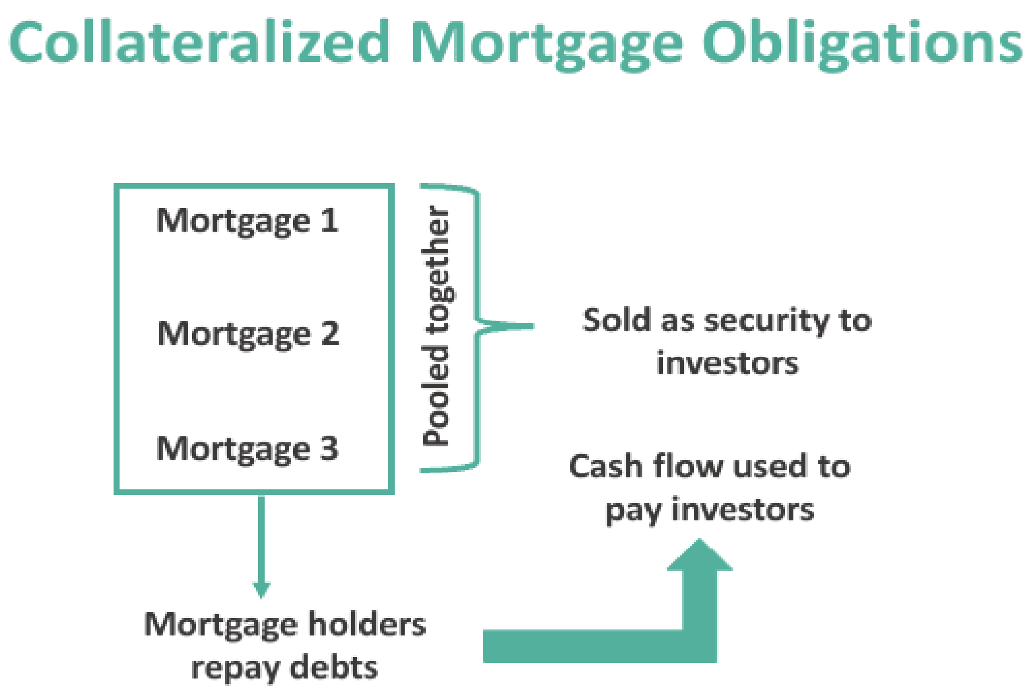
Most private equity strategies do not start realizing gains (or losses) on the underlying portfolio companies until after the capital drawdown and investment period, which typically lasts up to four years. On the other hand, CLO equity has a “front loaded” return profile, meaning that investors can expect cash flows right away.

***CLO Equity performance***

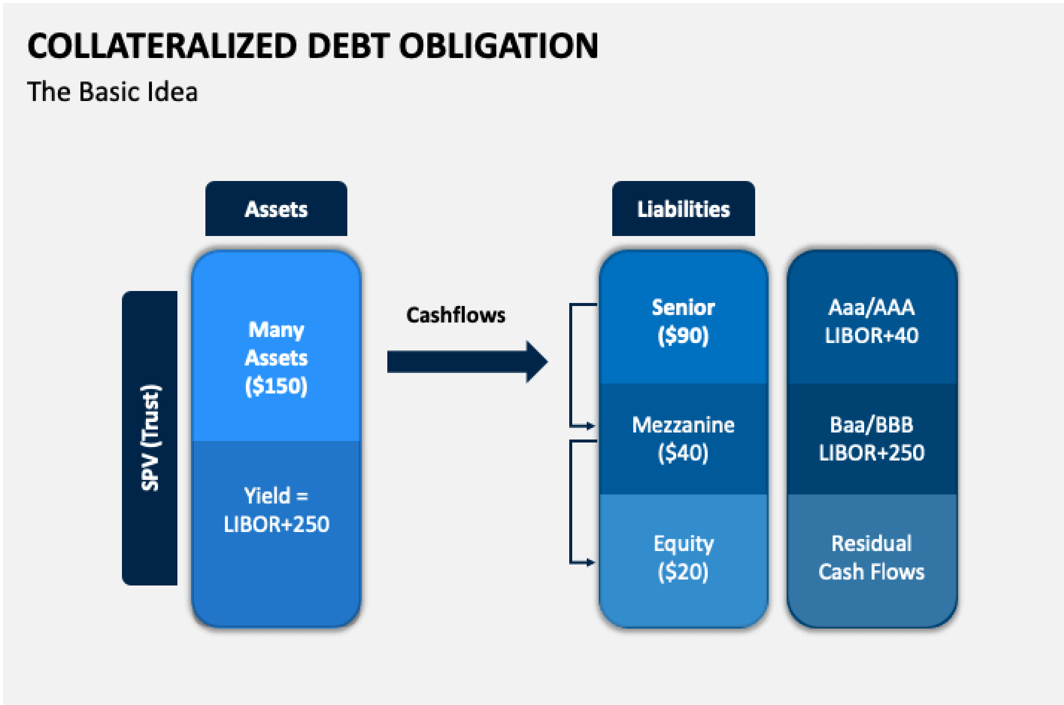
CLOs are important part of fixed income landscape because they offer investors an opportunity to invest in slices of the total collateral that could meet their particular risk and yield objectives. The equity tranche represents a claim on all excess cash flows once the obligations for each senior and mezzanine tranche have been met.

Though equity tranche bears the first loss arising out of default, CLO equity holders are given significant control over the length of the life of overall CLO structure and they are entitled to receive excess cash. Performance of CLO equity is driven by combination of market opportunities and managerial skill. While the debt investors enjoy structural protections from various tests like principal and interest over-collateralization ratios, credit quality, weighted average life and diversification, equity investors benefit from a stable funding structure with key attributes that are not achievable elsewhere – term, non-recourse and non-mark to market financing.

According to JP Morgan analyst, the overall market average returns for the past 14 years is 18.3%, with US CLO equity 2018 YTD returns were 7.4% outpacing the other fixed income assets class.




**Mortgage Obligation**




**Debt Obligation**

The creditworthiness of the borrower. Borrowers with stronger credit histories may be able to secure funds at a lower rate.

Market interest rates. The prevailing rates mostly established by short-term government securities often set the general direction of rates.

The competitiveness of issuance. CBLOs may be issued through a competitive bidding process where multiple borrowers bid to secure funds from lenders. In such cases, the interest rate is determined by the lowest bid that fulfills the lender's requirements.

Relevant reference rates. Some CBLOs may use reference rates, such as a benchmark government security yield, as a basis for setting the interest rate. The rate may be quoted as a spread above or below this reference rate.

The specific agreement. Once the borrower and lender agree on the interest rate, it is specified in the CBLO documentation, along with other terms and conditions of the transaction. This rate may or may not be related to any bullet above.

***What Types of Collateral Are Accepted in CBLOs?***

CBLOs typically use high-quality collateral, with government securities being a common choice. The specific collateral requirements may vary depending on the market and the clearinghouse involved in the transaction. The use of high-quality collateral enhances the safety and reliability of CBLOs.

***Are CBLOs Tradable in the Secondary Market?***

Yes, CBLOs are often tradable in the secondary market, which adds to their liquidity. Investors who hold CBLOs can buy or sell them before their maturity date, allowing them to manage their investments more effectively based on changing market conditions.

***Can Individuals Participate in CBLO Transactions?***

CBLOs are primarily designed for institutional participants, and individual investors typically do not directly participate in CBLO transactions. They are more commonly used by financial institutions and organizations to manage their short-term funding and investment needs.

***How Do CBLOs Compare to Other Short-Term Money Market Instruments?***

CBLOs share similarities with other short-term money market instruments like Treasury bills and commercial paper. However, they differ in terms of collateralization, as CBLOs specifically use collateral to secure transactions.

Additionally, CBLOs may have different market conventions and practices depending on the country in which they are traded.

***Objective of the study***

The objective of studying investment strategies in capital markets is multi-faceted, aiming to enhance the understanding andapplication of various approaches to optimize financial outcomes. Key objectives include:

1. Understanding Market Dynamics: To comprehend the fundamental principles governing capital markets, including thebehavior of different asset classes, market cycles, and the factors influencing market movements.

2. Risk Management: To identify, assess, and develop strategies to mitigate risks associated with investments, ensuring abalanced approach that aligns with investors' risk tolerance and financial goals.

3. Maximizing Returns: To explore and evaluate different investment strategies that aim to achieve the highest possiblereturns, considering both short-term gains and long-term growth.

4. Portfolio Diversification: To learn the principles of constructing a diversified investment portfolio that minimizes riskthrough appropriate asset allocation and the inclusion of various asset classes.

5. Strategic Decision-Making: To develop critical thinking and analytical skills necessary for making informed investmentdecisions based on market research, financial analysis, and economic indicators.

6. Adapting to Emerging Trends: To stay abreast of new developments and trends in the financial markets, such as sustainableinvesting, technological advancements, and regulatory changes, and incorporate these into investment strategies.

7. Behavioral Finance: To understand the psychological factors influencing investor behavior and decision-making processes,helping to mitigate biases and improve investment outcomes.

8. Performance Evaluation: To establish criteria and methodologies for assessing the performance of various investmentstrategies, enabling continuous improvement and adaptation.

9. Regulatory Compliance: To gain knowledge of the regulatory environment governing capital markets, ensuring thatinvestment strategies comply with legal and ethical standards.

10. Practical Application: To bridge the gap between theoretical knowledge and practical application, equipping investors,financial advisors, and portfolio managers with actionable insights and strategies for real-world investing.

By achieving these objectives, the study of investment strategies in capital markets aims to empower individuals andinstitutions to make informed, strategic, and effective investment decisions, ultimately enhancing financial stability andgrowth.

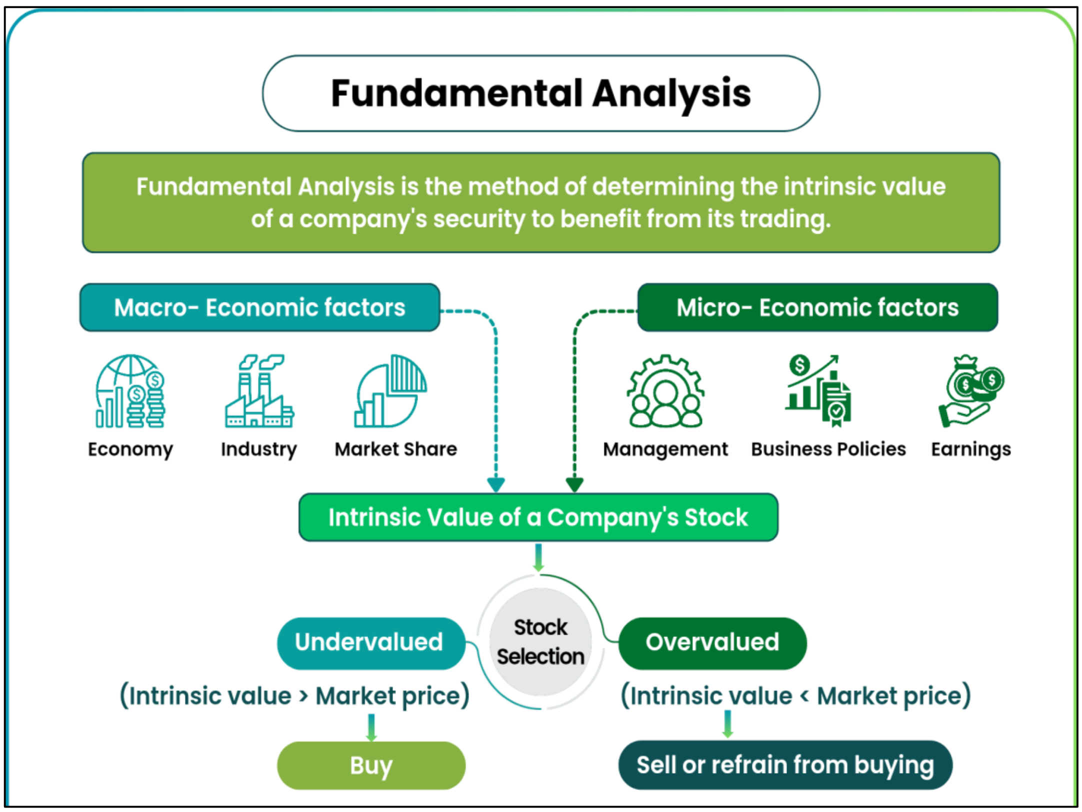
# UNIT III

## INVESTMENT STRATEGIES AND MARKET ANALYSIS

Investment strategies vary based on risk tolerance, time horizon, and financial goals. Common strategies include value investing, growth investing, income investing, and index investing. Value investors seek undervalued stocks, while growth investors focus on companies with high potential for expansion. Income investors prioritize assets that generate steady returns, like dividend stocks and bonds. Index investors prefer passive strategies that track market indices.

Market analysis involves fundamental and technical approaches. Fundamental analysis evaluates financial statements, economic indicators, and industry trends to determine an asset's intrinsic value. Technical analysis studies price patterns, trends, and trading volumes to forecast future movements. A balanced approach combining both methods helps investors make informed decisions.

An investor has number of options from which he must choose the investment which has high yield and low risk. The two characteristics of investment are time and risk. The price that must be paid is certain, but the future reward might not be. He may invest in Gold, property, provident fund, fixed deposits, shares, Insurance Policies, and stocks including mutual funds, etc. Each type of investment has its own advantages and disadvantages. Gold is considered the safest form of investment in terms of risk factor yet keeping its safety is a challenge. Property involves huge investment and is less liquid. Also maintaining a property is not an easy job. Provident Fund and Fixed Deposit has low return though the risk involved is minimal. Considering all the above factors investment in shares and mutual fund is the easiest and most lucrative option. The investment in shares / mutual funds can be made with very less capital and is highly liquid. But the challenge is in which securities to invest. For this the investor must follow certain investment strategies. For a wide range of players, the financial market is growing more and more popular. Investors, managers, as well as regulators, are all taking advantage of the financial markets. All kinds of theories exist in the literature, and they're used at the right time. In the new field of "behavioural finance," individuals' feelings and characteristics are taken into consideration when making financial decisions.

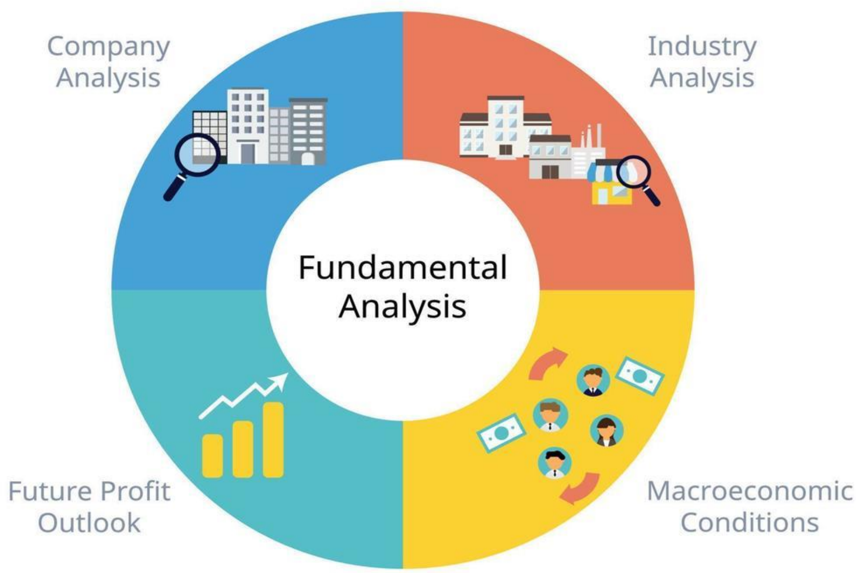



**Fundamental Analysis**

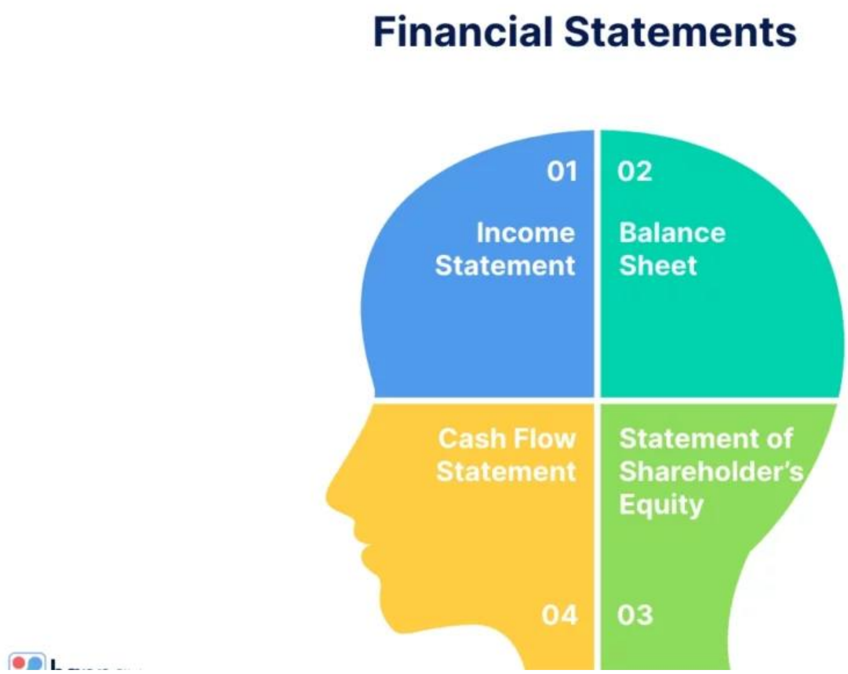
According to the classic theory of finance, arbitrage exists in the market and can be exploited at any time. Authors of behavioural finance, on the other hand, have conclusively demonstrated that arbitrage does not imply reduced return due to increased risk. There is always a cap on it. Furthermore, the related costs are quite substantial, meaning that there is no risk-free profit. When it comes to investing, the term "noise trader" is commonly used to characterise those who aren't reasonable, whereas "arbitrageurs" refers to people who are. The first theory, is irrational investor's view, in this approach, investors are irrational in that they do not keep up to date with current knowledge about the companies, whereas managers are rational in that they exploit any variation of their stock price from the fundamental value. For Indian capital markets, behavioral finance is not used. This study will help investors avoid falling into the trap of mispricing based on overvaluation in the markets, since many corporate operations such as capital restructuring, capital budgeting, and mergers are taking place in the corporate world.

### 3.1 Statement Of Problem

Although rational decision-makers do exist as company complexity increases, their capabilities are constrained. The truth is that people make decisions, both consciously and unconsciously, based on what they know and what they think. Making wise decisions is achievable as long as the information is accurate and useful from the past. However, decisions frequently result in unpredictable results. Numerous psychological elements that influence decision-making must be researched. The "Bigger and Better" idea and the "A Bird in Hand is Better than Two in the Bush" principle should both be followed by a fair decision-making standard. According to the first principle, larger benefits are preferred to smaller ones, and according to the second, earlier benefits are preferred to later benefits. The distribution of funds to assets with the expectation of a profit over time is known as financial investment. In return for cash, financial claims like stocks and bonds are exchanged. They are anticipated to generate income and increase in value over time. Because personal funds are invested in the capital market as financial assets to be used for economic purposes, the financial and economic meanings are intertwined. Despite their connection, we are only interested in the monetary transaction made in securities. Consequently, "a commitment of money made in the expectation of some positive rate of return" can be used to define investment. Investments must include the expectation of a profit. Since the return is anticipated to materialise in the future, it's possible that the actual return surpassed the anticipated return. Investment risk is the potential for variation in the real return. Consequently, every investment entails danger and return.




**Evaluation of Finance**




**Statement of Finance**

### 3.2 Objective Of The Study:

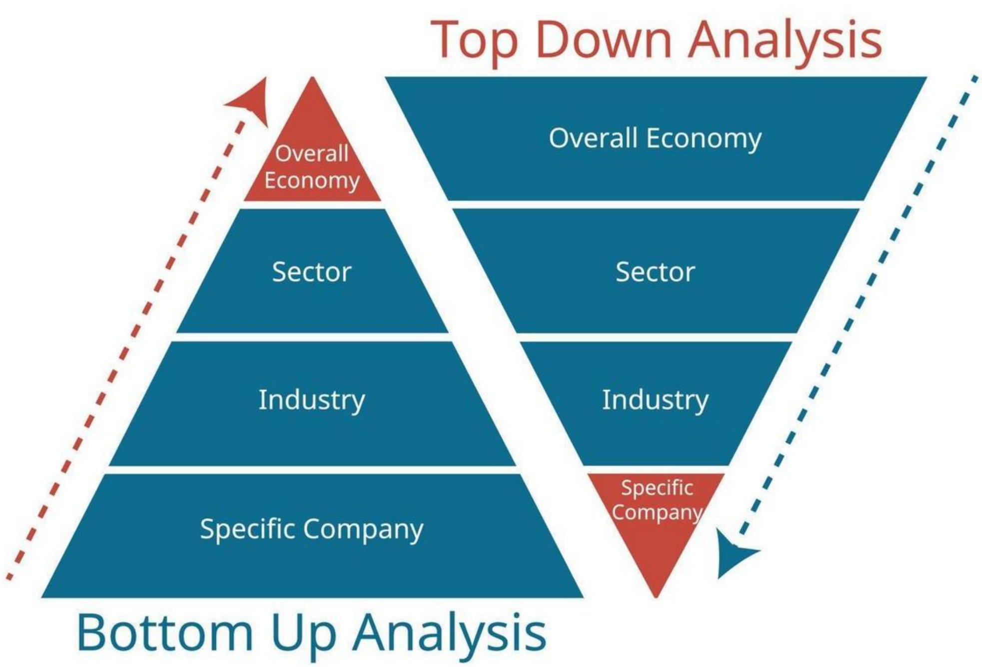
1) To study & analyze the perceptions of financial experts in relation to capital market investment.

2) To study & find out various investment strategies for young investors.

3) To draw various observations in order to suggest young investors for successful investment

### 3.3 What is investment strategy

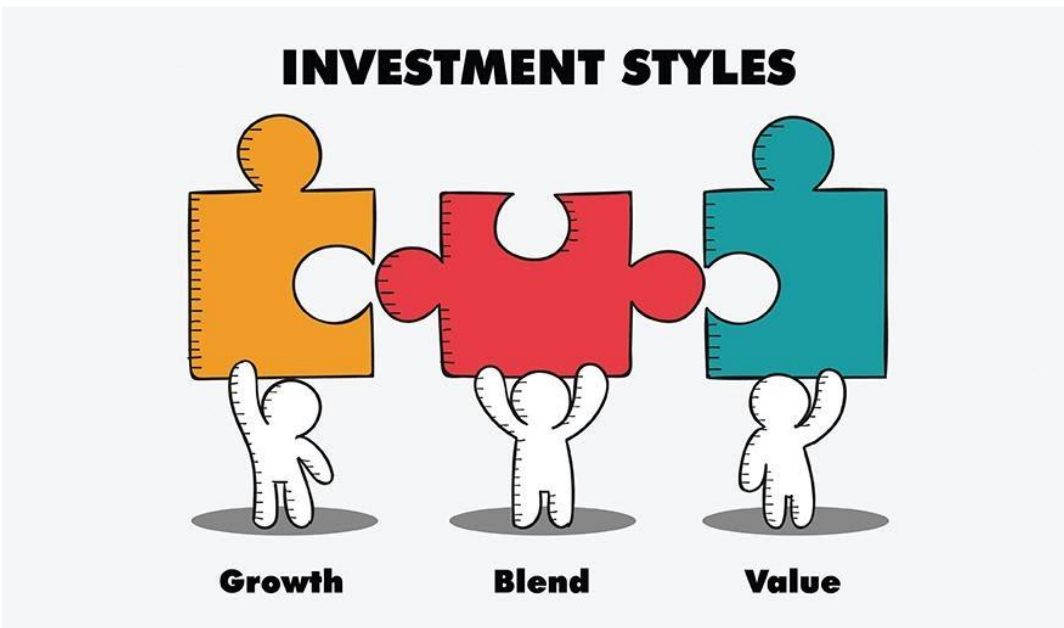
An investment strategy is a set of guidelines used in the field of finance to help investors choose their investment portfolio. People have various profit objectives, and according to their unique skills, they should use various techniques and strategies. Some decisions require balancing risk and reward. The majority of investors strike a balance between the two, taking some risk in exchange for higher expected profits. The general process that the fund manager does to put together a group of assets is sometimes referred to as an investment style or strategy. According to Joshi, an investor's spending choices "give some insight into which risks and returns investors are likely to be exposed to and what the drivers of those returns are likely to be." The four most common investment types are value, growth, quality, and momentum. Investment styles can be categorised using a wide range of usually highly esoteric techniques, including quality, momentum, cyclical, dividend growth, deep value, event-driven, and exceptional circumstances, to mention a few.




**Approach of Fundamental Evaluation**

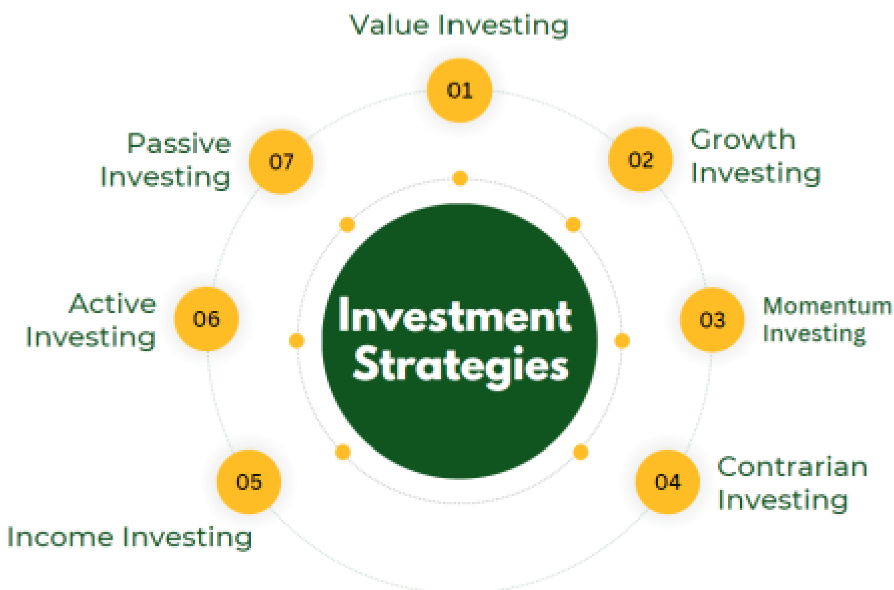
### 3.3.1 Investment Styles

The investing strategy is determined by the investor's or fund manager's investment style. Investment Style: What Is It? Investment style refers to the approach and philosophy a portfolio manager or investor uses while choosing investments. Investment style depends on a number of variables and frequently takes into account market cap, growth vs. value orientation, and risk preferences. The most common investment styles being practiced are Value, Growth, Quality and Momentum.



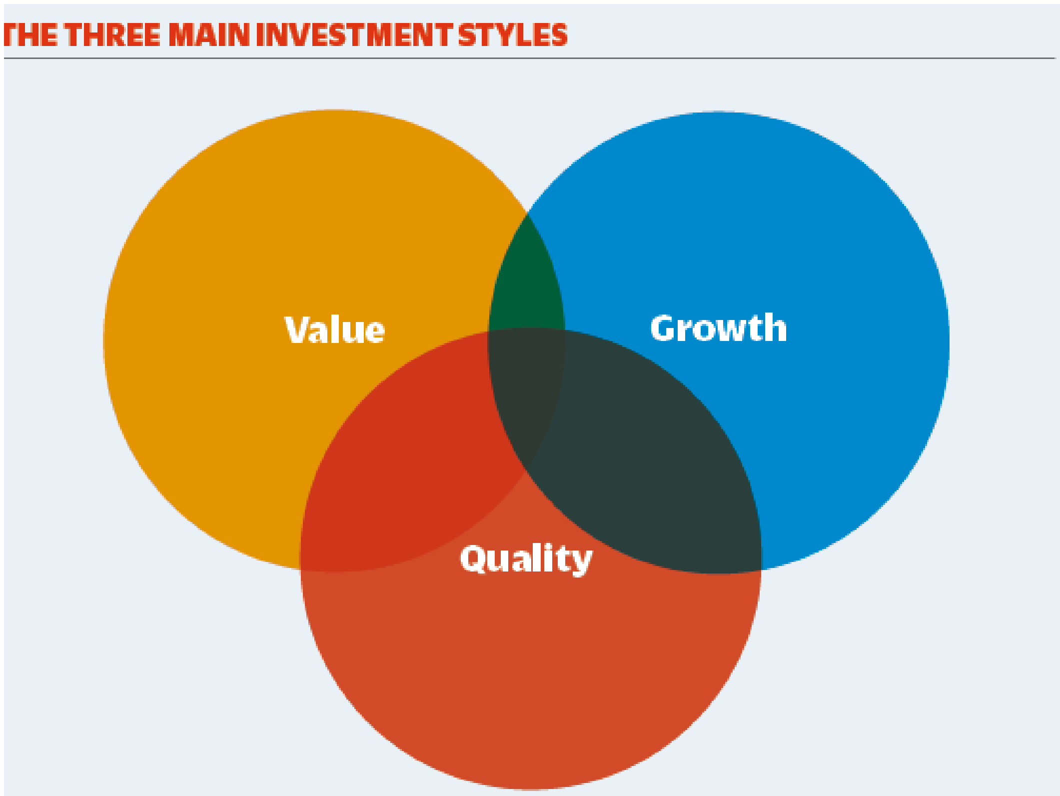

**Styles of Investment**

- ❖ Value Style:- This style of investing focuses on low priced stocks with higher dividend yield. The market value of these shares is low depicted by low P/E ratio and intrinsic value is high.




**Investing of Value**

- Growth Style:- This style focuses on those stocks whose profit margins are high return on equity is high but low dividend yields. These companies re invest their profits.
- Quality Style:- Quality style of investing focuses on a combination of financial productivity, low leverage, and stability. This style of investing is fruitful in the long run.
- Momentum Style:- It is a trading style in which investors buy securities whose prices are showing an upward trend and sell them when the investor is of the opinion that the security has reached its peak.




Main Investment Style

### 3.3.2 How Does It Help Investors

Investment strategies let investors choose where and how to spend their money based on their projected return, risk tolerance, time horizon, and preferred investment styles. It is governed by a set of rules and regulations created to help investors build their investment portfolios. A barbell investment plan, for instance, places a Value Style and a Growth Style at either end. A bucketing strategy uses Value style as the Core and Momentum style as the Satellite, and a core and satellite strategy uses Value style as the Core and Momentum style as the Satellite. Barbell trading entails taking positions in both extremes. To balance risk and reward, one might invest in highrisk and low-risk assets rather than those in the mushy centre. However, according to experts, the emergence of different investment styles has made it difficult to implement a barbell plan.


**Types Of Investment Strategy**

- Active and Passive Strategy

Active and Passive Strategy is when an investor is of the opinion that he can analyse and buy best investments and will be able to beat the market. He will be able to earn better than S & P 500 and cover all investment costs. On the other hand a passive investor's belief is that trading too often increases the transaction costs and it's a better strategy to do minimal trading as the market is volatile.

- Growth Investing

The investors who have faith in companies which have just started and are expected to outperform their competitors in the industry ; invest in the shares of these companies. These companies have good potential for growth and generally re invest their earnings in the business. As a result they are unable to declare any dividend or very less dividend. These investors look for those companies who use new technologies or services. These companies also invest part of their earnings for research and get their patents registered, The investors look at a few key factors namely the present profitability, Return on equity, future expected profitability, share price performance, etc. These investors wish to earn by selling the stocks rather than dividend.

- Value investing

This investment strategy focuses on intrinsic value of the share. There are various ways to determine the intrinsic value like company's financial performance, its cash flows (reflecting cash rich company), brand name, business model , having competitive edge over its competitors, etc including Price to book ratio. Book value is Net worth divided by number of shares. If the book value is higher than market value ; Value investors invest in these shares . The value investor beliefs that the market will correct itself in the long run and the share price will increase. They do not follow the herd. These investors also keep a good margin of safety. Sometimes the period of holding the stock depends on various other goals of the investor like his retirement plan , buying a house, etc and also his analysis whether the price will rise further or not.

- Income Investing

This sort of approach focuses on generating cash flow from stocks rather than investing in equities that simply increase the value of your portfolio. Dividends and fixed interest from bonds are the two main sources of cash income for investors. Investors that want dependable returns on their investments opt for such a method.

- Dividend Growth Investing

This kind of investment strategy is used by the investor to look for companies that consistently pay a dividend each year. Companies that have a track record of consistently paying dividends are less erratic and more stable than other companies, and they work to improve their dividend payout every year. The investors reinvest these profits in order to increase their wealth over time due to compounding.

- Contrarian Investing

Using this type of technique, investors might buy company stocks while the market is down. This strategy places a focus on buying cheap and selling expensively. Whenever there is a recession, war, natural disaster, etc., the stock market normally declines. But during a downturn, investors shouldn't just buy any company's stock. They should be on the lookout for companies that have the potential to increase in value and a brand that prevents rivals from doing business with them.

- Indexing

This kind of investment approach enables investors to place a small number of equities in an index of the market. S&P 500, mutual funds, and exchange-traded funds are a few examples.

- Barbell strategy

According to the barbell strategy, the ideal way to find a balance between reward and risk is to invest in the two extremes of high-risk and low-risk assets while avoiding middle-of-the-road choices.

| Investing Style | Investment Focus |
| --- | --- |
| Index Investing | Investments that mimic the performance of an index |
| Value Investing | Investments that appear underpriced |
| Growth Investing | Investments that are expected to grow faster than average |
| Income Investing | Investments that generate income on a regular basis (yield-focused) |

**Style and Focus**

All investment strategies entail attempting to maximise returns while taking into account the level of risk the investor is willing to accept. Investors that use the barbell method are adamant that this can only be accomplished by using severe measures.

The barbell method encourages pairing two assets that are very different from one another. Only extremely safe investments are contained in one basket, while only leveraged and speculative investments are contained in the other.

The barbell technique, as used in fixed income investment, suggests combining short-term and long-term bonds. As a result, the investor has long-term bonds as insurance in case yields decline and a chance to outperform short-term yields.

The majority of investment strategists start the portfolio-building process by determining the level of risk the investor can handle. A young professional might be willing to assume a lot of risk. A retiree might rely on a consistent income. The strategist then develops a portfolio by splitting the funds into three or more pools, each of which represents a different risk level. Risky investments include speculative equities like initial public offerings (IPOs) or small biotechnology firms. Although less hazardous, blue-chip stocks are nonetheless susceptible to economic ups and downs. Bank certificates of deposit (CDs) are the safest investment option out of all bonds. That youthful investor might invest 20% in bonds, 40% in blue-chip equities, and 40% in risky stocks. The retiree might retain 20% of blue-chip stocks and 80% of bonds. Each is seeking the greatest reward for the least amount of risk. ESG investing examines how a company's long-term value may be impacted by environmental, social, and governance aspects. It is argued that successful businesses are more inclined to take governance and the environment seriously.

SRI (socially responsible investing), impact investing, and ethical investment strategies are similar to ESG investing. These strategies, however, aim to limit how capital is employed. ESG investment examines how similar issues impact profits. Individual investors have two options: they can invest in ESG funds or use ESG stock selection tools. The effectiveness of these tactics has not been established, and the area is quiteyoung. Before making an investment in a fund or signing up for a ratings service, it is advisable to conduct some research.

### 3.3.3 How does it help investors

According to their expected return, risk tolerance, time horizon, and favoured investment styles, investment strategies assist investors in deciding where and how to spend. It is controlled by a collection of policies and guidelines developed to assist investors in creating their investment portfolios. A barbell investment plan, for instance, places a Value Style and a Growth Style at either end. Barbell trading entails taking positions in both extremes. To balance risk and reward, one might invest in highrisk and low-risk assets rather than those in the mushy centre. However, according to experts, the emergence of different investment styles has made it difficult to implement a barbell plan.

**Investment v/s Speculation**

| Basis | Investment | Speculation |
|---|---|---|
| Time Horizon | Long term – beyond 12 months | Short term – holding assets from one day up to one year |
| Risk | Limited | High |
| Source of income | Earnings of enterprise | Change in market price |
| Stability of income | Very Stable | Uncertain and |
| Use of funds | Own funds | Own Funds , borrowed funds |
| Type of contract | Creditor | Ownership |
| Psychological attitude of participants | Cautious and conservative | Aggressive and daring |

**Investment/Speculation**

## Things to keep in mind

There isn't a method that works for everyone. The investment styles and their weights can vary within each plan. To create an investment framework, one can combine different types of plan and style, according to Joshi. The risk and reward must be thoroughly understood, backed by back testing, scenario analysis, and other empirical evidence. According to industry specialists, the days when investors constructed portfolios haphazardly without a firm understanding of the investment strategy are long gone. Joshi continues, "Instead, people have realized that having the ideal blend of investment style and strategy greatly increases their odds of success and is essential for an All-Weather portfolio. And with good reason—the "how" of investing is just as crucial as the "what."

## Investing Tips

Before making a purchase, newbie investors should have the following advice in mind.

• Establish Objectives: Decide how much cash you'll need over the coming months. By doing this, you'll be able to decide whether to make investments for the long run or the short term and how much profit to expect.

• Conduct detailed research and trend analysis to thoroughly understand how the stock market and various instruments (equity, bonds, options, derivatives, mutual funds, etc.) operate. The price and return trends of the equities you have chosen to invest in should be monitored.

• Portfolio optimisation: From a range of portfolios, select the one that best achieves your objective. A portfolio that provides the best dividend at the lowest risk is optimal. The best advice is to locate a trustworthy brokerage or consulting firm. They'll give you suggestions on where to invest and how to spend money so you can reach your financial objectives.

• Risk Tolerance: To achieve the desired return, be aware of your level of risk tolerance. Additionally, this is dependent on your short- and long-term goals. If you want a bigger return quickly, the risk will be higher and vice versa.

• Risk diversification: Developing a portfolio with a mix of debt, shares, and derivatives will help you reduce your exposure to risk. Check to see that the two assets are not totally connected with one another.

**Advantages Of Investment Strategies**

The following are a few benefits of using investment methods.

• Investment methods provide risk diversification in the portfolio by investing in a variety of investment types and industries in accordance with timing and projected returns Depending on the desires and requirements of the investors, a portfolio may consist of a single strategy or a combination of strategies.

• Investing carefully enables investors to maximise the return on their capital.

• Investment strategies can help you pay less tax and cut transaction expenses.

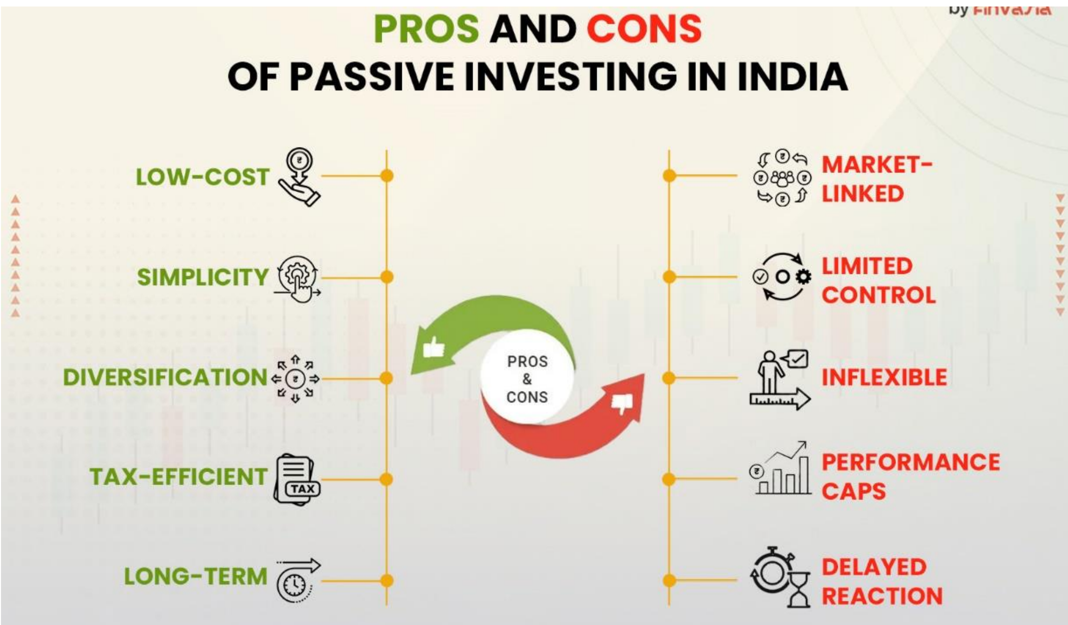

**Advantage of Investment**

**Limitations Of Investment Strategies**

These are a few of the investment methods' drawbacks.

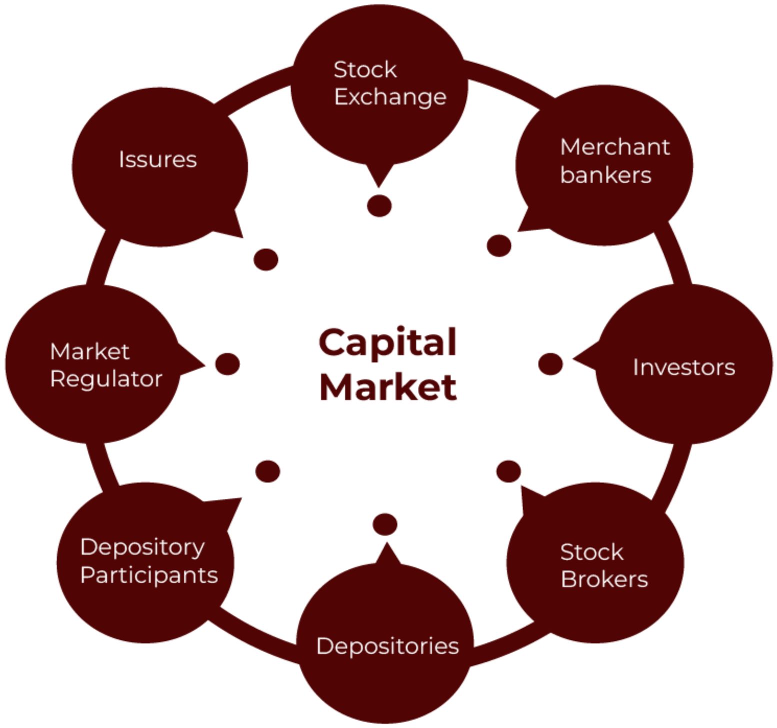
• Why Beating the market is difficult for typical investors. A professional investor would get the same result in a couple of weeks or months, but they could take years to achieve an average return on their assets.

• While thorough research, analysis, and historical data are considered before investing, the majority of choices are based on a predictive premise. Investors may not be able to meet their goals on time if performance and returns don't always meet expectations.Therefore, based on the aforementioned data, we may draw the conclusion that for young investors to succeed, a thorough market analysis is necessary to lower the likelihood of future losses. We have also conclude that a more effective investing plan will ultimately result in a future that is secure financially. Recent research indicates that human behaviour does not entirely determine Indian markets. Behavioural finance has not yet had an impact on every aspect of finance. The dominating theories in corporate finance continue to be rationalism and efficiency. According to this study, psychological, social, and demographic factors play a significant effect in financial decision-making. Additionally, it has been demonstrated that demographic variables like age, education, and experience all significantly affect these psychological biases. All of these traits together interact in various ways, such as the investor's age and level of confidence. When all of these factors were considered, an advantageous scenario for investing in stocks was produced.




### 3.4Functions and Types of Capital Market

Functions of Capital market Like the money market capital market is also very important. It plays a significant role in the national economy. A developed, dynamic and vibrant capital market can immensely contribute for speedy economic growth and development.



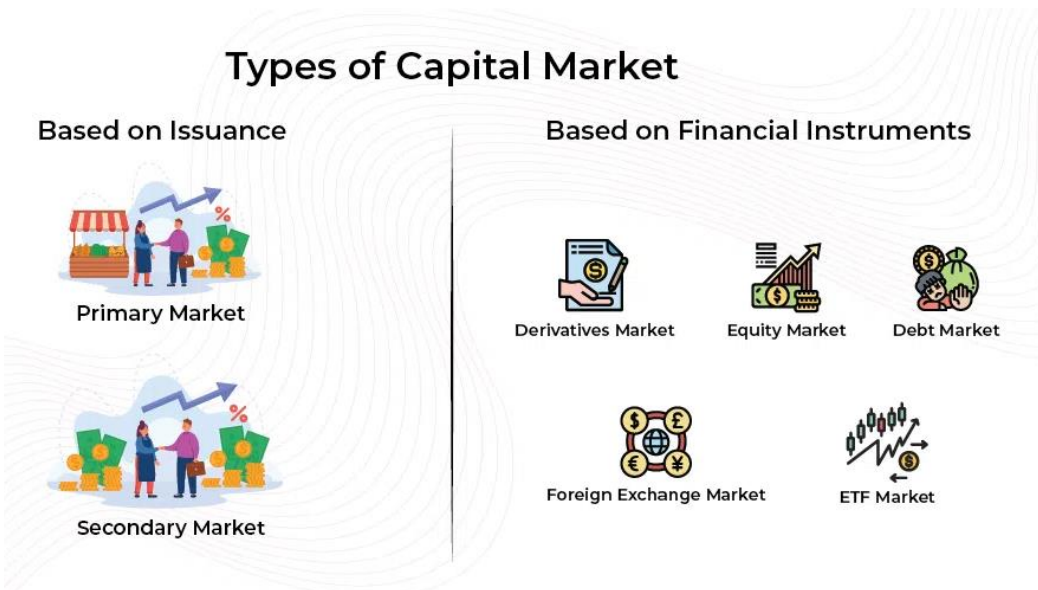

**Market of Capital**

Let us get acquainted with the important functions and role of the capital market.

1. Mobilization of Savings: Capital market is an important source for mobilizing idle savings from the economy. It mobilizes funds from people for further investments in the productive channels of an economy. In that sense it activates the ideal monetary resources and puts them in proper investments.

2.Capital Formation: Capital market helps in capital formation. Capital formation is net addition to the existing stock of capital in the economy. Through mobilization of ideal resources it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation.

3. Provision of Investment Avenue: Thus it provides an investment avenue for people who wish to invest resources for a long period of time. It provides suitable interest rate returns also to investors. Instruments such as bonds, equities, units of mutual funds, insurance policies, etc. definitely provides diverse investment avenue for the public.



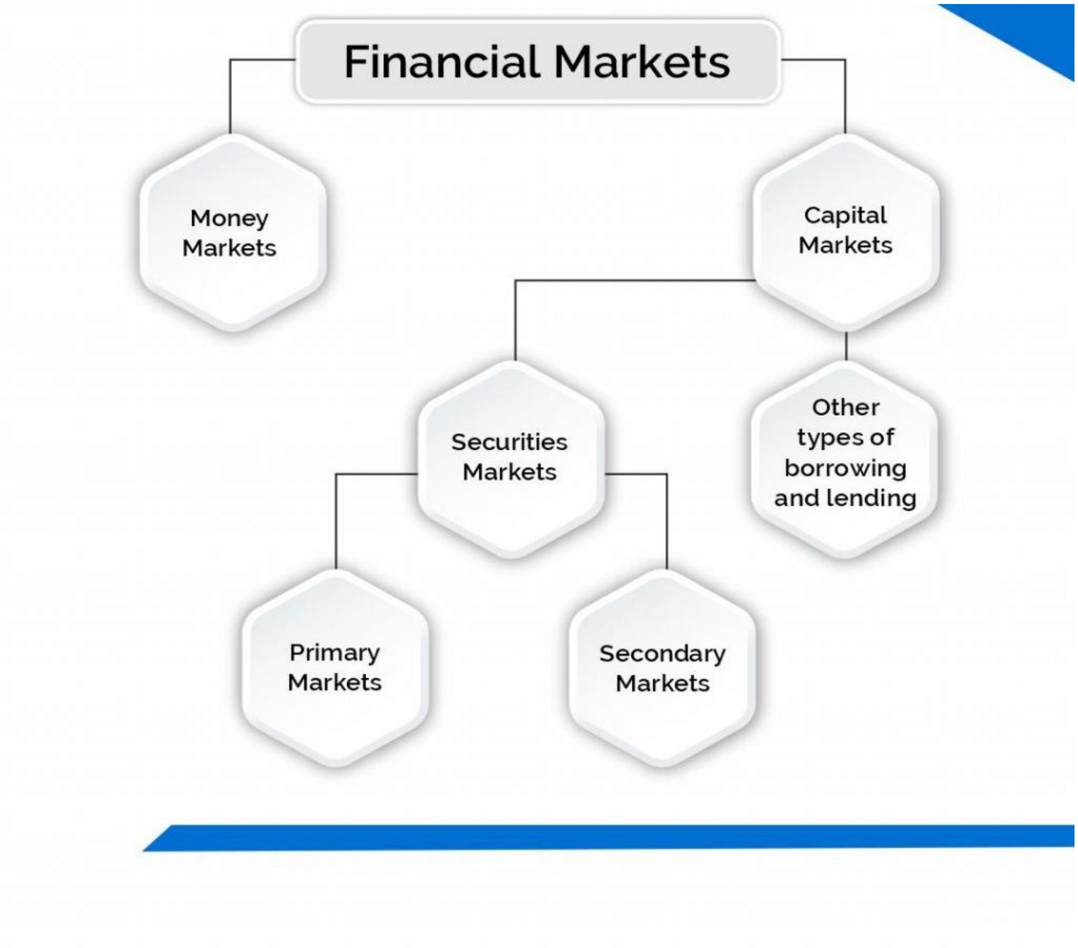

**Types of Capital**

4. Speed up Economic Growth and Development: Capital market enhances production and productivity in the national economy. As it makes funds available for long period of time, the financial requirements of business houses are met by the capital market. It helps in research and development. This helps in, increasing production and productivity in economy by generation of employment and development of infrastructure.

5. Proper Regulation of Funds: Capital markets not only helps in fund mobilization, but it also helps in proper allocation of these resources. It can have regulation over the resources so that it can direct funds in a qualitative manner.

6. Service Provision: As an important financial set up capital market provides various types of services. It includes long term and medium term loans to industry, underwriting services, consultancy services, export finance, etc. These services help the manufacturing sector in a large spectrum.

7. Continuous Availability of Funds: Capital market is place where the investment avenue is continuously available for long term investment. This is a liquid market as it makes fund available on continues basis. Both buyers and seller can easily buy and sell securities as they are continuously available. Basically capital market transactions are related to the stock exchanges. Thus marketability in the capital market becomes easy.




**Growth of Finance**

## Types of Capital Market

There are two types of capital market

1. Primary market

The primary market is that part of the capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.


**Work of Capital Market**

**Features of primary markets are:**

This is the market for new long term equity capital. The primary market is the market where the securities are sold for the first time. Therefore it is also called the new issue market (NIM).

In a primary issue, the securities are issued by the company directly to investors. The company receives the money and issues new security certificates to the investors. Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business. The primary market performs the crucial function of facilitating capital formation in the economy. The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as “going public.”

2. **Secondary market**

The secondary market, also known as the aftermarket, is the financial market where previously issued securities and financial instruments such as stock, bonds, options, and futures are bought and sold. The term “secondary market” is also used to refer to the market for any used goods or assets, or an alternative use for an existing product or asset where the customer base is the second market (for example, corn has been traditionally used primarily for food production and feedstock, but a second- or third- market has developed for use in ethanol production). Another commonly referred to usage of secondary market term is to refer to loans which are sold by a mortgage bank to investors such as Fannie Mae and Freddie Mac,

With primary issuances of securities or financial instruments, or the primary market, investors purchase these securities directly from issuers such as corporations issuing shares in an IPO or private placement, or directly from the federal government in the case of treasuries. After the initial issuance, investors can purchase from other investors in the secondary market.

The secondary market for a variety of assets can vary from loans to stocks, from fragmented to centralized, and from illiquid to very liquid. The major stock exchanges are the most visible example of liquid secondary markets – in this case, for stocks of publicly traded companies. Exchanges such as the New York Stock Exchange, Nasdaq and the American Stock Exchange provide a centralized, liquid secondary market for the investors who own stocks that trade on those exchanges. Most bonds and structured products trade “over the counter,” or by phoning the bond desk of one‟s broker-dealer. Loans sometimes trade online using a Loan Exchange.

## 3.5 Reforms in the Capital Market

The major reforms undertaken in capital market of India includes:-

1.Establishment of SEBI: The Securities and Exchange Board of India (SEBI) was established in 1988. It got a legal status in 1992. SEBI was primarily set up to regulate the activities of the merchant banks, to control the operations of mutual funds, to work as a promoter of the stock exchange activities and to act as a regulatory authority of new issue activities of companies. The SEBI was set up with the fundamental objective, "to protect the interest of investors in securities market and for matters connected therewith or incidental thereto."

The main functions of SEBI are:-

a) To regulate the business of the stock market and other securities market.

b) To promote and regulate the self-regulatory organizations.

c) To prohibit fraudulent and unfair trade practices in securities market.

d) To promote awareness among investors and training of intermediaries about safety of market.

e) To prohibit insider trading in securities market.

f) To regulate huge acquisition of shares and takeover of companies.


**Financial Regulators oversee Capital Markets**

**2. Establishment of Creditors Rating Agencies:**

Three creditors rating agencies viz. The Credit Rating Information Services of India Limited (CRISIL - 1988), the Investment Information and Credit Rating Agency of India Limited (ICRA - 1991) and Credit Analysis and Research Limited (CARE) were set up in order to assess the financial health of different financial institutions and agencies related to the stock market activities. It is a guide for the investors also in evaluating the risk of their investments.

**3.Increasing of Merchant Banking Activities:**

Many Indian and foreign commercial banks have set up their merchant banking divisions in the last few years. These divisions provide financial services such as underwriting facilities, issue organising, consultancy services, etc. It has proved as a helping hand to factors related to the capital market.

**4.Candid Performance of Indian Economy:**

In the last few years, Indian economy is growing at a good speed. It has attracted a huge inflow of Foreign Institutional Investments (FII). The massive entry of FIIs in the Indian capital market has given good appreciation for the Indian investors in recent times. Similarly many new companies are emerging on the horizon of the Indian capital market to raise capital for their expansions.

**5.Rising Electronic Transactions:**

Due to technological development in the last few years. The physical transaction with more paper work is reduced. Now paperless transactions are increasing at a rapid rate. It saves money, time and energy of investors. Thus it has made investing safer and hassle free encouraging more people to join the capital market.

**6.Growing Mutual Fund Industry:**

The growing of mutual funds in India has certainly helped the capital market to grow. Public sector banks, foreign banks, financial institutions and joint mutual funds between the Indian and foreign firms have launched many new funds. A big diversification in terms of schemes, maturity, etc. has taken place in mutual funds in India. It has given a wide choice for the common investors to enter the capital market.

**7. Growing Stock Exchanges:**

The numbers of various Stock Exchanges in India are increasing. Initially the BSE was the main exchange, but now after the setting up of the NSE and the OTCEI, stock exchanges have spread across the country. Recently a new Inter-connected Stock Exchange of India has joined the existing stock exchanges.

**8. Investor's Protection:**

Under the purview of the SEBI the Central Government of India has set up the Investors Education and Protection Fund (IEPF) in 2001. It works in educating and guiding investors. It tries to protect the interest of the small investors from frauds and malpractices in the capital market.

**9. Growth of Derivative Transactions:**

Since June 2000, the NSE has introduced the derivatives trading in the equities. In November 2001 it also introduced the future and options transactions. These innovative products have given variety for the investment leading to the expansion of the capital market.

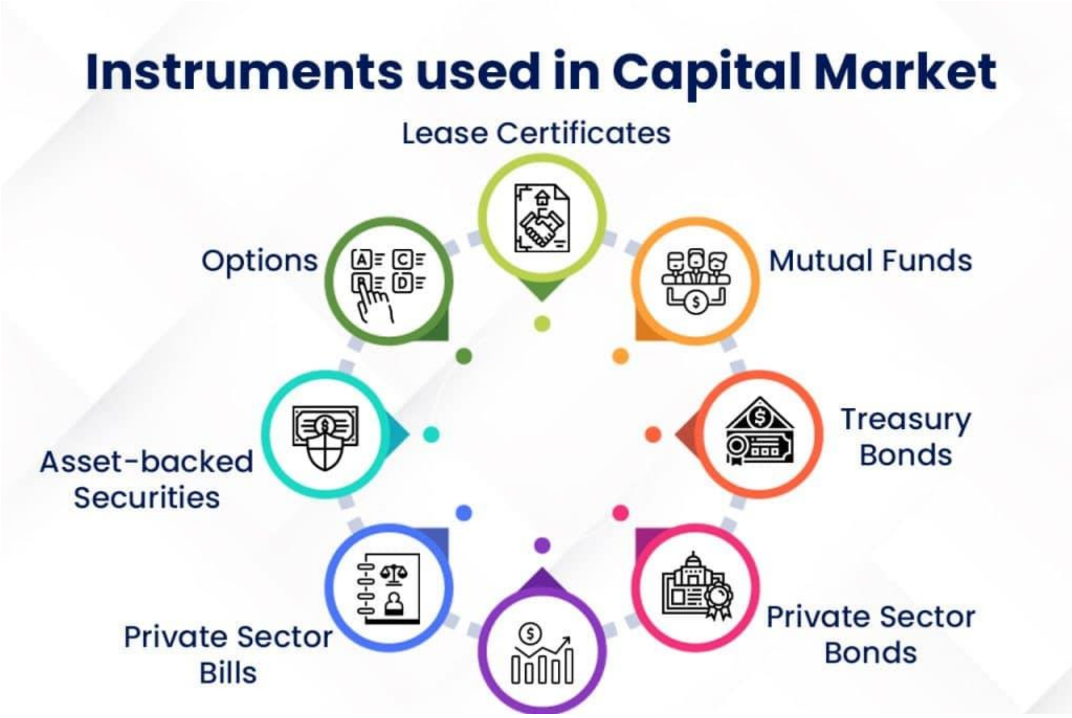
**10. Insurance Sector Reforms:**

Indian insurance sector has also witnessed massive reforms in last few years. The Insurance Regulatory and Development Authority (IRDA) were set up in 2000. It paved the entry of the private insurance firms in India. As many insurance companies invest their money in the capital market, it has expanded.

**11. Commodity Trading:**

Along with the trading of ordinary securities, the trading in commodities is also recently encouraged. The Multi Commodity Exchange (MCX) is set up. The volume of such transactions is growing at a splendid rate.

Apart from these reforms the setting up of Clearing Corporation of India Limited (CCIL), Venture Funds, etc. have resulted into the tremendous growth of Indian capital market.




**Instruments used in Capital Market**

### 3.6 Issue Mechanisms

As we all know that capital market (securities markets) is the market for securities, where companies and the government can raise long-term funds. The capital market includes the stock market and the bond market. Financial regulators, oversee the capital markets in their respective countries to ensure that investors are protected against fraud. The capital markets consist of the primary market, where new issues are distributed to investors, and the secondary market, where existing securities are traded.

Primary markets

The primary market is that part of the capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus.

Secondary markets

The secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. Alternatively, secondary market can refer to the market for any kind of used goods. The market that exists in a new security just after the new issue is often referred to as the aftermarket. Once a newly issued stock is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock.

In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market be highly liquid and transparent. Before electronic means of communications, the only way to create this liquidity was for investors and speculators to meet at a fixed place regularly. This is how stock exchanges originated.

## 3.7 Types of Primary Issues

Primarily, issues can be classified as a Public, Rights or Preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler. The classification of issues is illustrated below:

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

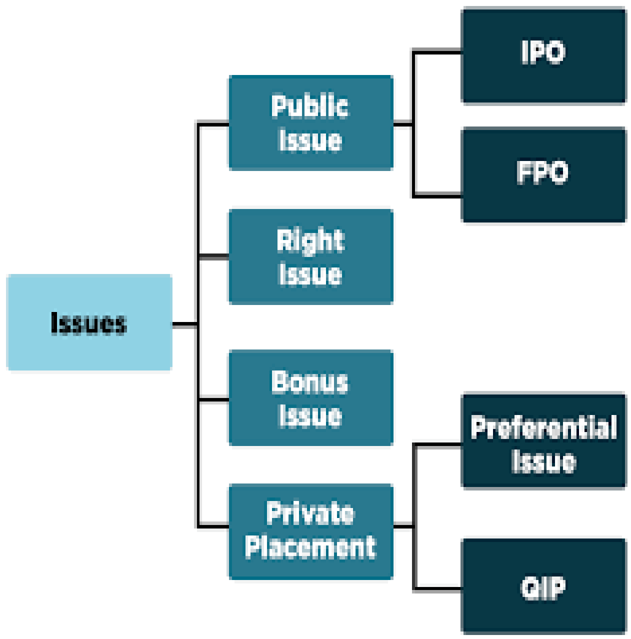
A follow on public offering (Further Issue) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document.

Rights Issue is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.

A Preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital. The issuer company has to comply with the Companies Act and the requirements contained in the Chapter pertaining to preferential allotment in SEBI guidelines which inter-alia include pricing, disclosures in notice, etc.

### 3.8 Public Rights and Private Placement

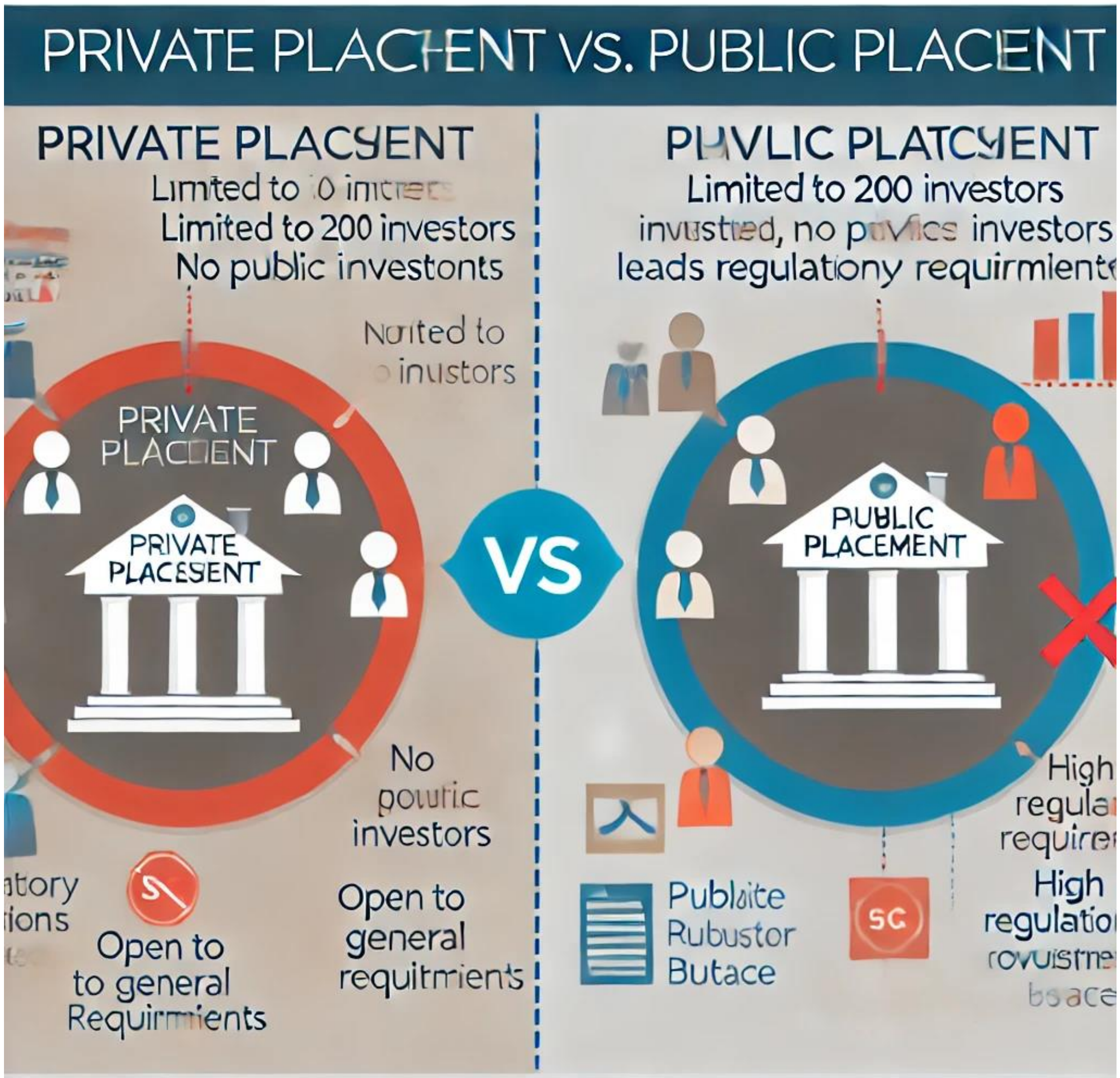
A rights issue involves selling securities in the primary by issuing rights to the existing shareholders, When a company issues additional equity capital, it has to be offered in the first instance to the existing shareholders on a pro rata basis. This is required under Section 81 of the Companies act, 1956. The shareholders however may be a special resolution forfeit this right, partially or fully to enable a company to issue additional capital the public.




**Issue with Public and Private**

**Procedure for rights issue:**

A company making rights issue sends a letter of offer along with a composite application form consisting of four forms (A, B, C and D) to the shareholders. Form A is meant for the acceptance of the rights and application of additional shares. This form also shows the number of rights shares the shareholders is entitled to. It also has a column through which a request for additional shares may be made. Form B is to be used if the shareholder wants to renounce the rights in-favour of someone else. Form C is meant for application by the renounces in whose favour the rights have been renounced by the original allotted, through Form B. Form D is to be used to make a request for split forms. The composite application form must be mailed to the company within a specific period which is usually 30 days.




**Private Placement Vs Public Placement**

## Private Placement or Preferential allotment:

In private placement, funds are raised in the primary market by issuing securities privately to some investors without resorting to underwriting. The investors in this case may be financial institutions, commercial banks, other company‟s shareholders of promoting companies, and friends and associates of the promoters.

**The merits of private placement are:**

(1) the process of raising funds is fairly simple. The elaborate procedure required in the case of a public issue is more or less by passed.

(2) The issues cost is minimal.

(3) In the case of a debenture issue, negotiated directly between the issuing company and the few investors, there may be greater flexibility with respect to terms and conditions. The disadvantageous of private placement are:

(1) The Quantum of funds that can be raised may be rather limited,

(2) The cost of capital of funds raised by way of private placements may be somewhat higher.

**Private Placement of Debentures:**

Private placement of debentures has become very popular in recent years. The principal buyers of such debentures have been mutual funds, insurance companies, financial institutions, Army Group Insurance, Navy Group Insurance, Air Group and so on.

## 3.9 Resource Mobilization from InternationalCapital Markets

Funds can be raised in the primary market from the domestic market as well as from international markets. After the reforms were initiated in 1991, one of the major policy changes was allowing Indian companies to raise resources by way of equity issues in the international markets. Earlier, only debt was allowed to be raised from international markets. In the early 1990s foreign exchange reserves had depleted and the country‟s rating had been downgraded. This resulted in a foreign exchange crunch and the government was unable to meet the import requirement of Indian companies. Hence allowing companies to tap the equity and bond market In Europe seemed a more sensible option. This permission encourages Indian companies to become global.


**Resource Mobilization**

India companies have raised resources from international capital markets through Global depository receipts (GDRs) / American Depository Receipts (ADRs), Foreign Currency Convertible Bonds (PCCBs) and External Commercial Borrowings (ECBs). The last are used as a residual source after exhausting external equity as a main source of finance for large value projects.

### 3.9.1 ADRs

ADRs are negotiable instruments denominated in dollars, and issued by the US Depository Bank. A non-US company that seeks to list in the US, deposits its shares with a bank and receives receipts which enable the company to issue American Depository Shares (ADSs). These ADS‟s serve as stock certificates and are used interchangeably with ADRs which represent ownership of deposited shares. There is no legal or technical difference between an ADR and a GDR. As they are listed on the New York Stock Exchange (NYSE) and NASDAQ (National Association of Securities Dealers Automated Association), ADR issued offer access to the US institutional and retail markets while GDR issues offer access only to the US institutional market. GDR listing requires comprehensive disclosures and greater transparency as compared to GDR listing.

### 3.9.2 GDRs

GDRs essentially equity instruments issued abroad by authorized overseas corporate bodies against the shares/bonds of Indian companies held with nominated domestic custodian banks. The issue of GDR creates equity shares of the issuing company which are kept with a designated bank. GDRs are freely transferable outside India and divided in respect of the share represented by the GDR is paid in Indian rupees only. They are listed and traded on a foreign stock exchange. Trading takes place between professional market makers on an OTC (over the counter) basis. A GDR may represent one or more shares of the issuing company. The shares correspond to other GDR in a fixed ratio. A holder of a GDR can, at any time, convert it into the number of shares that it represents. Till conversion, the GDRs do not carry any voting rights and once conversion takes place the underlying shares are listed and traded on the domestic exchange. Most of the

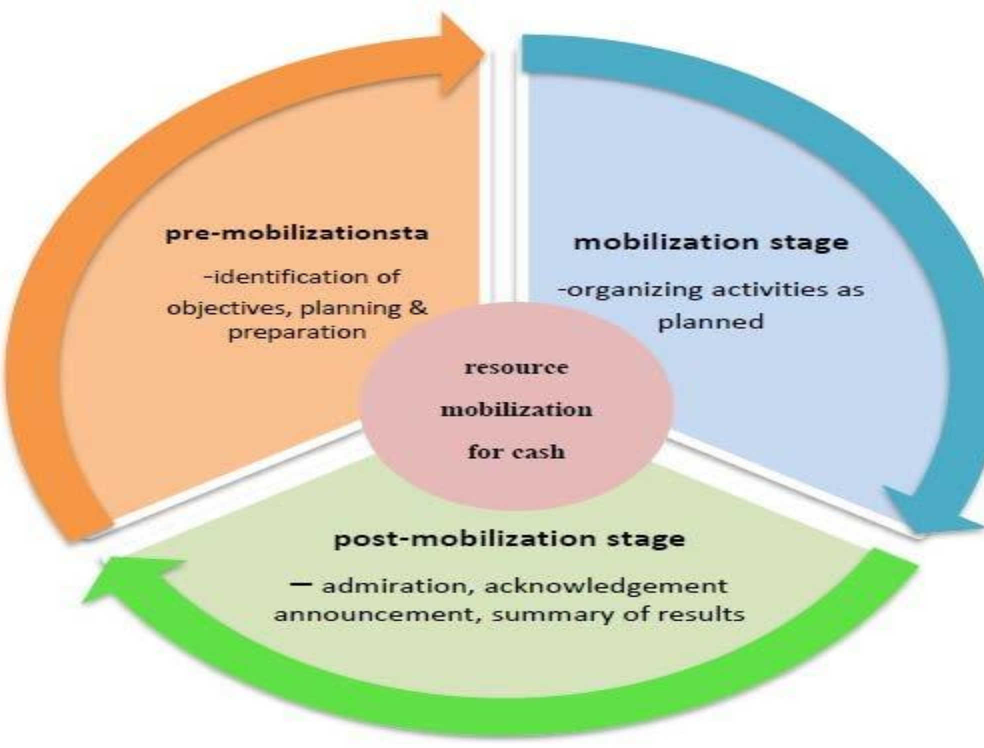
Indian companies have their GDR issues listed on the Luxembourg Stock Exchange and the London Stock Exchange.

Indian GDRs are primarily sold to institutional investors and the major demand is in the UK, US, Hong Kong, Singapore, France and Switzerland. Rule 144 A of the Securities and Exchange Commissions (SEC) of the US permits companies from outside the US to offer their GDRs to qualified institutional buyers. GDRs can be converted into ADRs by surrendering the existing GDRs and depositing the underlying equity shares with the ADR depository in exchange for ADRs. The company has to comply with the Securities and Exchange Commission requirements to materialize this exchange offer process. However, the company does not get any funds by this conversion. The trend is towards the conversion of GDRs into ADRs as ADRs are more liquid and cover a wider market. Besides these, many European investors have been disappointed by poor performance of Indian GDRs in traditional industries and are unwilling to provide more capital.

### 3.9.3 ECBs

An external commercial borrowing (ECB) is an instrument used in India to facilitate the access to foreign money by Indian corporations and PSUs (public sector undertakings). ECBs include commercial bank loans, buyers' credit and suppliers‟ credit, securitised instruments such as floating rate notes and fixed rate bonds, etc. credit from official export credit agencies and commercial borrowings from the private sector window of multilateral financial Institutions such as International Finance Corporation (Washington), ADB, AFIC, CDC, etc. ECBs cannot be used for investment in stock market or speculation in real estate. The DEA (Department of Economic Affairs), Ministry of Finance, Government of India along with Reserve Bank of India, monitors and regulates ECB guidelines and policies. For infrastructure and green-field projects, funding up to 50% (through ECB) is allowed. In telecom sector too, up to 50% funding through ECBs is allowed.

Recently Government of India allowed borrowings in Chinese currency Yuan. Corporate sectors can mobilize USD 750 million via automatic route, whereas service sectors and NGO's for microfinance can mobilize USD 200 million and 10 million respectively. Borrowers can use 25 per cent of the ECB to repay rupee debt and the remaining 75 per cent should be used for new projects. A borrower cannot refinance its entire existing rupee loan through ECB. The money raised through ECB is cheaper given near-zero interest rates in the US and Europe, Indian companies can repay part of their existing expensive loans from that.



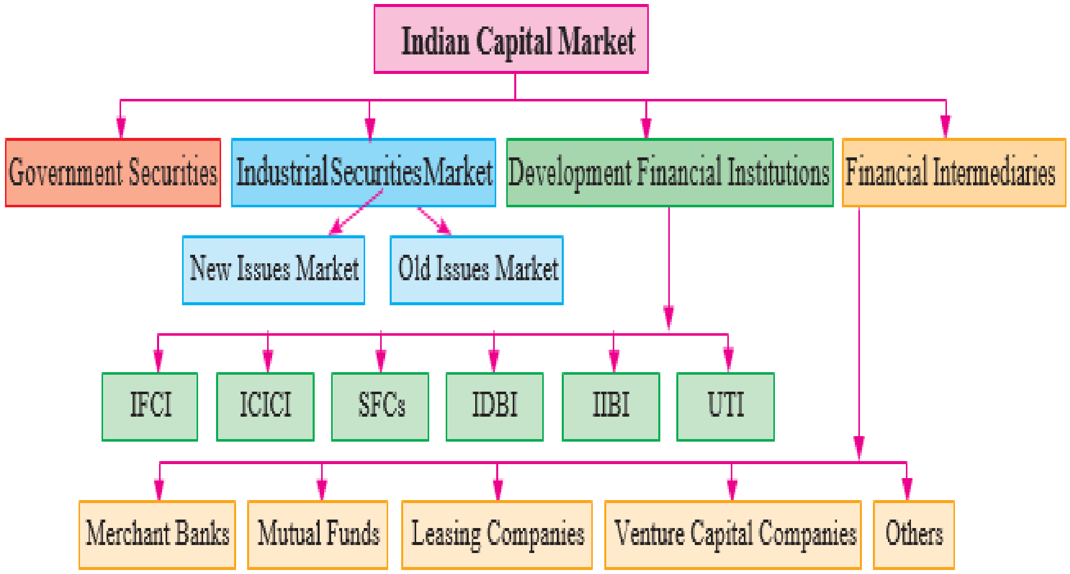

**Resource Mobilization for Cash**

### 3.10 Primary Market

The Primary Market consists of arrangements, which facilitate the procurement of long-term funds by companies by making fresh issue of shares and debentures. You know that companies make fresh issue of shares and/or debentures at their formation stage and, if necessary, subsequently for the expansion of business. It is usually done through private placement to friends, relatives and financial institutions or by making public issue. In any Business case, the companies have to follow a well-established legal procedure and involve a number of intermediaries such as underwriters, brokers, etc. who form an integral part of the primary market. You must have learnt about many initial public offers (IPOs) made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and the private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on.

#### 3.10.1 Scenario in India

In the Financial Year 2008, India saw the greatest year in Indian capital Market raised when the Total Capital raised went Northwards of US$ 9 Billion.




**Indian Capital Market**

- India has seen a tremendous growth of its Capital Markets with close to 500 Initial Public Offerings (IPO) second only US. While India Ranked IV with respect to the amount of Capital raised contributing to 3.7% of global IPO share.

- At the end of F.Y 12,the P/E ratio of BSE Sensex and S & P CNX NIFTY were 17.8 and 18.7 respectively as compared to 21.2 and 22.1 respectively as at the end of F.Y11 1st Development in Primary Market

- The Overall growth of GDP at factor Cost at contrast Prices, as per Advanced Estimates, is estimated at 6.9 percent in F.Y12 as compared to the revised growth of 8.4% during F.Y11

- Industrial Growth measured by Index of Industrial Production reached 2.9% during F.Y12 as compare to 8.2% in F.Y11 2nd Development in Primary Market

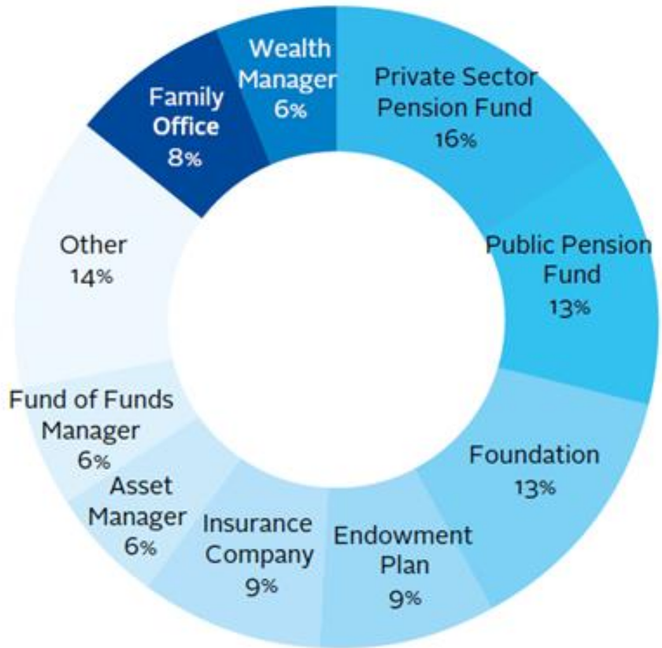
•Among the 17 listed companies that were approved for ordinary share issue, 16 have completed their Initial Public Offering(IPO) and among them 12 have already been listed in the Secondary Market too.

• In order to create efficient Capital Market QFI‟s been allowed to directly invest in the Indian Equity Market in Jan 2012.

It is mandatory for Companies to issue IPO of 100 and above in electronic form through Nation Wide Broker Network of Stock Exchanges. 3rd Development in Primary Market Resources mobilized in primary market 0 50 100 150 200 250 300 350 400 450 FY08 FY09 FY10 FY11 FY12 IPOs FPOs Bond/NCD Right Issues Source: SEBI Source: BSE

**3.11Debt Market: Private Corporate**

Debt market refers to the financial market where investors buy and sell debt securities, mostly in the form of bonds. Entire debt segment is generally consists of 2/3 of primary market and 4/5 of secondary market. The Indian debt market is today one of the largest in Asia and includes securities issued by the Government (Central & State Governments), public sector undertakings, other government bodies, financial institutions, banks and corporates.




**Overview of Debt**

Debt Market Can Be Broadly Classified in To:-

1) Govt. securities market)

2) Corporate debt market. The government debt market is the market for bonds and securities issued by the central govt., state govt. and the semi govt. authorities which includes local govt. authorities like city corporations, metropolitan authorities public sector corporations and other govt. agencies such as IDBI, IFCI, SFCs. In broader terms Corporate bonds are fixed income securities issued by corporates i.e. entities other than Government.

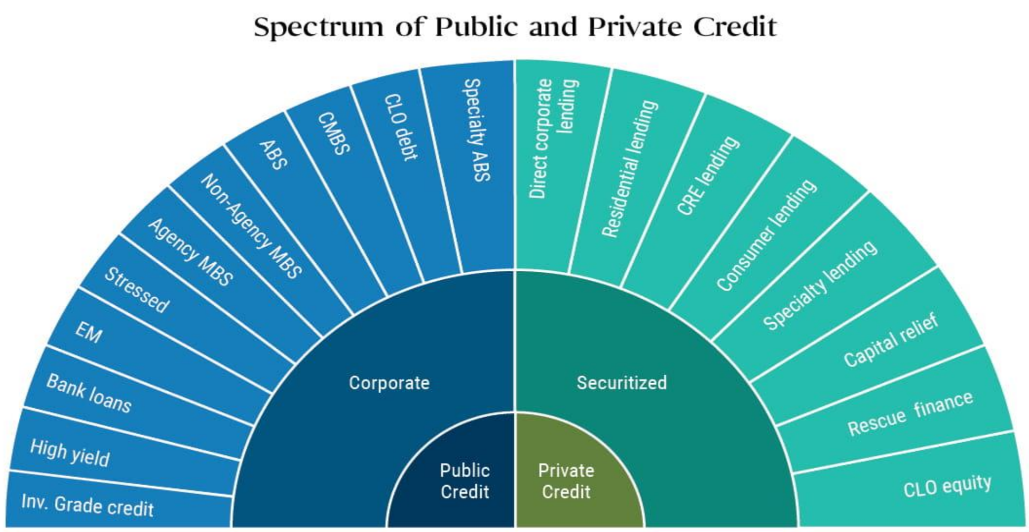
Corporate debt market can be classified into:-

• Primary market

• Secondary market

Primary market for corporate debt:-The corporate sector can raise debt funds either through prospectus or private placement. It is a market wherein debt securities of corporate i.e., debentures, bonds, commercial papers, certificate of deposits, etc. of private & public sectors are issued for the first time.

Secondary market for corporate debt:-It is a market where the corporate debt securities of both private sector & public sector undertakings are traded. These securities are traded on Wholesale Debt Segment (WDM) segment of NSE, OTCEI &BSE.




**Credit based on Public vs Private**

Corporate bonds can be issued in two ways:-Public issue in public issue, corporations issue bonds to the market as a whole. Institutions as well as retail investors can participate in this issue. The cost of borrowing is little high in case of public issue. Private placement in private placement corporate, generally park the bond issuance with few institutions. In India, more than 90% of the corporate bonds are issued through private placement. It is an easiest and cheapest way of borrowing corporate bonds.

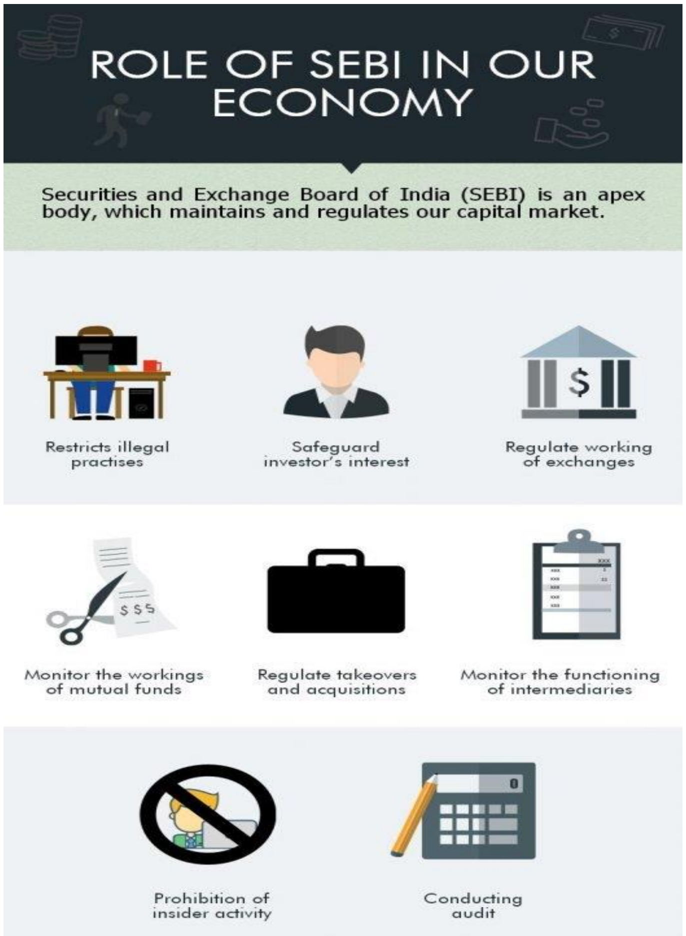
Structure of corporate debt market in India The primary market for corporate debt is mainly dominated by private placements (93 per cent of total issuance in 2011-12) as corporates prefer this route to public issues because of operational ease, i.e., minimum disclosures, low cost, tailor made structures and speed of raising funds. Banks/FIs (42.3 per cent of total issuances) followed by finance companies (26.4 per cent) were the major issuer‟s in2011-12. India lacks a long-term debt market for pure project finance. Corporate bonds issued in India usually carry a rating of AAA indicating lack of interest in bonds of lower rated borrowers in the debt market. Institutional participants, such as, banks, primary dealers, mutual funds, insurance companies, pension funds, corporates, etc. are the major players in this market.

According to SEBI, the total trading volume in the secondary corporate bond market has increased from Rs.961 bn in FY2008 to Rs.2,207 bn in FY2010CAGR of over 50% over the last two years.• SeFY2008 16,547 967FY2009 21,651 1,487Fy2010 20,933 2,20711/28/2012

**3.12 Role of SEBI in the Capital Market**

Repealing of CCI Act: SEBI guidelines were issued after the repeal of the CCI Act where by the CCI guidelines became out of date. New guidelines by SEBI were issued starting from the month of June 1992. Some CCI guidelines were still retained, as in the case of those for premium fixation. Guidelines for new issues made by new companies: They have to be issued at par. Free pricing is permitted only if the new company is promoted by the existing company with not less than 50% of equity.

Guidelines for new issues made by private limited companies: New issues made by Private Limited Companies and Closely held companies could be made by free pricing, for listing purposes if such companies have had three years of track record of consistent profitability out of last 5 years. Not less than 20% of equity is to be offered to the public, in such cases.




**Role of SEBI**

Guidelines for new issues made by existing listed companies: Public issues by existing listed companies can be made through free pricing, if they are further issues and if they are disclosed in the prospectus. The NAV and the market price have to be considered for the last 3 years. The companies with foreign holding wishing to enhance the limit up to 51% will have to get the prices approved in the general body meeting by a special resolution under Sec. 81 (A) of the Companies Act, and subject to RBI approval.

Listing of shares on the OTC: If the new issues are made through OTC, normal guidelines will apply if the sponsor is not taking any share. If the shares are taken by the sponsor, subsequent offer to the public may be made at such a price as the sponsor may deem fit. The promoters should retain 25% quota with a lock in period of 5 years, the sponsor should act as market maker for a period of at least 3 years and also find another market maker for compulsory market making. This condition was relaxed recently to encourage OTC Listing.

Underwriting issues: Underwriting is optional if the issue is made to the public and should not include reserved or preferential quota or employees' quota. If the subscription is not up to 90% of the total issue from the public including contribution of underwriters, the public should be refunded of their subscription within 120 days from the date of opening the issue. The compulsory underwriting provision was also waived for smaller issues.


**Power of SEBI**

Composite issues: Issues to the public by existing company can be priced differently as compared to the rights issued to shareholders. FCD & PCD: The issues of Fully Convertible Debentures (FCDs) with a conversion period of more than 36 months will not be permissible unless conversion is optional. In case FCDs are convertible after 18 months, credit rating is compulsory; credit rating is now made compulsory for all issues made to public, other than equity. In case, the non-convertible portion of the Partially Convertible Debentures is to be rolled over, non-maturing debenture holders should have option to withdraw from the scheme.

New Financial Instruments: The terms and conditions of the new instrument such as Deep Discount Bonds, debentures with warrants and secured premium notes etc. Should be disclosed clearly so that the investor can assess the risk and return scenario of the instrument.

Reservation in issues: The unreserved portion offered to public should not be less than the minimum required for listing purposes. Preferential allotment can be made to promoters, companies and shareholders of those companies, NRIs, employees and associate companies of the same group. The allotment shall be subject to a lock in period of three years, if it is made on firm basis, outside public issue.

Deployment of issue proceeds: Where the total proceeds exceed Rs.250 crores, the company will voluntarily disclose the arrangements made to utilize proceeds. When the total issue proceeds exceed Rs.500 crores, there is need for making compulsory disclosure and for the financial institutions to monitor the deployment of funds, to the stock exchanges.

Minimum interval between two issues: 12 months should elapse between the public or rights issue and bonus issue. The promoters should bring in their share of the capital before the public issue.

Employee's stock option scheme: The reservation for employees should not be more than 10% at present and this quota is non-transferable for 3 years and subject to a maximum allotment of 200 shares per employee, and the lock in was removed later.

The Lock in period for Promoters' quota is 5 years and the lock in period for preferential allotment for associates and friends is 3 years.

Bonus shares: Bonus issues are to be made out of free reserves, the share premium collected in cash, Development Rebate Reserves and Investment Allowance Reserve. Contingent liabilities disclosed in the audited accounts should be deducted from net profit for calculation of residual reserves. Residual reserves after the bonus issues should be at least 40% of the increased paid-up capital. 30% of the average profits before tax for the previous 3 years should yield a rate of dividend of 10% on the expanded capital base. Reserves out of revaluation should not be used for bonus payment. Bonus issue cannot be made in lieu of dividends, and if there are partly paid up shares; no bonus issue is permitted. Expanded paidup capital after bonus issue should not exceed authorized share capital. When a company has PCD or FCD, pending conversion, no bonus issue can be made unless this right is kept open to the holders of FCD and PCD falling due for conversion within 12 months.

Debenture issues: All debentures, which have a life of more than 18 months, should have a DRR created by company out of profits. DRR should be created only for non-convertible portion of the debentures. Contribution to DRR should commence from the date of commercial production and when there are profits after tax, interest and depreciation. The DRR will be considered as a part of the general reserves for payment of the bonus issues. DRR should be created and maintained at 50% of the amount of the debentures before repayment starts. The company should have already redeemed some liability. DRR and the creation of Debentures Trust are necessary only if the debentures have a maturity period exceeding 18 months. The Lead Institution for each issue should monitorthe use of debenture funds either from the working capital or from the project finance.

The SEBI now insists on prior licensing of debenture Trustees; Trust deed should be ready within 6 months from the date of allotment. Recent amendment: By a recent amendment to Listing Agreement, the Companies have been asked to provide unabridged Balance Sheet to Shareholders. The companies have to give the disposition of the funds raised in public issues and compare the actual with targets every six months, when they presentbalance sheet to investors.


**Need of SEBI**

### *Fundamental Analysis*

#### *1. Financial Statements & Ratio Analysis*

Fundamental analysis involves assessing a company's financial health using key financial statements:

**Balance Sheet** – Shows assets, liabilities, and shareholder equity, helping assess financial stability.

**Income Statement** – Reports revenue, expenses, and profits, indicating business performance.

**Cash Flow Statement** – Tracks cash inflows and outflows, measuring liquidity and operational efficiency.Ratio analysis is crucial for evaluating financial performance:

**Profitability Ratios** (e.g., Return on Equity, Gross Margin) assess earnings efficiency.

**Liquidity Ratios** (e.g., Current Ratio, Quick Ratio) measure short-term financial health.

**Leverage Ratios** (e.g., Debt-to-Equity, Interest Coverage) indicate financial risk.

**Efficiency Ratios** (e.g., Asset Turnover, Inventory Turnover) reflect operational effectiveness.

***2. Economic Indicators and Market Trends***

Macroeconomic factors influence investment decisions and market conditions. Key indicators include:

**GDP Growth** – Measures overall economic health and expansion.

**Inflation Rates** – Affects purchasing power and interest rates.

**Unemployment Rates** – Reflects labor market strength and consumer spending potential.

**Interest Rates (Federal Reserve Policies)** – Influence borrowing costs and investment returns.

**Consumer Confidence Index (CCI)** – Indicates spending behavior and economic sentiment.

***Understanding Fundamental Analysis***

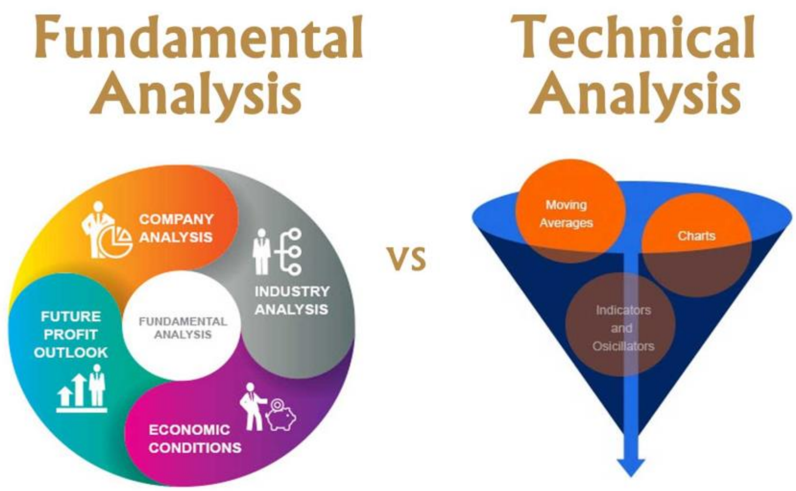
When performing fundamental analysis, you study the company's revenue growth, profitability, and competitive advantages within its industry. You also assess macroeconomic factors such as the overall state of the economy and the demand for the company's products or services. It also takes into account the effectiveness of the company's management team. A skilled and experienced leadership team can navigate challenges and seize opportunities, driving the company's growth and increasing its value.

This approach to the market often allows you to see behind investor sentiment and company marketing to determine whether the company has the potential for long-term success. With fundamental analysis, you can then gauge if the security's market price is over- or undervalued.

Fundamental analysis typically starts by analyzing a company's financial statements, including the income statement, balance sheet, and statement of cash flows. The information in these materials can be used to calculate and assess a company's financial health and intrinsic value. Key ratios derived from these financial statements include the price-to-earnings (P/E) ratio, earnings per share (EPS), return on equity (ROE), and debt-to-equity (D/E) ratio, among others.

Fundamental analysts use measures like these to determine whether a stock is undervalued or overvalued relative to its market price and competitors.

In addition, fundamental analysis frequently involves looking at gross domestic product, inflation, unemployment rates, industry or sector trends, and the company's competition. Fundamental analysis thus takes how a company should perform, not just in the market, but as a producer of goods and services. This requires looking at the overall economy, sector performance, and the company's position within the industry to estimate its value and forecast future performance. This approach not only considers economic and financial data but also often includes reviewing its business model, management effectiveness, brand awareness, and potential for growth and profitability.




**Evaluation between Fundamental vs Technical**

Ultimately, fundamental analysis aims to give you a number, a value, for the company you can use when buying, holding, or selling stocks. It requires a comprehensive understanding of financial statements and a strategic view of how external factors could impact the company's future earnings and market position.

***Why Is Fundamental Analysis Important?***

Fundamentals allow investors to look beyond short-term price fluctuations and focus on the underlying factors that drive a company's operations and long-term performance.

The main benefit of fundamental analysis is to help quantify the value of a company and its shares. Financial statements offer hard data that reveal insights into a company's profitability, liquidity, and overall financial stability. This information, along with an assessment of the company's management team, competitive advantages, and industry trends, furnishes a picture of the company's fair or target value. With this knowledge, investors can make more informed decisions about buying, holding, or selling a particular stock.


**Evaluation of Fundamental**

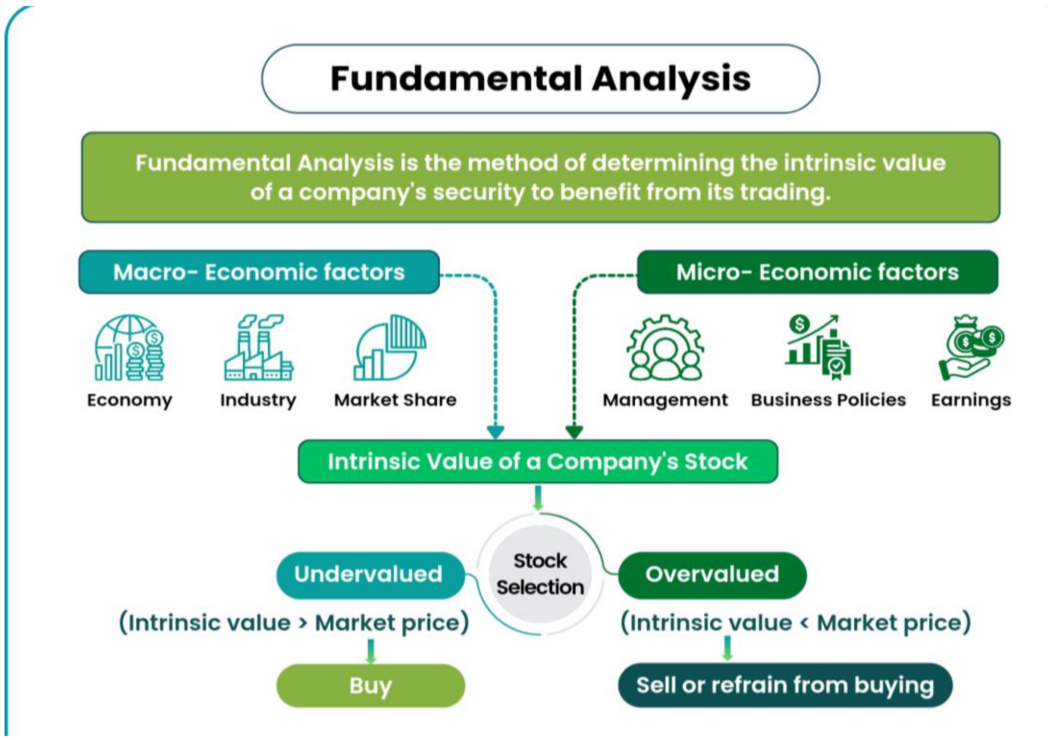
Fundamental analysis can also help investors identify undervalued companies. By considering a company's sales growth, market share, and product pipeline, investors can gauge its ability to increase future profits and grow shareholder value. By investing in companies with solid fundamentals and promising growth prospects, investors can benefit from long-term trends and capitalize on emerging prospects. Value investors, in particular, look for undervalued shares relative to their fundamental potential.

Finally, fundamental analysis can help you spot red flags and overvalued investments. By researching a company's financial health and market position, investors can more easily avoid stocks that may be more likely to underperform or experience significant downturns. This is especially important during economic uncertainty or market volatility when a company's underlying strength can be the difference between weathering the storm and being pushed out of the market altogether.

***Where to Find Fundamentals for a Company***

Some of the most common and reliable sources for the fundamentals of a company include the following:

**Company filings**: Public companies are required to file regular reports with the Securities and Exchange Commission (SEC), such as Form 10-K (annual report), Form 10-Q (quarterly report), and Form 8-K (current events report). These filings contain detailed financial statements, management discussions and analyses, and other important information about the company. You can access these filings for free on the SEC's EDGAR database.




**Evaluation of Fundamental**

**Company website**: Most publicly traded companies have an investor relations section that provides financial statements, earnings releases, investor presentations, and other relevant information for shareholders and potential investors. Transcripts of earnings reports can be particularly helpful since company leads typically find it necessary to address company soft spots for journalists.

**Financial platforms**: Yahoo! Finance, Google Finance, and MarketWatch, among others, provide financial news, analysis, and fundamental data on publicly traded companies, including financial statements, key ratios, and analyst ratings.

**Broker research reports**: Many brokerage firms supply research reports on companies they and their affiliates cover, often with detailed fundamental analysis and investment recommendations.

**Financial data providers**: Subscription-based financial data providers such as Bloomberg, FactSet, and Morningstar offer extensive fundamental data and analysis on companies, industries, and markets. Subscriptions are often pricey, so they are more typically used by professional investors and analysts.

**Industry trade journals**: Trade publications covering specific industries can provide valuable insights on industry trends, competitive dynamics, and company-specific developments that inform your fundamental analysis.

### *How to Read a Company's Annual Report*

Reading a company's annual report is an essential part of fundamental analysis. Here's a step-by-step guide on how to read and analyze an annual report:

**Start with the CEO's letter to shareholders**: This section gives an overview of the company's performance, key developments, and outlook from the perspective of top management. Pay attention to the tone and content of the letter, as it can give insights into the company's strategy, challenges, and prospects.

**Review the business description**: This section describes the company's main products or services, target markets, competitive advantages, and key risks. It can help you understand the company's business model and the factors that drive its success.

**Analyze the management's discussion and analysis (MD&A)**: The MD&A provides a detailed discussion of the company's financial performance, including revenue and expense trends, cash flows, and key financial ratios. It also has management's perspective on the factors that affect the company's performance and outlook for the future.

**Examine the financial statements**: The annual report has the company's audited financial statements, including the income statement, balance sheet, and statement of cash flows. Review these carefully while looking for trends in revenue, expenses, profits, assets, liabilities, and cash flows. From there, you can compute the critical financial ratios.

**Read the notes to the financial statements**: The notes (or footnotes) provide additional details and explanations about the company's accounting policies, significant transactions, and other important information that may not be clear from the financial statements alone.

**Review the auditor's report**: This provides an independent opinion on whether the financial statements fairly present the company's financial position and performance following generally accepted accounting principles. Look for any qualified opinions or disclaimers that may indicate potential issues.

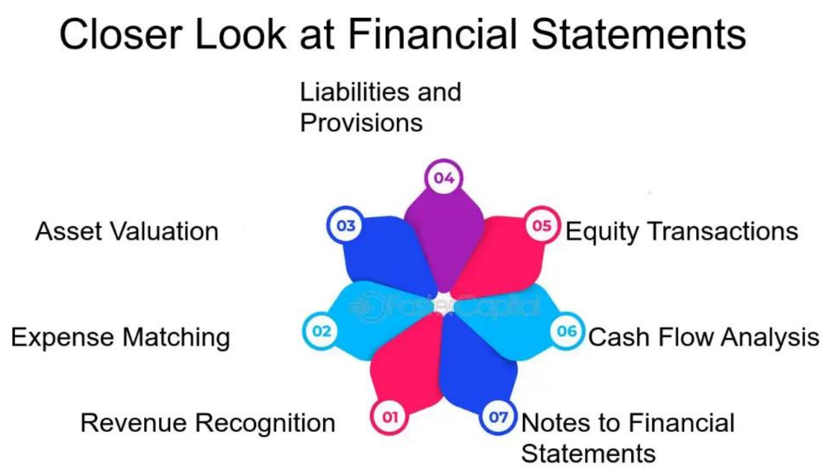
**Analyze the company's corporate governance**: The annual report often has information on the company's board of directors, executive compensation, and other corporate governance matters. Consider whether the company's governance practices align with the interests of shareholders and whether there are any red flags, such as conflicts of interest or excessive compensation.

**Look for additional disclosures**: The annual report may include additional disclosures about legal proceedings, regulatory issues, or environmental, social, and governance (ESG) factors that could impact the company's performance and reputation.

### *A Closer Look at Financial Statements*

The information in financial statements is among the most valuable about a company's financial health and performance. Here's a breakdown of what you can learn from each one:

**Income Statement**: This shows how much money a company is making (revenue), how much they're spending (expenses), and then what's left over (profit or loss). By looking at trends in revenue and expenses over time, you can get a sense of whether the company is growing or struggling. You can also calculate important ratios like the company's profit margin, which tells you how much of each dollar in sales the company gets to keep as profit.




**Statement Look of Finance**

**Balance Sheet**: This gives you a snapshot of what a company owns (assets), what it owes (liabilities), and what is left over (shareholders' equity). This can help you assess a company's financial stability and liquidity. For example, if a company has a lot more assets than liabilities, that's generally a good sign. You can also look at how much debt the company has relative to its equity to understand its financial leverage and risk.

**Statement of Cash Flows**: This shows how much cash is coming in and going out of the company over a given period. It's broken down into three main categories: cash from operations (the money generated by the company's core business activities), cash from investing (the money spent or earned from investments not related to the core business), and cash from financing (the money raised or paid out and used to fund the business). By looking at a company's cash flows, you can better understand its ability to generate cash, pay its bills, and invest in growth.

The cash flow statement is crucial because it's harder for a business to manipulate its cash situation. An aggressive accountant can do plenty of things to manipulate earnings, for example, but it's tough to fake cash in the bank. For this reason, some investors use the cash flow statement as a more conservative measure of a company's performance.

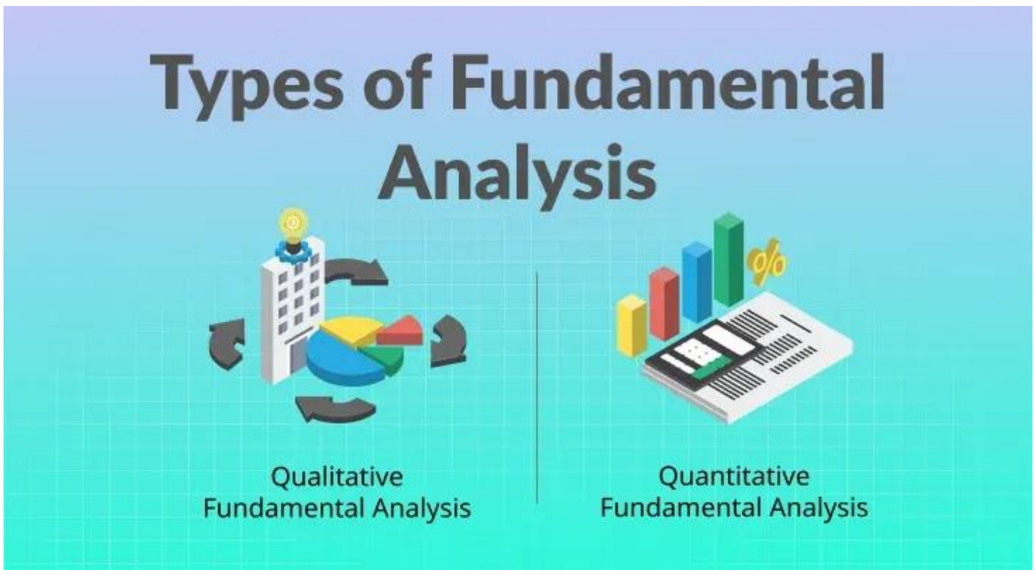
***Quantitative and Qualitative Fundamental Analysis***

The problem with defining the "fundamentals" is that they can cover anything related to a company's economic well-being. They can include numbers like revenue and profit, but they can also include anything from a company's market share to the quality of its management. Generally, these are all grouped into two categories: quantitative and qualitative:

**Quantitative**: information that can be shown using numbers, figures, ratios, or formulas

**Qualitative**: rather than a quantity of something, it is its quality, standard, or nature

In this context, quantitative fundamentals are hard numbers, the measurable characteristics of a business. The most significant source of quantitative data is financial statements. The qualitative fundamentals are less tangible. They might include the quality of a company's key executives, brand-name recognition, patents, and proprietary technology. Neither qualitative nor quantitative analysis is inherently better. Many analysts consider them together.




**Various Evaluation of Fundamental**

**The Business Model:** What exactly does the company do? This isn't always straightforward. If a company's business model is based on selling fast-food chicken, is it making its money that way? Or is it coasting on royalty and franchise fees?

**Competitive Advantage**: A company's long-term success is primarily driven by its ability to maintain its competitive advantage. Competitive advantages, such as Coca-Cola Co.'s (KO) brand name and Microsoft Corporation's (MSFT) long domination of the personal computer operating system, create a moat around a business, allowing it to keep competitors at bay and enjoy growth and profits.

**Management Team:** Some think management is the most important criterion for investing in a company. This makes sense: Even the best business model is doomed if the company's leaders fail to execute the plan properly. While it's hard for retail investors to meet and truly evaluate managers, you can look at the corporate website and check the resumes of the top brass and the board members. How well did they do in previous jobs? Have they been unloading a lot of their stock shares lately?

**Corporate Governance and Board Structure**: These are provided by the policies within an organization indicating the relationships and responsibilities among management, directors, and stakeholders. These policies are defined and determined in the company charter, its bylaws, and corporate laws and regulations. You want to do business with a company that is run ethically, fairly, transparently, and efficiently. Note whether management respects shareholder rights and shareholder interests. Ensure their communications to shareholders are transparent and understandable. If you don't get it, if there are major issues you know surround the company and they aren't addressed, it's not a sign that they have good answers for you.

**Industry Trends**: It's also important to consider a company's industry: its customer base, market share among firms, industrywide growth, competition, regulation, and business cycles. Learning how the industry works will give an investor a deeper understanding of a company's financial health.

**Stakeholder Satisfaction**: Employees, managers, customers, suppliers, investors, and other stakeholders should all have positive views on the company and its prospects. Without that, a company's brand equity and image can suffer, which can lead to fewer sales, lower profits, and flagging share prices.

**Quantitative Fundamentals to Consider: Financial Ratios**

Financial statements are how a company discloses information about its financial performance. Here are some of the most important financial ratios with their formulas:

| **Key Financial Ratios** | | |
|---|---|---|
| **Category** | **Ratio** | **Formula** |
| **Profitability** | Gross profit margin | (Revenue - Cost of Goods Sold) / Revenue |
| *Higher margins and returns generally indicate a more profitable and efficient business.* | Operating profit margin | Operating Income / Revenue |
| | Net profit Margin | Net Income / Revenue |
| | Return on assets (ROA) | Net Income / Average Total Assets |
| | Return on equity (ROE) | Net Income / Average Shareholders' Equity |
| **Liquidity** | Current ratio | Current Assets / Current Liabilities |
| *A higher ratio suggests that the company has enough liquidity to cover its near-term liabilities.* | Quick ratio | (Cash + Marketable Securities + Accounts Receivable) / Current |

| | | |
|---|---|---|
| | | Liabilities |
| **Solvency** | Debt-to-equity ratio | Total Liabilities / Total Shareholders' Equity |
| *These ratios measure a company's ability to meet its long-term debt obligations. Lower debt ratios and higher interest coverage ratios generally indicate a more financially stable company.* | Debt-to-assets ratio | Total Liabilities / Total Assets |
| | Interest coverage ratio | Operating Income / Interest Expense |
| **Efficiency** | Asset turnover ratio | Revenue / Average Total Assets |
| *These ratios measure how effectively a company manages its assets to generate sales. Higher turnover ratios suggest that the company is using its assets more efficiently to generate revenue.* | Inventory turnover ratio | Cost of Goods Sold / Average Inventory |
| | Receivables turnover ratio | Revenue / Average Accounts Receivable |
| **Valuation** | P/E | Market Price per Share / Earnings per Share |
| *Lower ratios may indicate that the stock is undervalued, while higher ratios may suggest that it is overvalued.* | Price-to-book (P/B) ratio | Market Price per Share / Book Value per Share |
| | Price-to-sales (P/S) ratio | Market Price per Share / Revenue per |

| | | |
|---|---|---|
| | | Share |
| | Dividend yield | Annual Dividends per Share / Market Price per Share |

**Fundamental Analysis vs. Technical Analysis**

Fundamental analysis contrasts starkly with technical analysis, which attempts to forecast prices by investigating historical market data such as price and volume. Technical analysis uses price trends and action, often plotted on charts, to create indicators and identify patterns. Some indicators develop patterns that have names resembling their shapes, such as the "head and shoulders" pattern.

A major distinction is where "value" comes from. For technical analysts, the market sets prices, and hence, the changes there give a company its value. For fundamental analysts, there is an intrinsic value that the market can often miss.

***Fundamental vs. Technical Analysis***

**Fundamental Analysis**

- Estimates the intrinsic value of a company from its operations
- Considers a company's financial statements and qualitative factors
- Longer-term focus (months/years)
- Best for buy-and hold investing

**Technical Analysis**

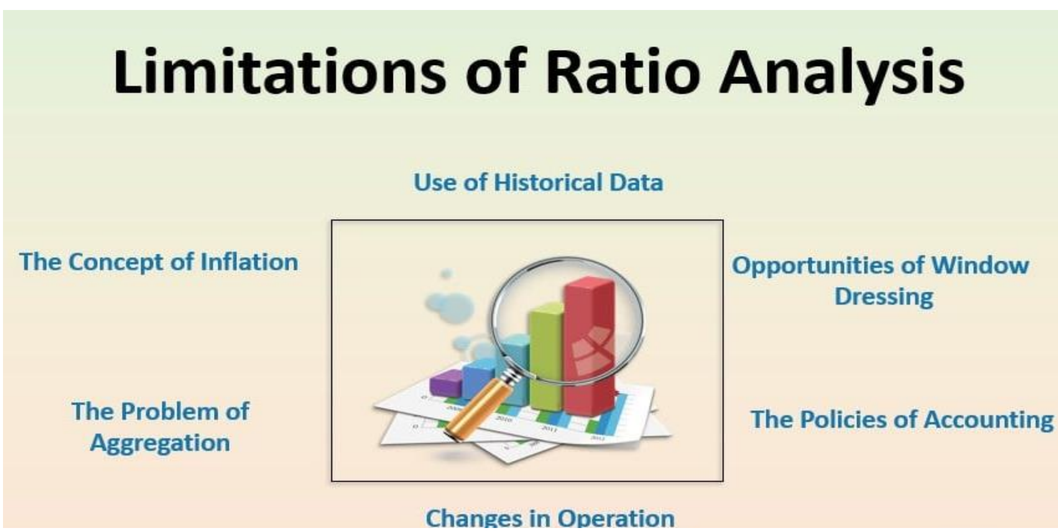
- Looks at price and market trends to uncover market psychology

- Considers historical prices and chart patterns
- Shorter-term focus (days/weeks)
- Best for short-term or swing trading

**Limitations of Fundamental Analysis**

Though fundamental analysis can provide investors with insights into the future of a company, it does come with some downsides. Keep these items in mind when performing fundamental analysis:

**It's Time-Consuming**: Fundamental analysis involves a detailed examination of financial statements, economic data, industry reports, and company-specific factors. This process requires collecting extensive data, performing complex calculations, and interpreting various financial metrics - which all times time (which leads into the next downside....).




**Limitation of Evaluations**

**It's A Lagging Indicator**: In addition to being a slow process, fundamental analysis often acts as a lagging indicator because it relies on financial data that reflects past performance. By the time changes in a company's fundamentals become apparent in its financial statements, the stock price might have already adjusted.

**Relies on Historical Data**: Similarly, fundamental analysis is based largely on historical financial information. While this data provides a basis for estimating future performance, it may not fully capture future risks or opportunities, as past performance is not an indicator of what's to come in the future.

**Subject to Accounting Practices**: The accuracy of fundamental analysis depends on the integrity and transparency of a company's financial statements. Keep in mind that things like management estimates, depreciation, or other GAAP-compliant requirements can (perhaps improperly) impact the fundamental analysis.

**Difficult to Value Intangibles**: Intangible assets like patents, trademarks, brand reputation, and human capital are increasingly important in today's economy. However, these assets are challenging to quantify and may not be fully reflected in a company's financial statements. Consider how some investors would have believed in Apple simply because of Steve Jobs; that notion is not captured in fundamental analysis.

**Economic Assumptions**: Fundamental analysis often involves assumptions about future economic conditions such as interest rates, inflation, and economic growth. Again, these are always changing and may not materialize as expected.

**Overlooked Short-Term Opportunities**: Fundamental analysis is geared towards long-term investment decisions, focusing on a company's intrinsic value and potential for growth over time. This long-term focus might cause investors to miss short-term trading opportunities that technical analysis can identify such as price patterns, volume spikes, or momentum indicators.

***Example of Fundamental Analysis***

Let's analyze a hypothetical company called ABC Inc. using fundamental analysis. We'll examine its financial statements and calculate key ratios to assess its financial health and performance.

First, let's look at some data from ABC Inc.'s financial statements for the previous fiscal year:

| **ABC Income Statement & Balance Sheet** | | | | |
|---|---|---|---|---|
| **Income Statement** | **($ millions)** | **.** | **Balance Sheet** | **($ millions)** |
| Revenue | $1,000 | . | **Assets** | |
| Cost of Goods Sold | $600 | . | Current Assets | $750 |
| **Gross Profit** | $400 | . | Cash | $200 |
| Operating Expenses | $200 | . | Marketable Securities | $250 |
| Operating Income | $200 | . | Accounts Receivable | $300 |
| **Net Income** | $150 | . | Non-Current Assets | $750 |
| | | . | **Total Assets** | $1,500 |
| | | . | **------------------** | |
| | | . | **Liabilities** | |
| | | . | Current Liabilities | $250 |
| | | . | Non-Current Liabilities | 250 |
| | | . | **Total Liabilities** | $500 |
| | | . | | |
| | | . | **Shareholder Equity** | $1,000 |

| ABC Statement of Cash Flows & Stock Information | | | | |
|---|---|---|---|---|
| **Cash Flows from:** | **($ millions)** | **.** | **Stock Information** | |
| Operations | $250 | . | # Shares Outstanding | 100 million |
| Investments | $100 | . | Stock Price | $25.00 |
| Financing | $150 | . | | |

**Profitability Ratios**:

Gross profit margin = ($1,000 - $600) / $1,000 = 40%

Operating profit margin = $200 / $1,000 = 20%

Net profit margin = $150 / $1,000 = 15%

Return on assets (ROA) = $150 / $1,500 = 10%

Return on equity (ROE) = $150 / $1,000 = 15%

ABC Inc.'s profitability ratios suggest that the company is generating healthy profits from its operations. Its gross margin is 40%, operating margin is 20%, and net margin is 15%. Its ROA and ROE of 10% and 15%, respectively, indicate that the company is generating solid returns on its assets and equity.

**Liquidity Ratios**:

Current ratio = $750 / $250 = 3.00

Quick ratio = ($200 + $150 + $200) / $250 = 2.20

Assuming ABC Inc.'s current assets are $750 million, with $200 million in cash, $150 million in marketable securities, and $200 million in accounts receivable, and its current liabilities are $250 million, the company's liquidity ratios are strong. A current ratio of 3.0 and a quick ratio of 2.2 suggest that ABC Inc. has ample liquidity to cover its short-term obligations.

**Solvency Ratios**:

Debt-to-equity ratio = $500 / $1,000 = 0.50

Debt-to-assets ratio = $500 / $1,500 = 0.33

ABC Inc.'s solvency ratios indicate that the company has a manageable level of debt relative to its equity and assets. A debt-to-equity ratio of 0.5 and a debt-to-assets ratio of 0.33 suggest that the company is not overly leveraged and has the financial flexibility to meet its long-term obligations.

**Valuation Ratios** (Assuming ABC Inc. has 100 million shares outstanding and its stock price is $25 per share):

Price-to-earnings (P/E) Ratio = $25 / ($150 / 100) = 16.67

Price-to-book (P/B) Ratio = $25 / ($1,000 / 100) = 2.50

Price-to-sales (P/S) Ratio = $25 / ($1,000 / 100) = 2.50

ABC Inc.'s valuation ratios suggest that the company's stock is trading at a reasonable valuation relative to its earnings, book value, and sales. A P/E ratio of 16.67 aligns with the broader market, while P/B and P/S ratios of 2.5 indicate that the stock is not overly expensive relative to the company's assets and revenue.

In addition to these quantitative measures, we can also consider certain qualitative fundamentals:

**Competitive Advantages**:

- Has strong brand recognition in its industry and high customer loyalty
- Proprietary technology that differentiates its products from competitors
- Efficient supply chain and distribution network, enabling faster delivery and lower costs

**Management Quality**:

- It has an experienced management team with a proven track record of success.
- The CEO has been with the company for 15 years and has led the company through several periods of growth.
- Management has demonstrated a commitment to creating new goods and services and has strategic investments in research and development.

**Industry Trends**:

- The industry in which ABC Inc. operates is growing at a steady rate of 5% per year.
- There's increasing demand for eco-friendly and sustainable products, which aligns with ABC Inc.'s product offerings.
- The regulatory environment is becoming more favorable for the company's products.

**Growth Prospects**:

- ABC Inc. has a robust pipeline of new products set to launch in the next 12-18 months.

- The company has been expanding into new geographic markets and plans to enter two new countries next year.
- Recent acquisitions have provided opportunities for synergies and increased market share.

**Corporate Governance**:

- ABC Inc. has a diverse and independent board of directors.
- The company has a strong track record of transparency and timely financial reporting.
- Executive compensation is aligned with long-term shareholder interests.

***ESG Factors:***

- ABC Inc. has set ambitious targets for reducing its carbon footprint and increasing its use of renewable energy.
- The company is committed to diversity, equity, and inclusion, with programs in place to promote a diverse workforce.
- ABC Inc. engages with local communities and supports various philanthropic initiatives.


**Factors of ESG**

Based on this hypothetical fundamental analysis, ABC Inc. appears to be a financially healthy and potentially attractive investment. However, it's important to remember that this is just a simplified example. In practice, investors would need to conduct a more thorough analysis, considering the company's competitive position, industry trends, management quality, and growth prospects, before making an investment decision.

***What Is Fundamental Analysis and Its Objective?***

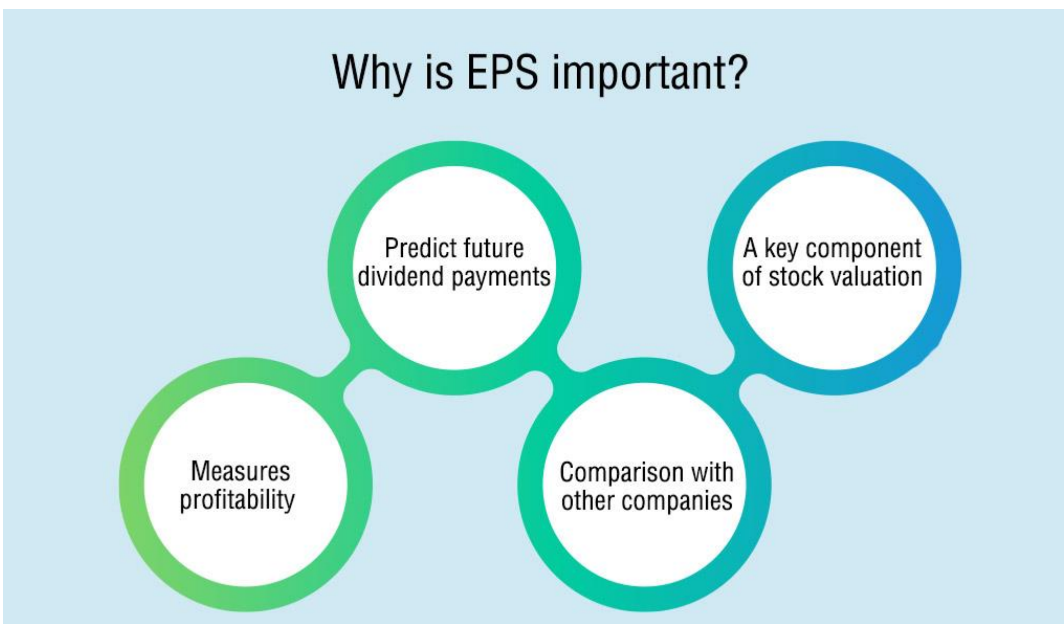
Fundamental analysis uses publicly available financial information and reports to determine whether a stock and the issuing company are valued correctly by the market.

***What Are the 3 Layers of Fundamental Analysis?***

When conducting an analysis, you can be top-down and start with economic analysis, then analyze the industry, then the company. Or, you can be bottom-up and work in the reverse order.

***What Are the Tools for Fundamental Analysis?***

Analysts use many tools. Some examples are financial reports, ratios from the reports, spreadsheets, charts, graphs, infographics, government agency reports on industries and the economy, and market reports.




**Importance of EPS**

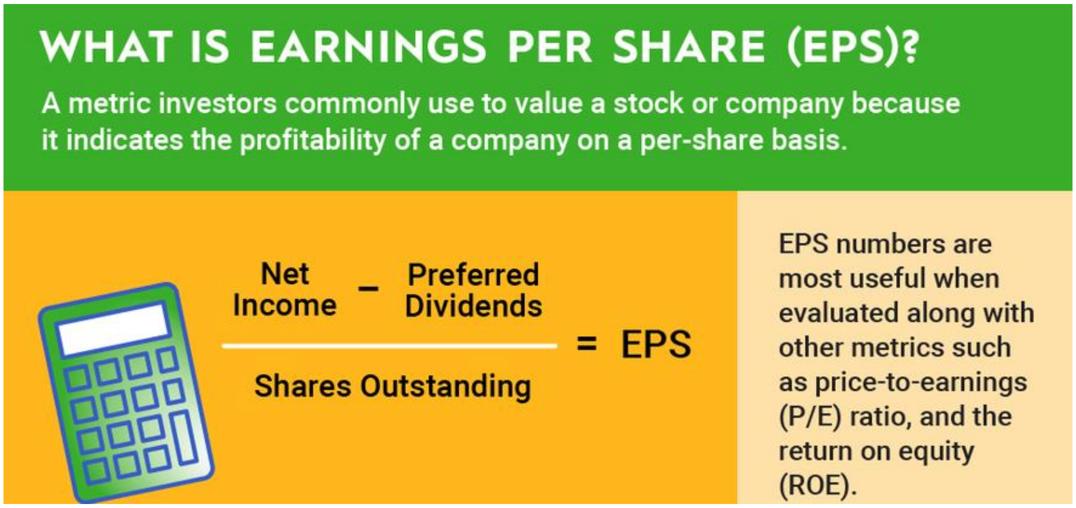
*How Does Fundamental Analysis Differ From Technical Analysis?*

Fundamental analysis focuses on evaluating a security's intrinsic value based on financial and economic factors, while technical analysis studies price movements and trading volumes to identify patterns and predict future price movements.

*Why Is Earnings Per Share (EPS) Important in Fundamental Analysis?*

EPS indicates a company's profitability on a per-share basis, helping investors determine how much profit a company generates for each share of its stock. It is a critical metric for assessing company performance and valuing stocks.

1.It helps compare the performance of promising companies to help pick the most suitable investment option.




**Share as Per EPS**

2. EPS can also be used to compare the financial standing of a company over the

years. Companies that have a steady EPS increase can be a reliable investment option. Conversely, companies' irregular EPS are usually not preferred by seasoned investors.

**Earnings Per Share Formulas**

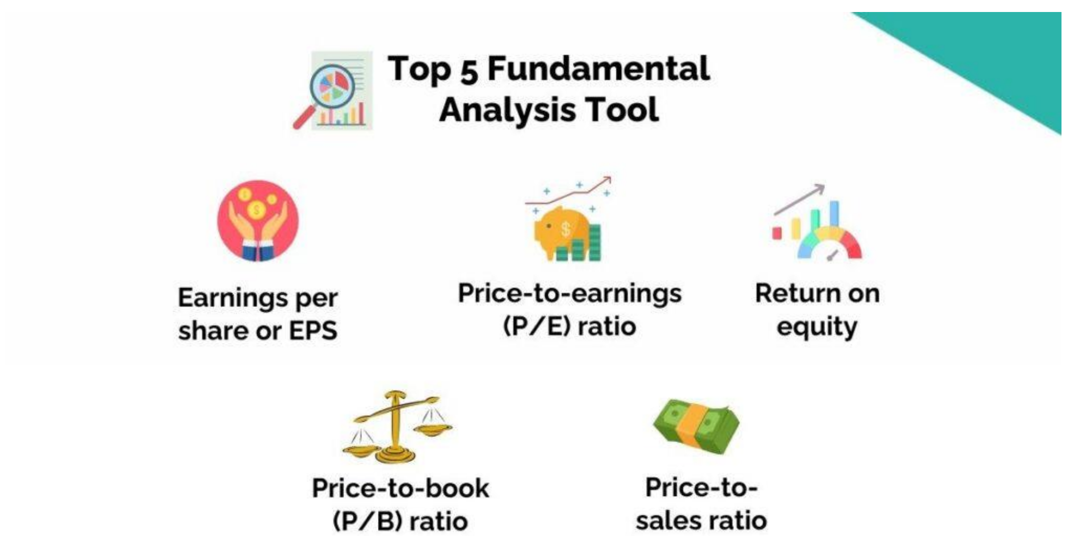
$$\text{EPS} = \frac{\text{Net Income of the Company}}{\text{Average Outstanding Shares of the Company}}$$

$$\text{EPS} = \frac{\text{Net Income of the Company - Dividend to Preferred Shareholders}}{\text{Average Outstanding Shares of the Company}}$$

**Formula for EPS**

3. A higher EPS means more profitability, which suggests that the company may increase dividend payout over time.

4. EPS not only helps measure a company's current financial standing but also helps track its past performances.



## Limitations of EPS

Although Earnings per Share are considered a powerful financial tool, one must remember that EPS has its share of drawbacks. Here are some limitations that both business owners and investors should remember:

1. Most business owners tend to manipulate the EPS to project their venture as profitable frequently. However, most of such attempts are made for the short-term, which often hampers a business venture's image and profitability in the long run.

2. Cash flow is not considered in EPS calculation, which means a high EPS may not accurately signify the company's financial health.

3. Cash flow is an important aspect of gauging a company's ability to repay its debt. However, cash flow is not factored in EPS calculation, which means a high EPS may still prove ineffective for gauging a company's solvency.

## UNIT IV

## PORTFOLIO MANAGEMENT AND RISK MANAGEMENT

### 4.1 Principles of Portfolio Construction

Portfolio management refers to the strategic process of selecting and overseeing a collection of investments to achieve specific financial goals. It involves:

Asset Allocation – Distributing investments across different asset classes (e.g., stocks, bonds, real estate) to balance risk and reward.

Diversification – Spreading investments across various sectors and industries to minimize risk.

Performance Monitoring – Continuously assessing and adjusting the portfolio based on market conditions and investment objectives.

Investment Strategies – Active (frequent buying and selling) vs. passive (long-term holding, index investing) approaches.

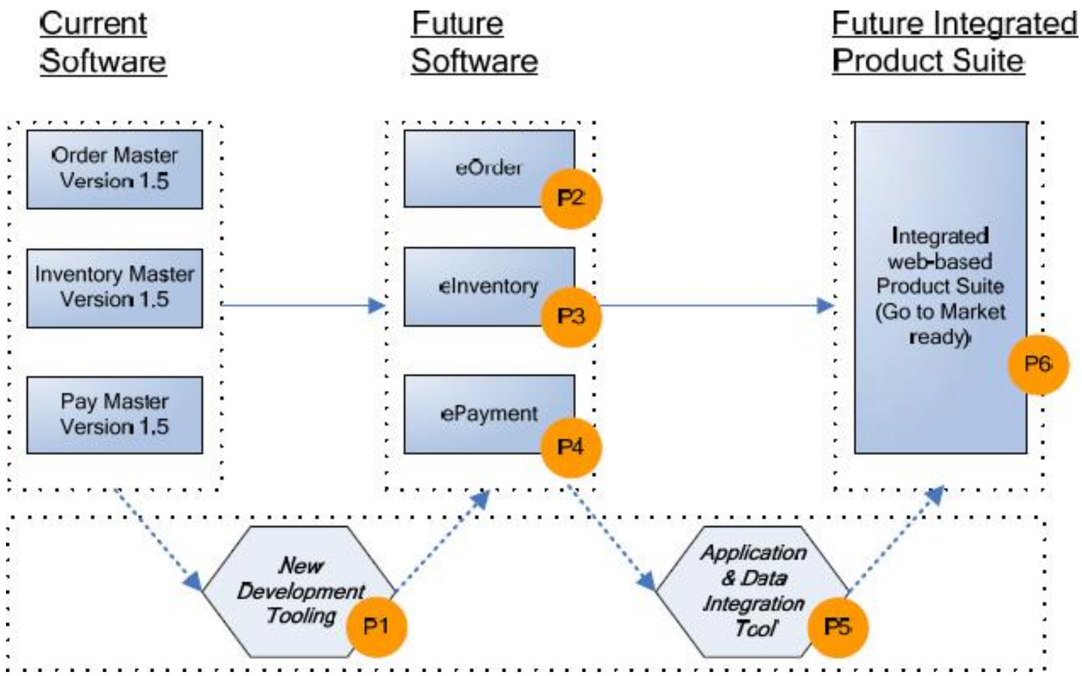
# Portfolio Risk management

## Risk Management

Risk management involves identifying, assessing, and mitigating financial risks to minimize potential losses. Key aspects include:

- Types of Risks – Market risk, credit risk, liquidity risk, operational risk, etc.
- Risk Measurement – Using metrics like Value at Risk (VaR), standard deviation, and beta.
- Hedging Techniques – Using derivatives, options, and futures to protect against downside risks.
- Regulatory Compliance – Ensuring adherence to financial laws and risk guidelines.

Both portfolio and risk management are essential for maximizing returns while minimizing potential losses, helping investors and businesses achieve financial stability.



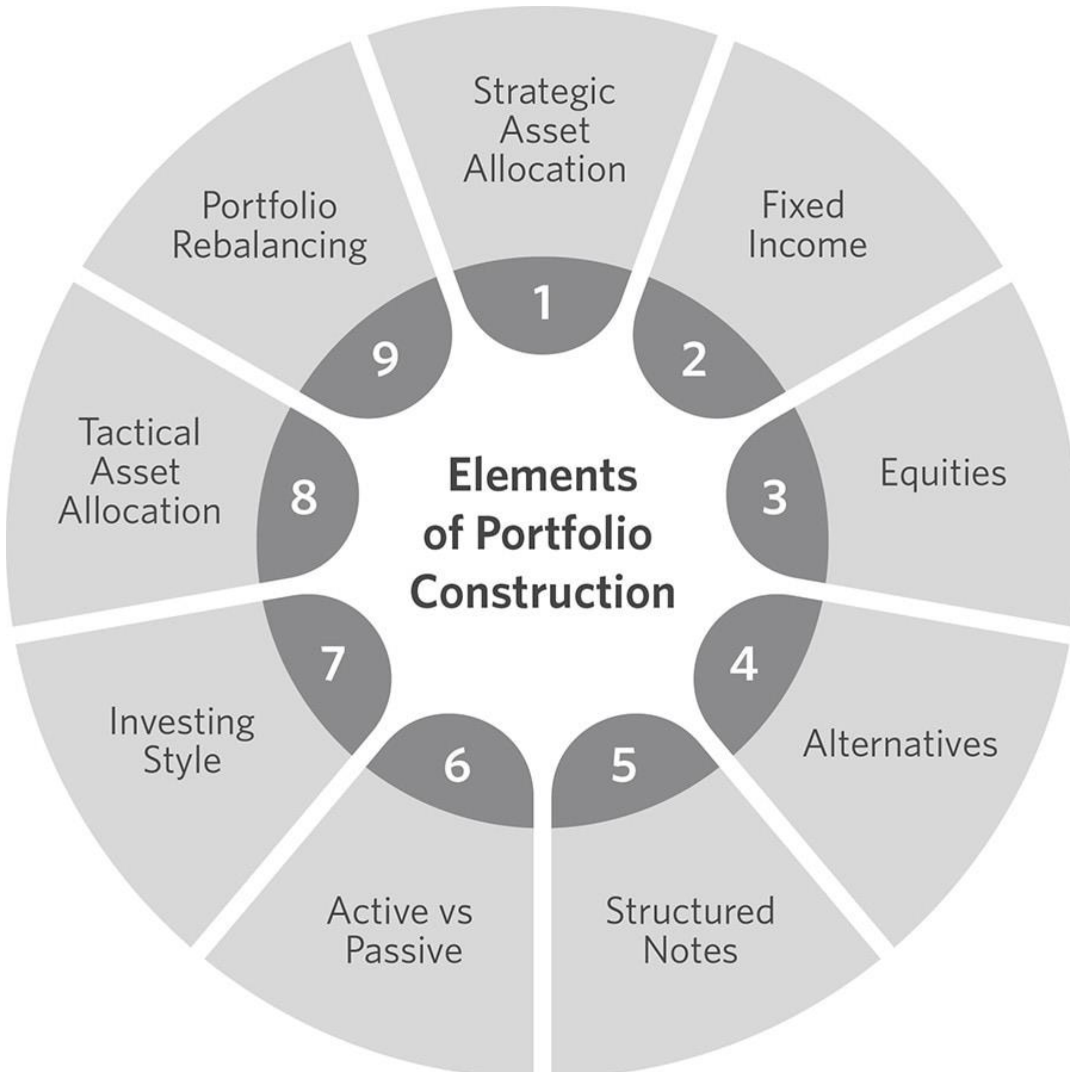

**Types of Software**

## 4.1 Principles of Portfolio Construction

Building an effective investment portfolio requires a structured approach that balances risk and return based on an investor's financial goals. The key principles of portfolio construction include:

1. Defining Investment Objectives

- ✓ Establish clear financial goals (e.g., capital appreciation, income generation, wealth preservation).
- ✓ Determine the investment horizon (short-term, medium-term, or long-term).
- ✓ Assess risk tolerance based on personal or institutional preferences.




**Elements for Portfolio**

2. Asset Allocation

- ✓ Allocate investments across different asset classes (stocks, bonds, real estate, commodities, etc.).
- ✓ Balance risk and return by selecting appropriate proportions based on market conditions.

- ✓ Consider strategic (long-term) vs. tactical (short-term) asset allocation.

3. Diversification

- ✓ Spread investments across industries, sectors, and geographies to reduce risk.
- ✓ Avoid over-concentration in a single asset, company, or market.
- ✓ Combine assets with low or negative correlation to stabilize portfolio performance.

4. Risk Management

- ✓ Assess and manage different types of risks (market risk, credit risk, liquidity risk, etc.).
- ✓ Use tools like Value at Risk (VaR), Sharpe ratio, and beta analysis to measure risk exposure.
- ✓ Implement hedging strategies using options, futures, or stop-loss orders.

5. Liquidity Considerations

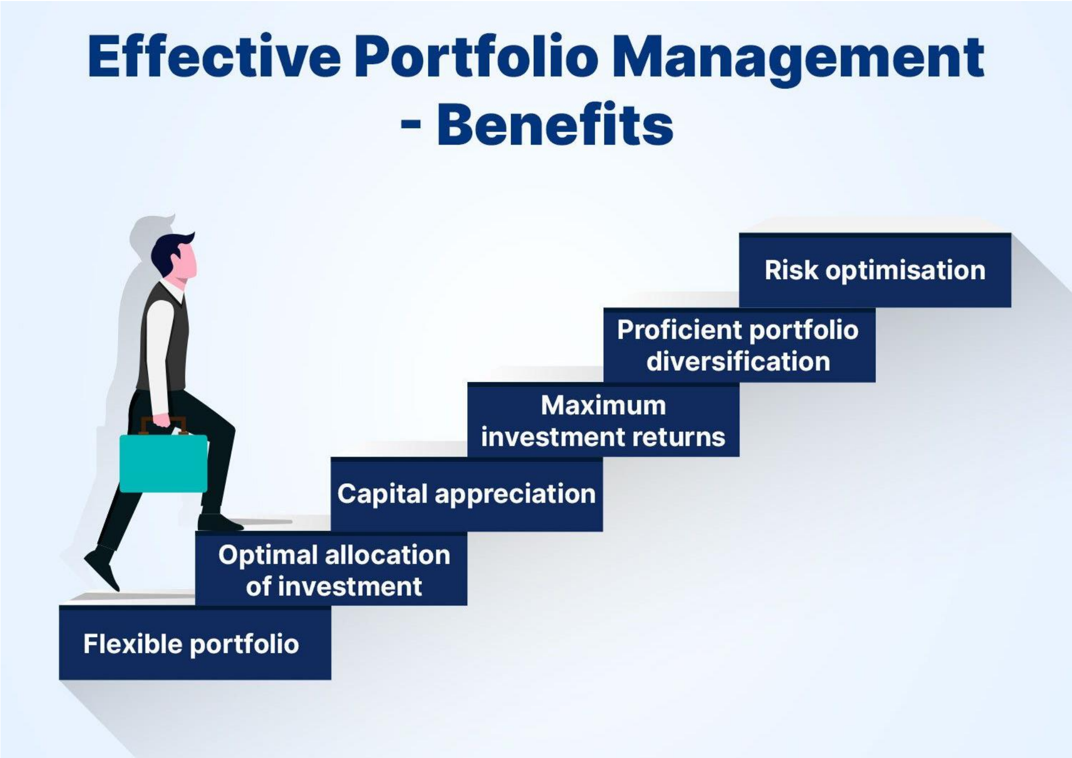
- ✓ Ensure a portion of the portfolio is easily convertible to cash.
- ✓ Balance between highly liquid assets (e.g., stocks) and less liquid ones (e.g., real estate).
- ✓ Consider emergency fund requirements and unexpected financial needs.

6. Tax Efficiency

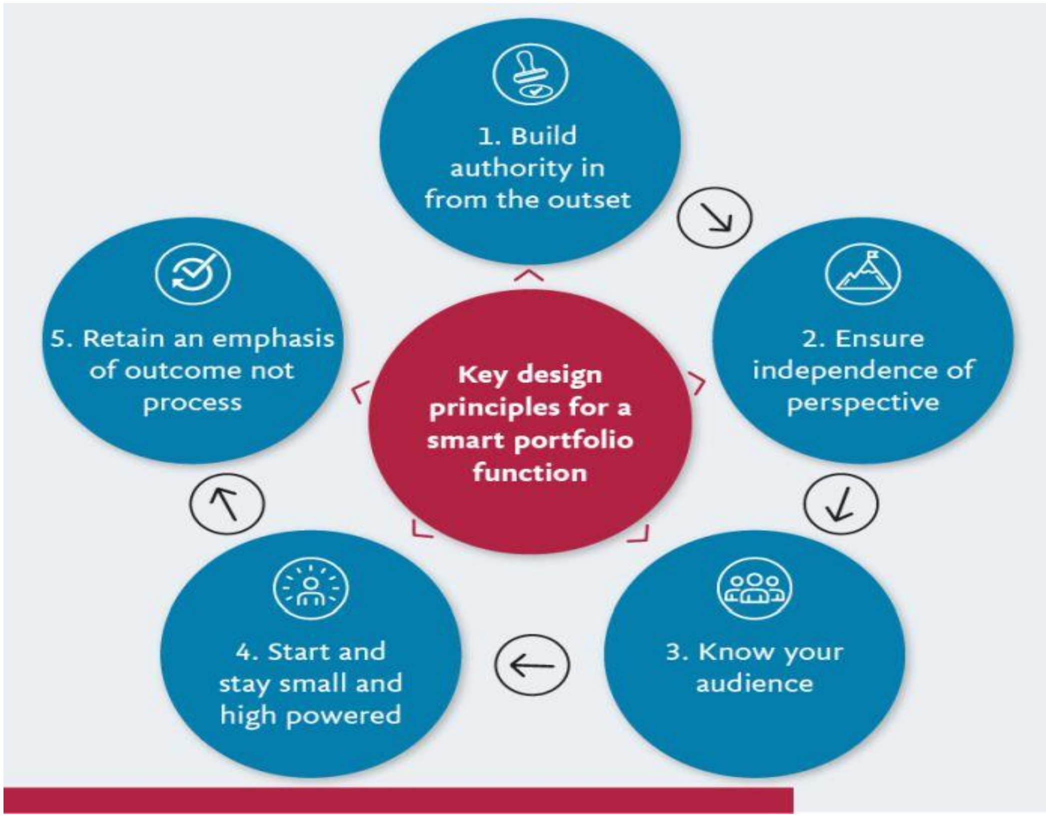
- ✓ Optimize investments for tax advantages (e.g., tax-deferred accounts, tax-loss harvesting).
- ✓ Minimize capital gains tax through long-term holdings.
- ✓ Understand local tax regulations affecting different asset classes.

7. Performance Monitoring and Rebalancing

- ✓ Regularly review the portfolio to ensure alignment with investment goals.
- ✓ Rebalance by adjusting asset allocation in response to market movements.
- ✓ Adapt strategies based on economic changes, interest rates, and personal financial circumstances.




**Benefits of Portfolio Management**



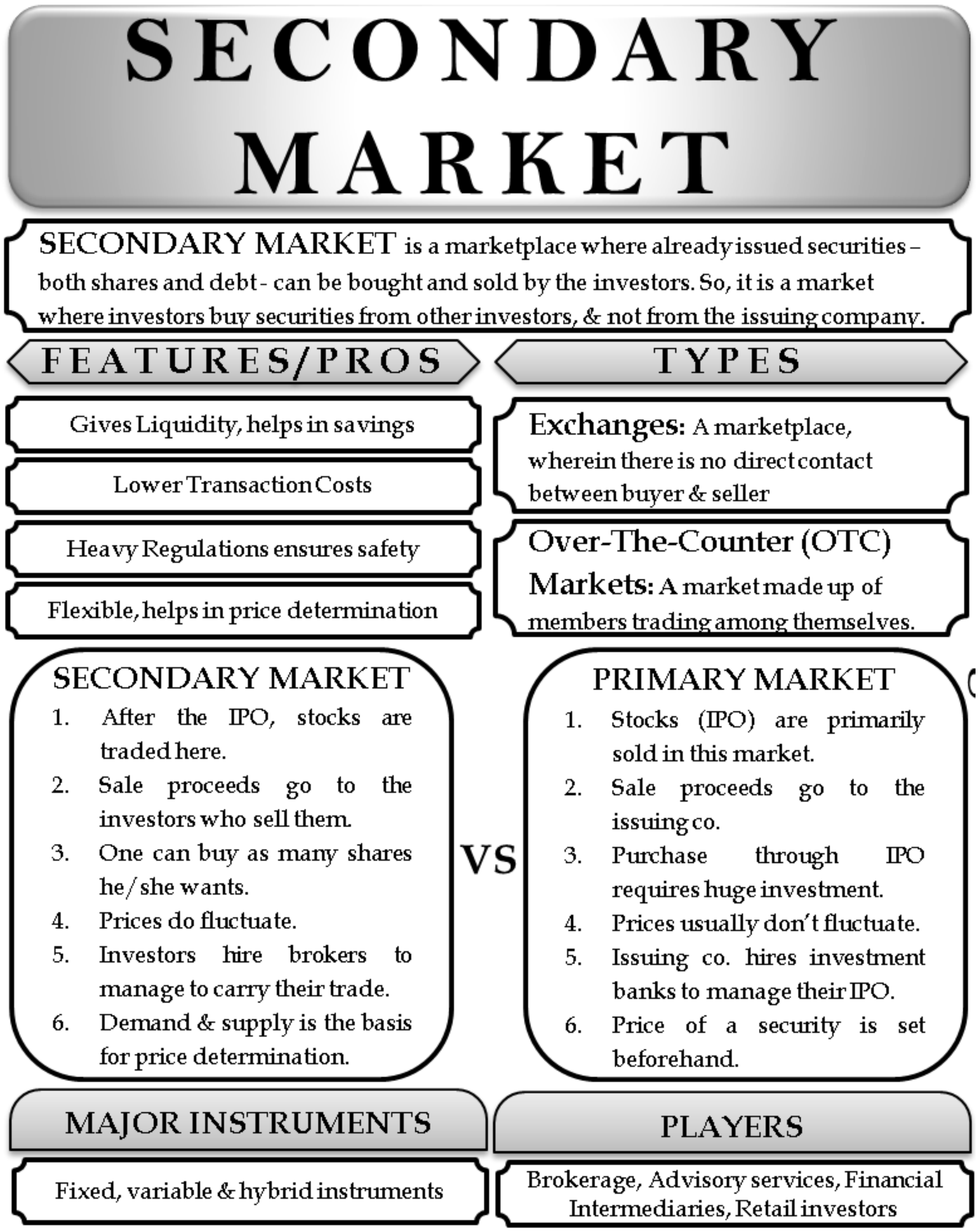

**Smart Portfolio function**

## 4.2 Functions of Secondary Market

1. Economic Barometer: A stock exchange is a reliable barometer to measure the economic condition of a country. Every major change in country and economy is reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. Stock exchange is also known as a pulse of economy or economic mirror which reflects the economic conditions of a country.

2. Pricing of Securities: The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The

valuation of securities is useful for investors, government and creditors. The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.




**Functions of Secondary Market**

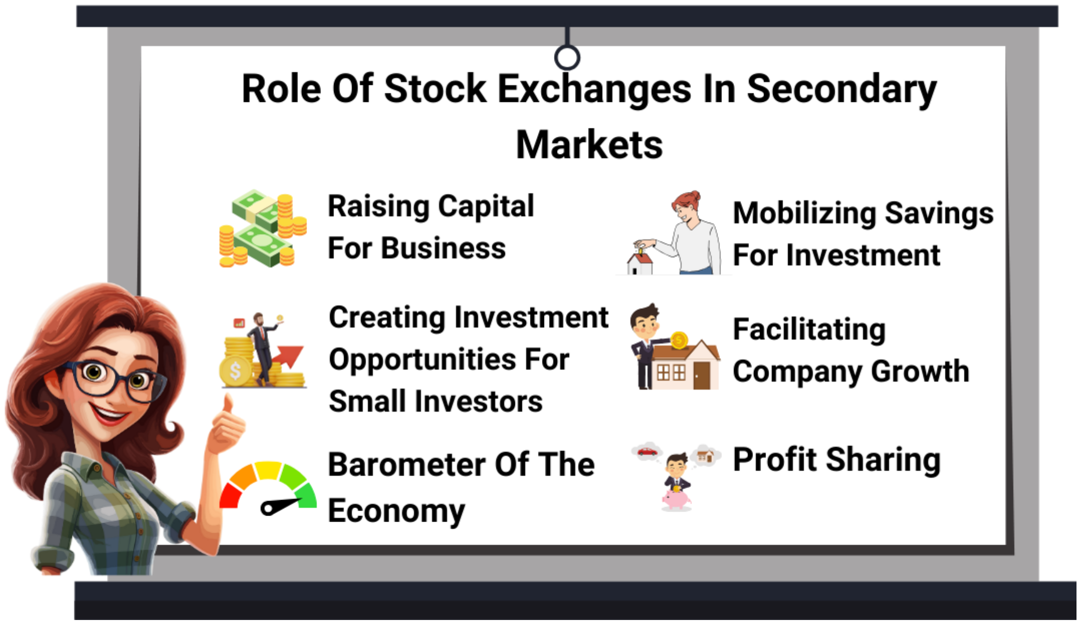
3. Safety of Transactions: In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

4. Contributes to Economic Growth: In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

5. Spreading of Equity Cult: Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

6. Providing Scope for Speculation: To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

7. Liquidity: The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.




**Role of Stock Market**

8. Better Allocation of Capital: The shares of profit-making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor"s fund to profitable channels.

9. Promotes the Habits of Savings and Investment: The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

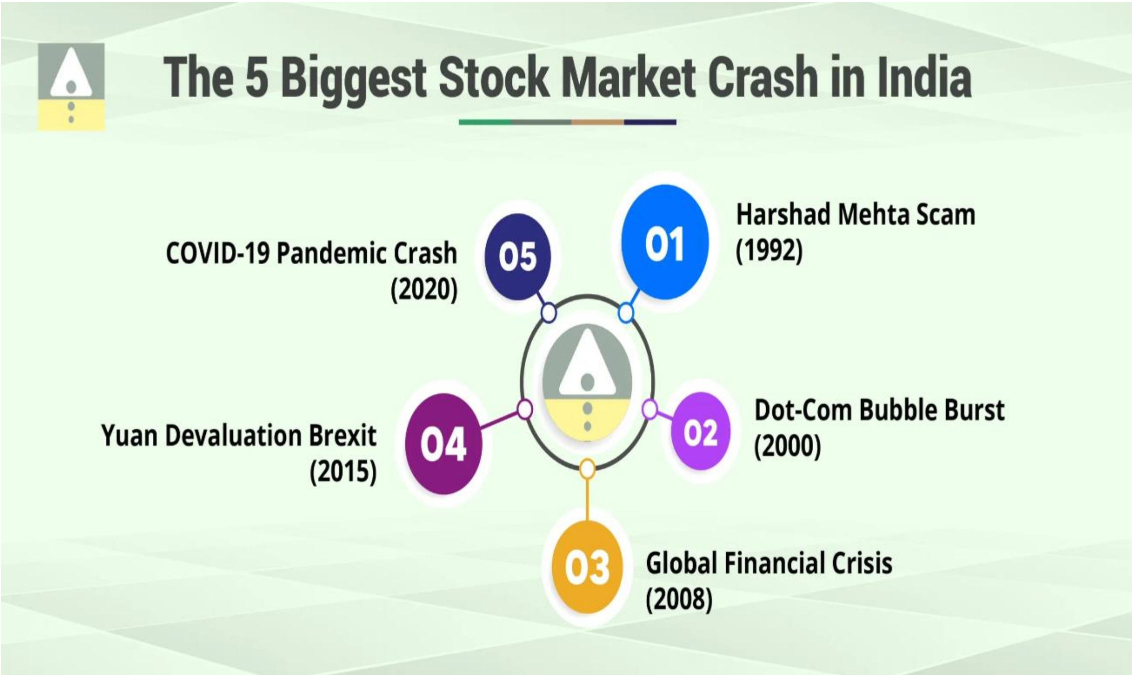
## 4.3 Post Reforms Stock Market Scenario

After the initiation in 1991 the Indian secondary market now has a three tier form.

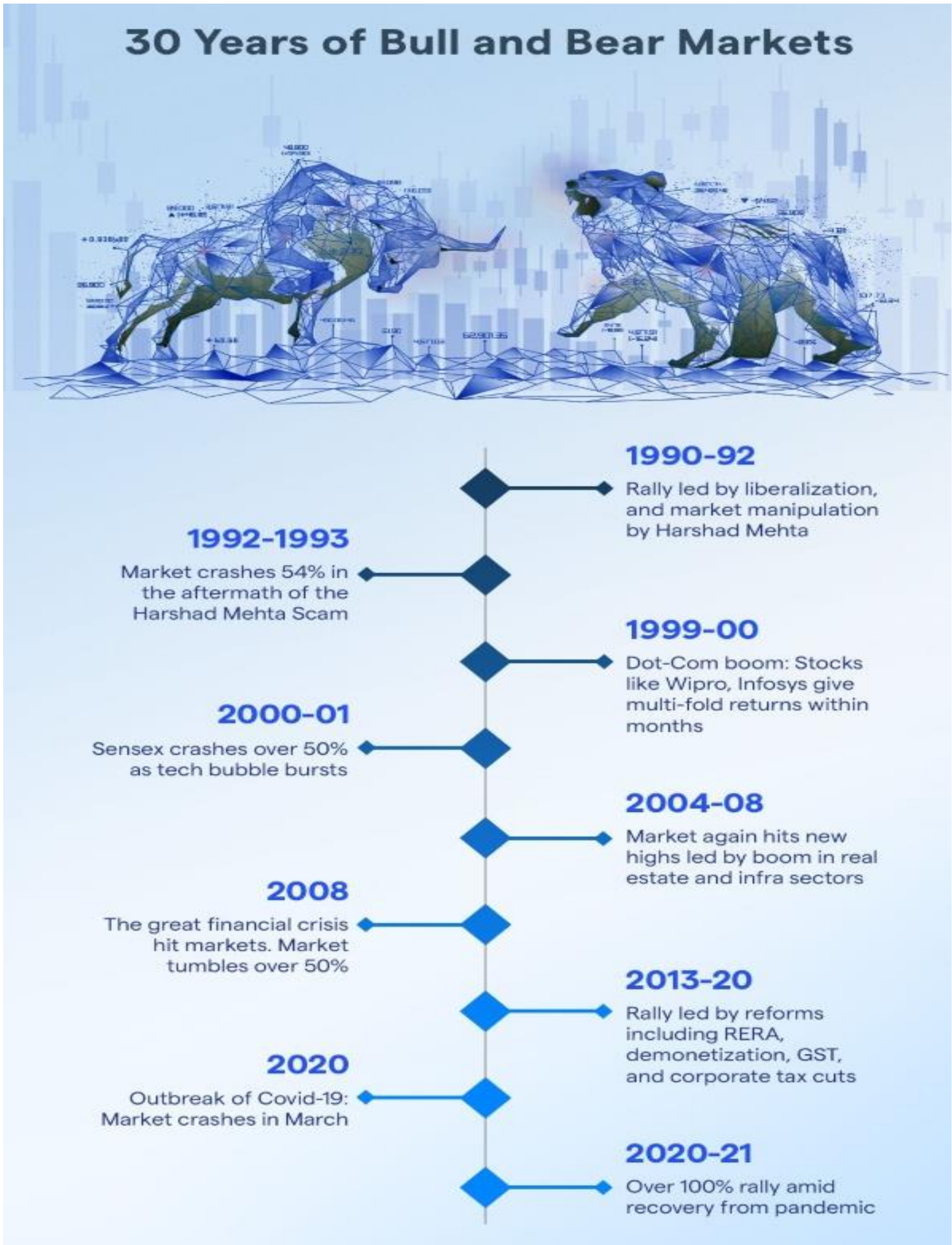
1) Regional stock exchanges

2) National Stock Exchange (NSE)

3) Over the Counter Exchange of India (OTCEI)




**Stock Market Crash in India**




**Bull and Bear Market**

The NSE was set up in 1994. It was the first modern stock exchange to bring in new technology, new trading practices, new institutions, and new products. The OTCEI was set up in 1992 as a stock exchange providing small and medium sized companies the means to generate capital.

In all, there are, at present 23 stock exchanges in India – 19 regional stock exchanges, BSE, NSE, OTCEI and the Inter connected Stock Exchange of India (ISE). The ISE is a stock exchange of stock exchanges. The 19 regional stock exchanges are located at Ahmedabad, Bangalore, Bhubaneswar, Kolkata. Cochin, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Chennai, Mangalore, Pune, Patna, Rajkot and Vadodara. They operate under the rules, by laws and regulations approved by the government and SEBI.

**4.4Organization, Management and Membership ofStock Exchange**

National Stock Exchange of India (NSEI) commenced operations in Wholesale Debt Market (WDM) in June 1994 and trading in equities has been started in the Capital Market Segment (CM) in November 1994. A large number of members are successfully trading from their respective offices through NSEI"s Very Small Aperture Terminal (VSAT) based satellite network. The exchange has opened membership to 13 cities including Mumbai and operations from other cities are expected to commence shortly.

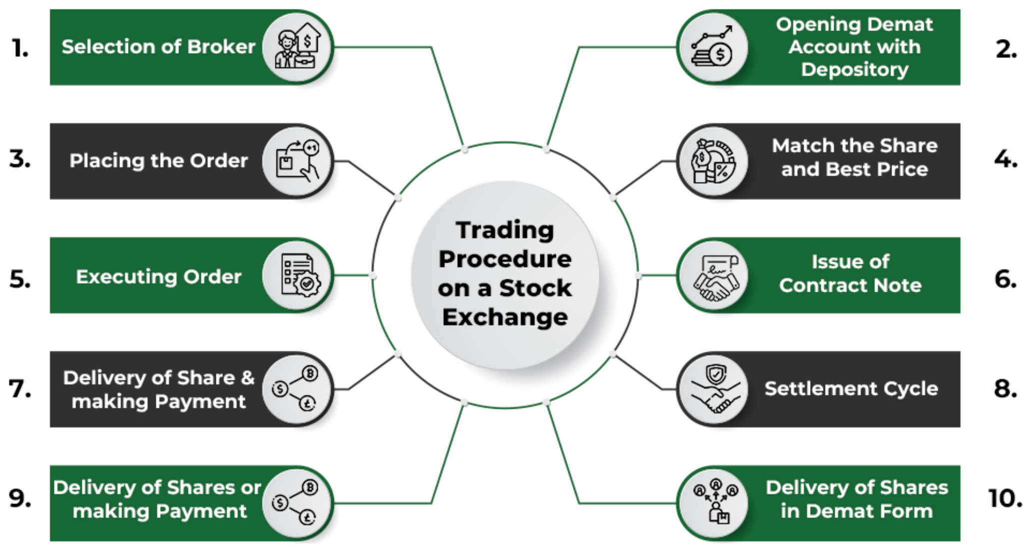

**Function of Stock Exchange**

As a national exchange it has set fairly stringent criteria for membership in terms of net worth, education and experience, to ensure that trading members are well capitalised and can provide other professional services to investors.

The main participant in WDM regiment (Government Securities, Treasury Bills, PSU Bonds, CDs, CPs and Corporate debentures) are banks, financial institutions and large corporate, RBI has recently directed banks to use only the NSEI for all transactions in debt securities done earlier through brokers to ensure transparency and facilitate regulations. This has raised the volumes of NSEI"s debt trade substantially.

### 4.5 Listing of Securities

Listing means admission of securities to dealings on a recognized stock exchange. The securities may be of any public limited company, Central or State Government, quasi-governmental and other financial institutions/corporations, municipalities, etc.




**Trading Steps for stock Market**

The objectives of listing are mainly to:

- provide liquidity to securities
- mobilize savings for economic development
- protect interest of investors by ensuring full disclosures

A company, desirous of listing its securities on the Exchange, shall be required to file an application, in the prescribed form, with the Exchange before issue of Prospectus by the company, where the securities are issued by way of a prospectus or before issue of 'Offer for Sale', where the securities are issued by way of an offer for sale.


**Securities**

Delisting of securities means permanent removal of securities of a listed company from the stock exchange where it was registered. As a result of this, the company would no longer be traded at that stock exchange.

**Companies Act, 1956.**

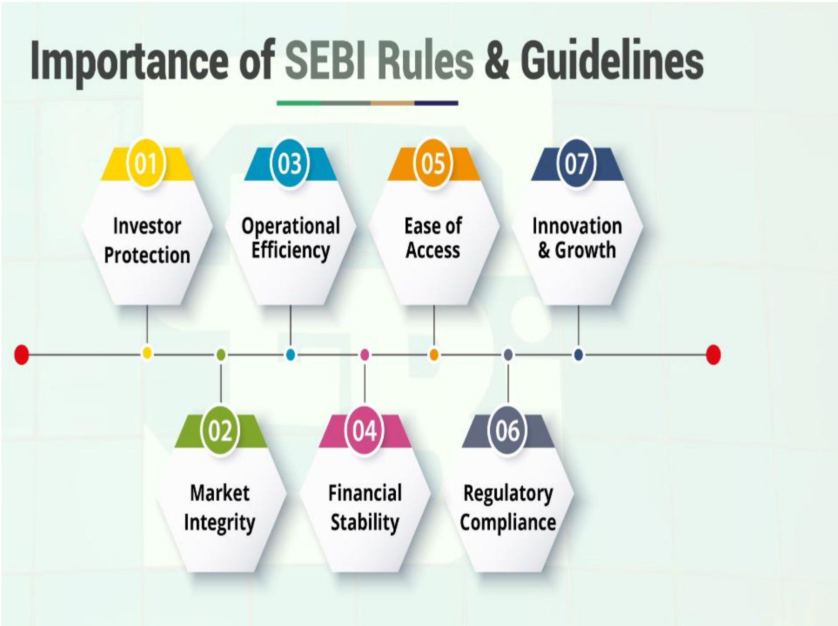
As per S. 73 of the companies Act, 1956, a company seeking listing of its securities on a stock exchange is required to submit a Letter of application to all the stock exchanges where it proposes to have its securities listed before filing the prospectus with the registrar of companies.

**SEBI Guidelines.**

a. A company is required to complete the allotment of securities offered to the public within 30 days of the date of closure of the subscription list and approach the designated stock exchange for approval of the basis of allotment.

b. Issuer company to complete the formalities for trading at all the stock exchanges where the securities are to be listed within 7 working days of finalization of the basis of allotment.

c. Companies making public/rights issues are required to deposit 1 % of the issue amount with the designated stock exchange before the issue price.




**Importance of SEBI**


**SEBI Investor and Protection**

**Stock Exchange guidelines**

In addition to all these rules, regulation and compliance every stock exchange have a set of guidelines of its own for the companies to be listed on them. For example they may provide for the minimum issue size and market capitalization of the company

A company has to enter into a listing agreement before being given permission to be listed on the exchange. Under this agreement the company undertakes amongst other things, to provide facilities for prompt transfer, registration, sub-division and consolidation of securities: to give proper notice of closure of transfer books and record dates, to forward 6 copies of unabridged Annual reports, balance sheets and profit & loss accounts, to file shareholding patters and financial results on quarterly basis and to intimate promptly to the exchange the happenings which are likely to materially affect the financial performance of the company and its stock price and to comply with the conditions of Corporate governance.


**Stock Exchange and Market Regulators**

The companies are also required to pay to the exchange some listing fee as prescribed by the exchange every financial year.

A company not complying with these requirements are may face some disciplinary action, including suspension/ delisting of their securities.

In case the exchange does not give permission to the company for listing of securities, the company cannot proceed with the allotment of shares. However the company may file an appeal before SEBI under S. 22 of SCRA, 1956.

A company delisted by a stock exchange and seeking relisting at the same exchange is required to make a fresh public offer and comply with the extant guidelines of the exchange.


**Workflow for Stock market**

**Delisting**

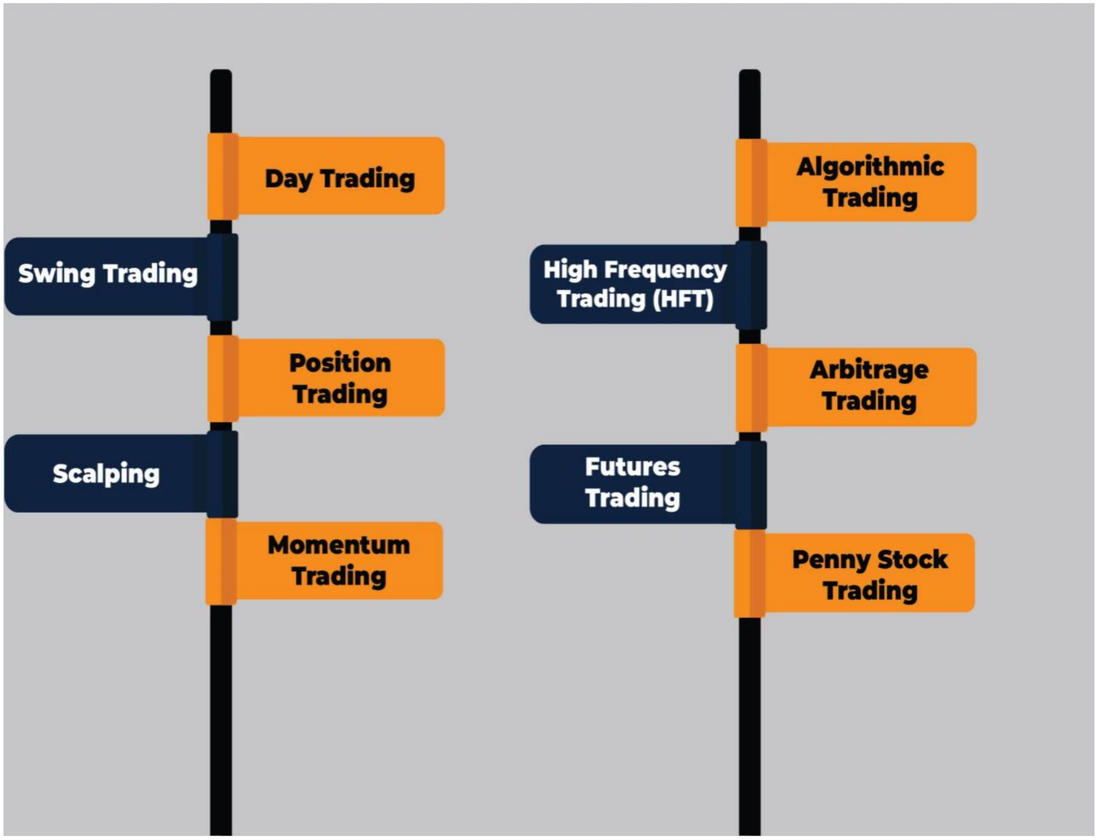
As stated above delisting of securities means removal of the securities of a listed company from the stock exchange. It may happen either when the company does not comply with the guidelines of the stock exchange, or that the company has not witnessed trading for years, or that it voluntary wants to get delisted or in case of merger or acquisition of a company with/by some other company. So, broadly it can be classified under two head:

1. Compulsory delisting
2. Voluntary delisting

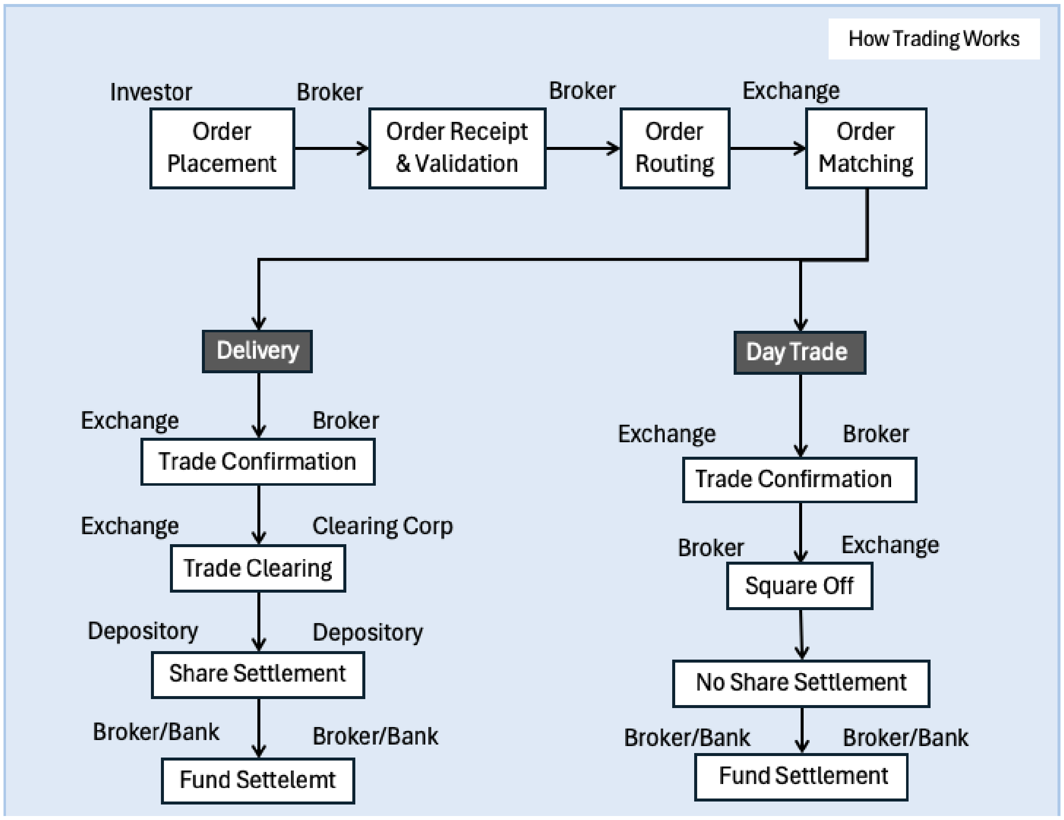
Compulsory delisting refers to permanent removal of securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submissions/comply with various requirements set out in the Listing agreement within the time frames prescribed. In voluntary delisting, a listed company decides on its own to permanently remove its securities from a stock exchange. This happens mainly due to merger or amalgamation of one company with the other or due to the non-performance of the shares on the particular exchange in the market.

## 4.6 Trading Arrangements

During the second half of the 1990's, trade liberalization and the pursuit of global free trade underwent a metamorphosis. The political momentum shifted away from what was seen by some nations as the painstakingly slow process of multilateral tariff negotiations to smaller regional and bilateral arrangements - the Regional Trade Agreement. RTAs are not a new means of trade liberalization; historically, whenever multilateral trade negotiations broke down, bilateral and multilateral free trade agreements filled the void. Such strategic trade arrangements have enabled many states to move towards freer trade at their own pace, and for their own benefits.




**Types of Trade**

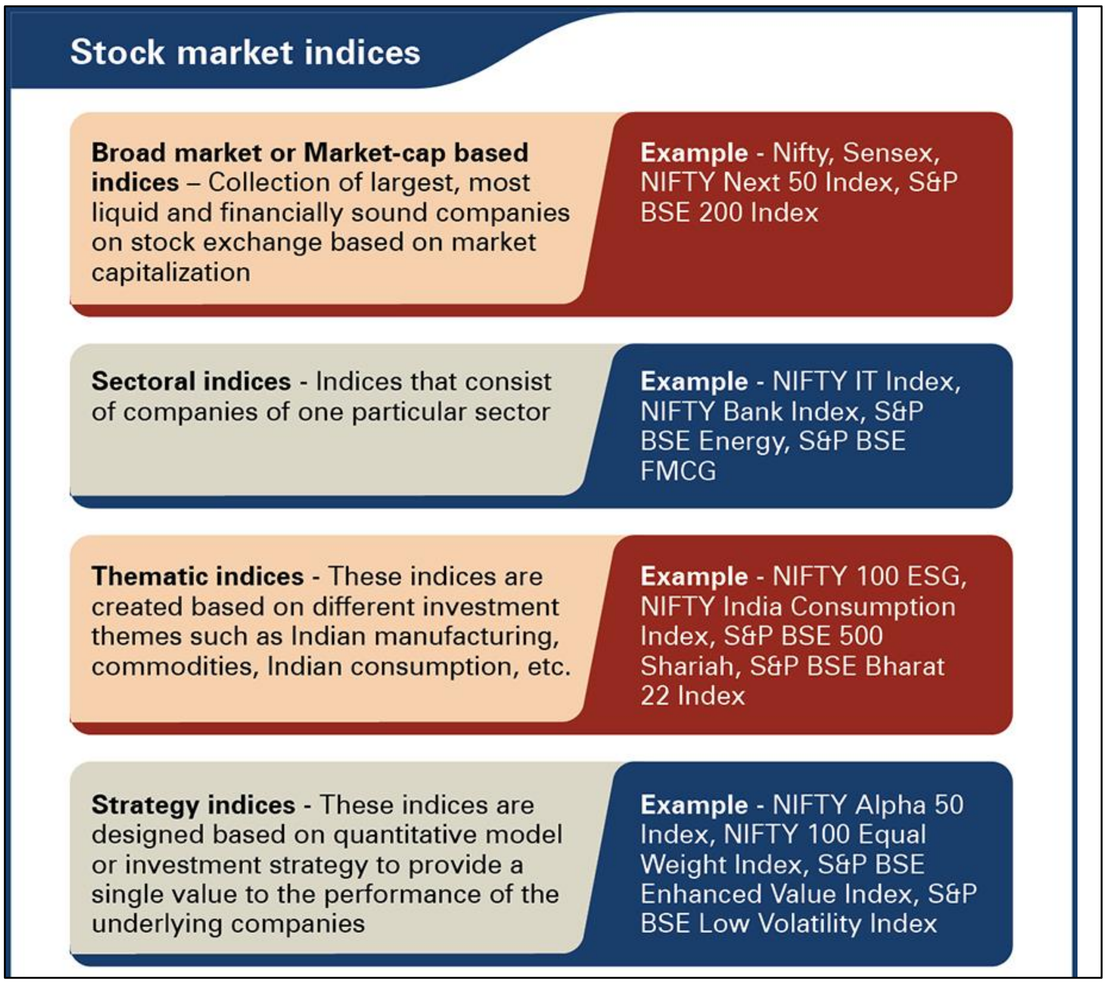



**Work for Trading**

## 4.7 Stock Market Index

A stock index or stock market index is a measurement of the value of a section of the stock market. It is computed from the prices of selected stocks (typically a weighted average). It is a tool used by investors and financial managers to describe the market, and to compare the return on specific investments. An index is a mathematical construct, so it may not be invested in directly. But many mutual funds and exchange-traded funds attempt to "track" an index, and those funds that do not may be judged against those that do.

Some indices, such as the S&P 500, have multiple versions. These versions can differ based on how the index components are weighted and on how dividends are accounted for. For example, there are three versions of the S&P 500 index: price return, which only considers the price of the components, total return, which accounts for dividend reinvestment, and net total return, which accounts for dividend reinvestment after the deduction of a withholding tax. As another example, the Wilshire 4500 and Wilshire 5000 indices have five versions each: full capitalization total return, full capitalization price, float-adjusted total return, float-adjusted price, and equal weight. The difference between the full capitalization, float-adjusted, and equal weight versions is in how index components are weighted.




**Stock Market Index**

## 4.8 Stock Exchanges in India

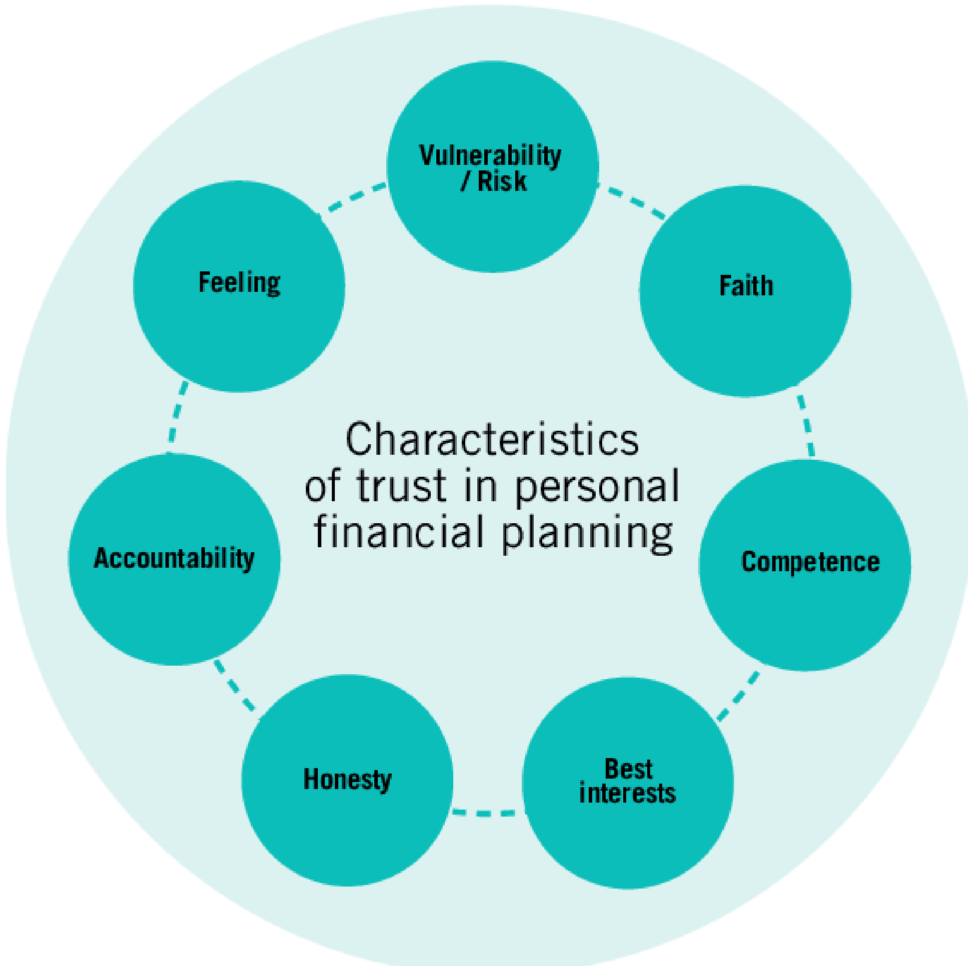
The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went up to 7by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as kerb market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It is also based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage.


**Stock Exchange in India**

Another stock exchange that needs special mention is Over The Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992 specially to cater to small and medium sized companies with equity capital of more than Rs.30 lakh and less than Rs.25 crore. It helps entrepreneurs in raising finances for their new projects in a cost effective manner. It provides for nationwide online ring less trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalise it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

### 4.9 Characteristics of Financial Services

Financial services are quite distinct in nature from the other services. The services provided by the financial institutions have some typical characteristics that make these products quite distinct from the products turned out by the industrial enterprises. Some of the basic characteristics of financial services are as discussed:




**Attributes for Financial Planning**

1. Customer-Specific: Financial services are usually customer focussed. The firms providing these services, study the needs of their customers in detail before deciding their financial strategy, giving due regard to costs, liquidity and maturity considerations. Financial services firms continuously remain in touch with their customers, so that they can design products which can cater to the specific needs of their customers. The providers of financial services constantly carry out market surveys, so they can offer new products much ahead of need and impending legislation. Newer technologies are being used to introduce innovative, customer

friendly products and services which clearly indicate that the concentration of the providers of financial services is on generating firm/customer specific services.

2. Intangibility: In a highly competitive global environment brand image is very crucial. Unless the financial institutions providing financial products and services have good image, enjoying the confidence of their clients, they may not be successful. Thus institutions have to focus on the quality and innovativeness of their services to build up their credibility.

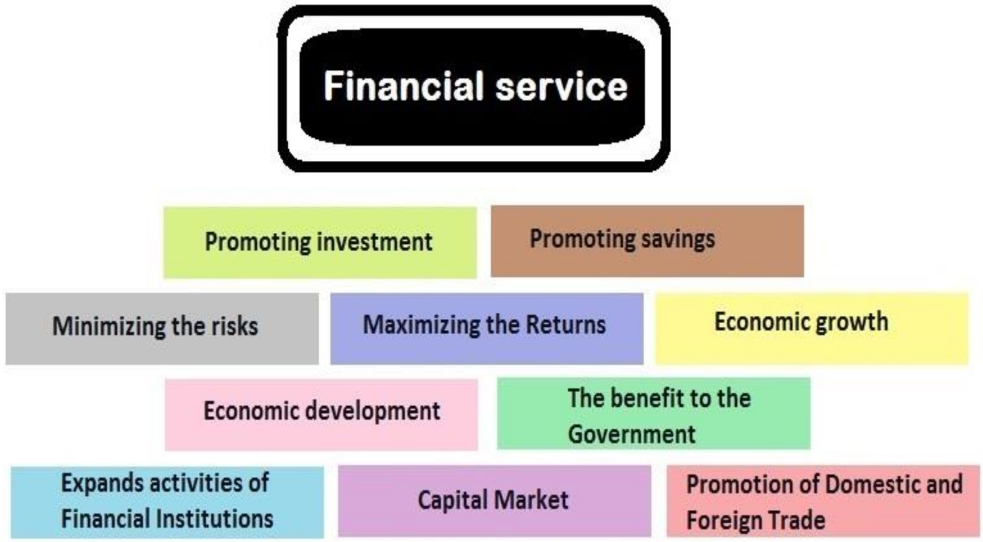
3. Concomitant: Production of financial services and supply of these services have to be concomitant. Both these functions i.e. production of new and innovative financial services and supplying of these services are to be performed simultaneously.

4. Tendency to Perish: Unlike any other service, financial services do tend to perish and hence cannot be stored. They have to be supplied as required by the customers. Hence financial institutions have to ensure a proper synchronization of demand and supply

5. People based services: Marketing of financial services has to be people intensive and hence it‟s subjected to variability of performance or quality of service. The personnel in financial services organisation need to be selected on the basis of their suitability and trained properly, so that they can perform their activities efficiently and effectively.

6. Market Dynamics: The market dynamics depends to a great extent, on socioeconomic changes such as disposable income, standard of living and educational changes related to the various classes of customers. Therefore financial services have to be constantly redefined and refined taking into consideration the

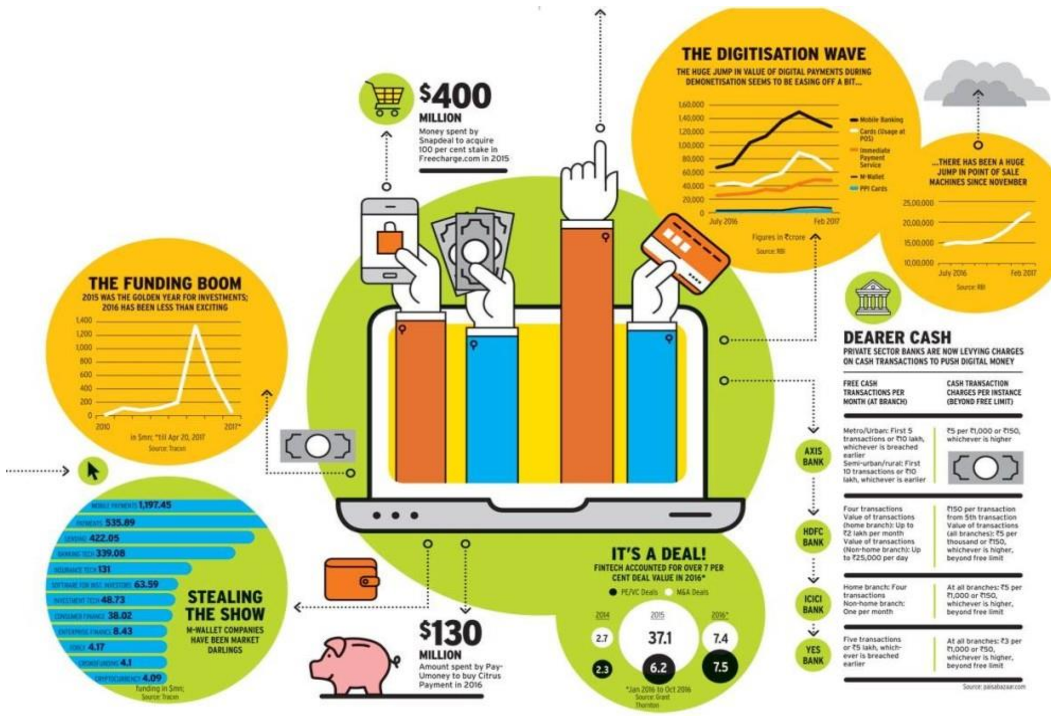
market dynamics. The institutions providing financial services, while evolving new services could be proactive in visualising in advance what the market wants, or being reactive to the needs and wants of their customers.




**Service in Finance**

## 4.10 Evolution of Financial Services in India

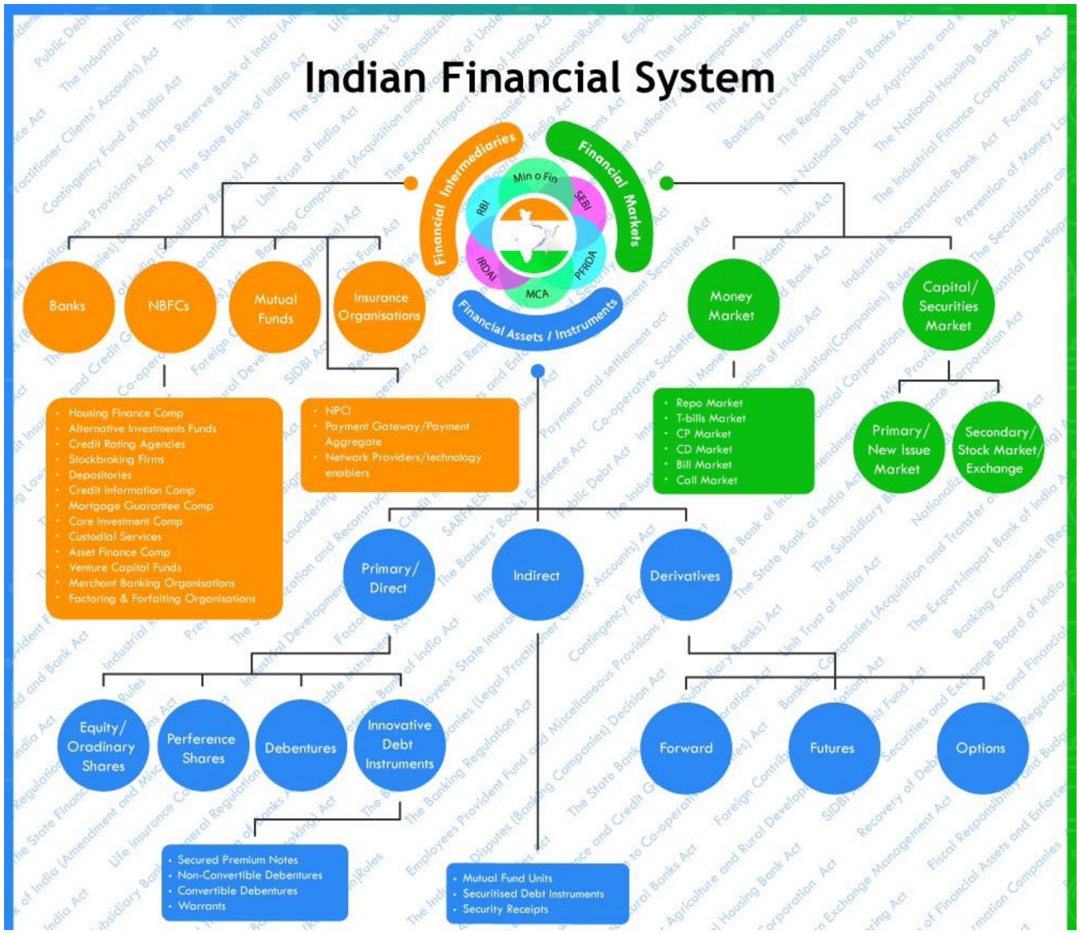
The financial services industry in India is in the process of attaining full bloom. To reach the present position, it has passed through a number of stages as mentioned below:




**Evolution of Finance**

## The Stage of Infancy:

This existed between 1960 and 1980 and covered in its gamut merchant banking insurance and leasing services.




**System of Finance**

Merchant Banking Services were unknown until the early 1960s. The policy makers and researchers had lack of clarity about the term "merchant bankers". Someone defined them as institutions which were acting; neither as merchants nor as bankers. However the term was used as an umbrella function, providing a wide range of services, starting from project appraisal to arranging funds from bankers. The merchant bankers are expected to identify projects, prepare feasibility reports, develop detailed project reports, and in doing so conduct marketing, managerial, financial, and technical analyses. Having done this, they are approached to garner project finance, and in order to do this resolve the problem‟s of capital structuring.

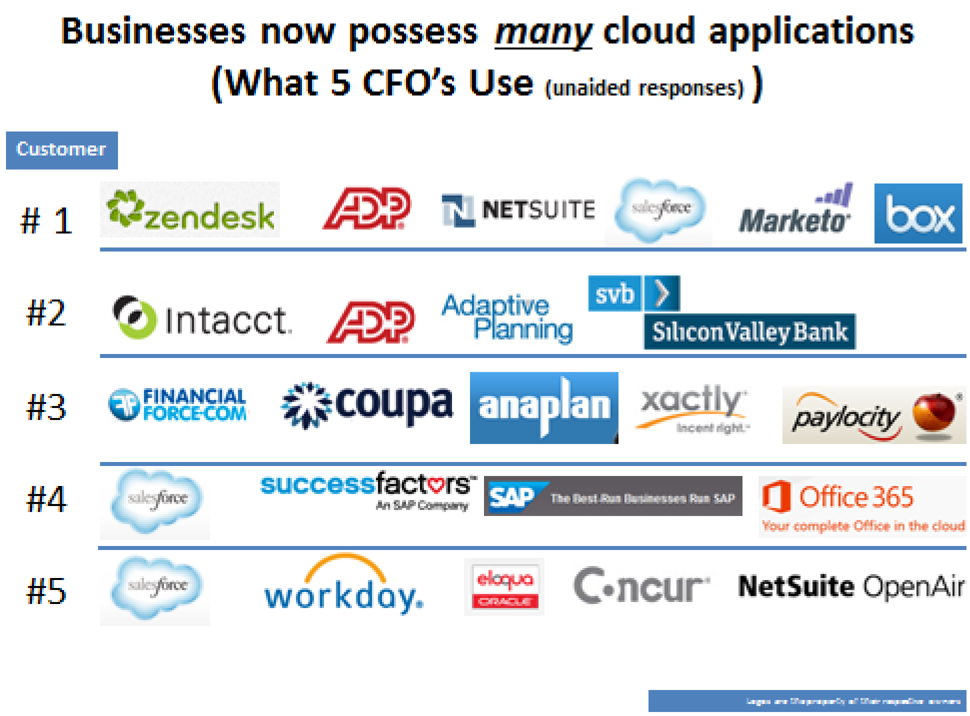
They are asked to act as abridge between the capital market and the fund-seeking institutions. They underwrite the issues and become subject to developments in case such issues are not fully subscribed. They assist the enterprises in getting listed on the stock exchanges. They offer legal advice on registration of companies and removing legal tangles. They provide advice and help in mergers and acquisitions. They give technical advice on leveraged - buyouts and takeovers. Recently they have added the syndication activity in their portfolio, wherein they form a syndicate or become a part of it to raise project finance. They arrange working capital loans and manage the risk element present in the form of general risk which is covered by the insurance policies of the General Insurance Company.

Investment companies such as the Unit Trust of India, the life insurance business initiated by the Life Insurance Corporation of India, and the general insurance business, also made their mark in the first stage of financial services. During this period, the Life Insurance Corporation of India has grown as a public monopoly. Prior to its setting up, the private sector was operating the life insurance business.The general insurance business was nationalised in the early 1970s. A holding company was set up with four subsidiaries to handle the general insurance business in the public sector. Suggestions were given very frequently to privatise the insurance business, as in no way could the insurance business be considered as a national monopoly.

Leasing made its mark in the closing years of the 1970s. Initially such companies were engaged in equipment lease financing. Later, they undertook leasing operations of different kinds, including financial, operating and wet leasing. During this period the number of leasing firms has shot up to a high of 400. The reorganisation of such firms due to their non-viability later led to a contraction in their numbers.

**Modern Financial Services:**

Financial services have entered the second rung during the later part of the 1980s. Over the counter services, share transfers, pledging of shares, mutual funds, factoring, discounting, venture capital, and credit rating, constitute some of the modern financial services. In the West, these services emerged on the scene about 100 years back. The mutual fund business is the major provider of funds to industry anywhere in the developed countries. The mutual funds there have been innovative in terms of schemes.They have been giving stable rate of return. Their asset and liability management is transparent. The small investor is secure in their hands. Their business policies are such that they create value for their investors.Investorsare not victimised by shifts in valuation policies, and efforts are made to harmonise the net asset valuation. The mutual funds have their own code of conduct.

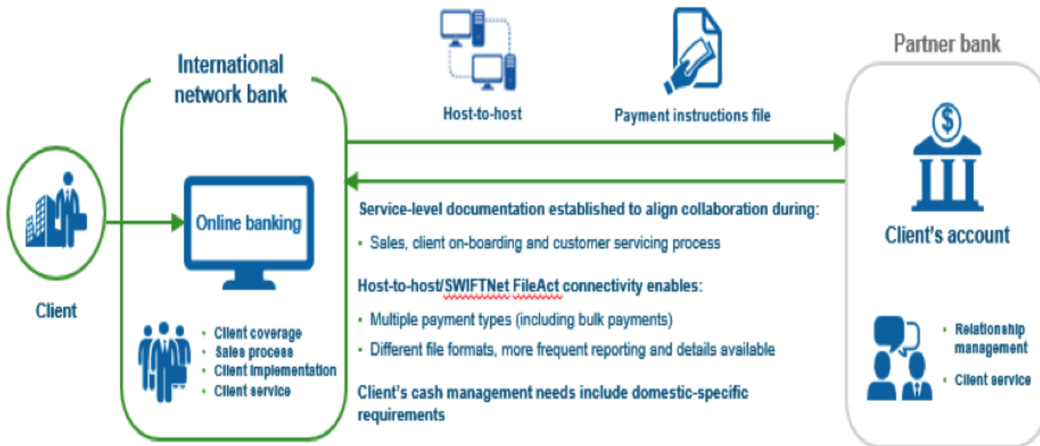



**Modern Financial Services**

Credit rating is another important financial service which made its mark in India in the mid-1980s. Credit rating boosts investor‟ confidence in capital market operations and prevents fly -by-night companies from making forays in the capital market. There was one credit rating company initially and we have ended up with eight finally. In terms of spread of the credit rating function, initially only debt instruments issues were covered. However later, instruments such as commercial papers and fixed deposits were brought under the purview of credit rating. Incidentally, there is a sovereign credit rating assigned by credit rating firms for the country. The Discount and Finance House of India Limited and a number of factoring institutions, such as State Bank of India Factors and Canbank Factors Ltd. Venture capital funds made their appearance in the late 1980s, Most of these firms have been operating in the public sector.

## The Third Flush

The third flush in financial services includes the setting up of new institutions, and paving the way innovating new instruments and also their flotation.




**Financial Services**

The setting up of depositories has brought the India financial services industry in line with the global financial services industry. It has promoted the concept of paperless trading and resulted into dematerialisation of shares and bonds. The stock-lending scheme approved by the Central Government in 1997- 98 budget and the setting up of a separate corporation to deal with the trading of the "Gilts" are innovative measures. The steps initiated to popularise book building in order to help both the investorsand fund users. The online trading interface by the Bombay Stock Exchange, the Delhi Stock Exchange, and computerisation of the National Stock Exchange, is acting as the fulcrum for the development of financial services arid is another major advancement in the field of financial services. This has given a fillip to paperless trading, save the investors from the onslaught of jobbers and brokers, and reduces tax evasion. The guidelines from the Securities and Exchange Board of India in relation to the capital adequacy ratio for the merchant bankers and their categorisation into different groups are a major advancement.

This will ensure investor protection and create a differentiation in the market place. The creation of the Securities and Exchange Board of India itself can be hailed as a path-breaking development in terms of regulation, growth, and development of financial services. The ongoing efforts to revamp the Companies Act, Income-Tax Act, etc. would also lead to the deliverance of effective financial services. The guidelines about permitting foreign financial institutions to operate in the Indian capital market will do a two-way good to the country In terms of enabling the foreign investors to plug into the Indian capital market, and the Indian investors and financial institutions to study the modus operandi of such firms.

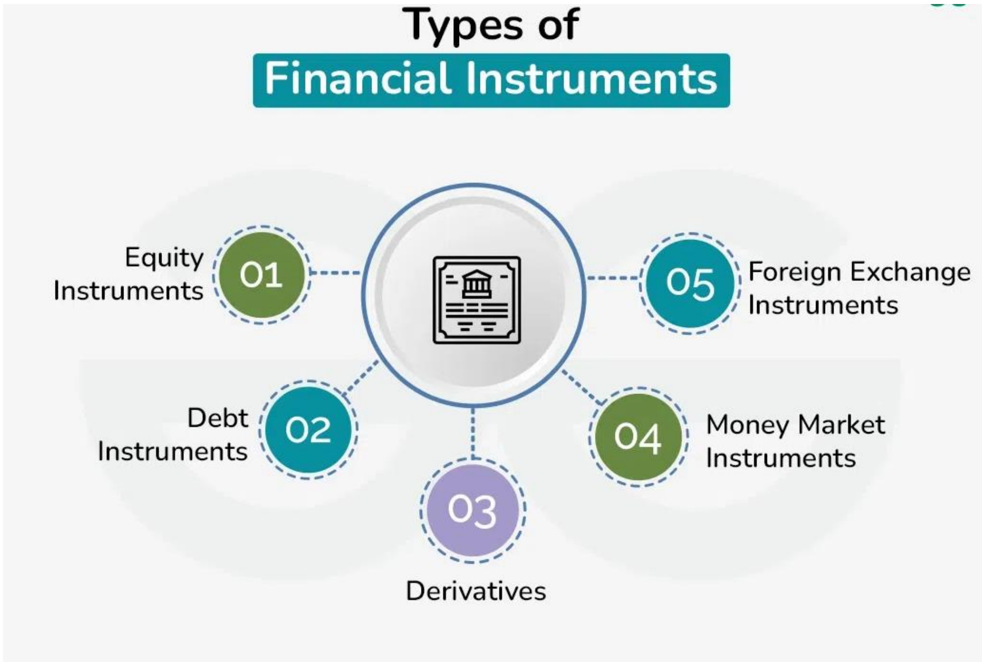
Public enterprise disinvestments are sure to prop up the state-of-art in the realm of financial services. It would provide a fillip to the presence of foreign financial firms in India, as well as result into creating pressure on the Indian financial firms to master the disinvestment business. The financial services firms would have to gain expertise in valuation, financial and legal restructuring, and taking the public sector firms to the commercial and capital markets.

During this period financial services firms scouted for funds abroad to finance the Indian corporate sector. They have approached the European capital markets, the most prominent of which belong to the UK and Luxembourg. These portfolio investments have flowed to India through the GDR route. It requires an understanding of raising funds abroad and also working together with world level financial services institutions, such as Lehman Brothers, Arthur Anderson, and Goldman Sachs, to mention a few.

With the passage of the Insurance Regulatory and Development Authority (IRDA) Act, 1999, the Insurance Regulatory and Development Authority was set up with statutory powers to function as the regulator for the insurance sector in India. This act has opened the doors for private players including foreign equity participation up to a prescribed limit of paid up capital. It has come out with regulations on various aspects of insurance business such as licensing of agents, solvency margin for insurers, accounting norms, investment norms and registration of Indian Insurance Companies. RBI allowed banks to enter into the insurance business by issuing a notification specifying insurance as a permissible form of business under section 6(1) (o) of the Banking Regulation Act, 1949. Thus providing banks another avenue for generating fee based income.

**New Financial Instruments:**

The new financial instruments are both being talked about and are also being used. The critical factors governing the chemistry of the issuance of the new financial instruments relate to maturity, risk, and interest rate. Based on these, in Germany some 400 financial instruments have been innovated. In India, both the market players, such as mutual funds, banks, brokers, stock markets, and the regulators, including the Finance Ministry, the Reserve Bank of Indiaand the regulators, and the Securities and Exchange Board of India, have to make more efforts to create new funds and new instruments. One may like to mention in this case the very non cordial welcome given to securitisation.

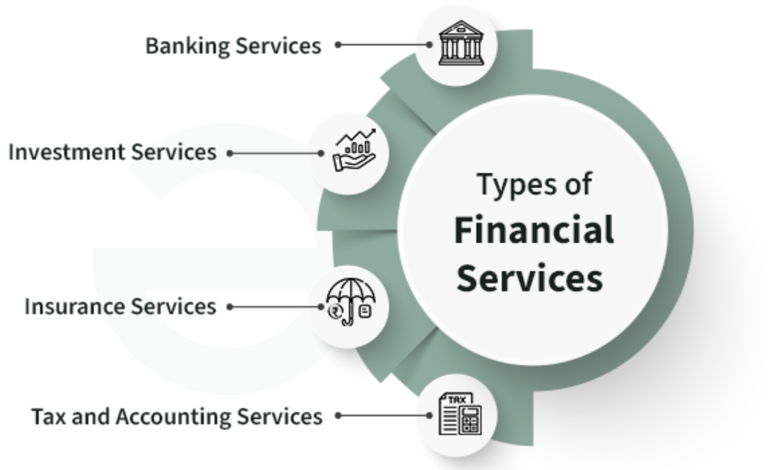



**Financial Instruments**

The housing finance companies, automobile manufacturers, and development and commercial banks can use this method greatly to their advantage. However, only a few companies have devoted their mind to the application of this method. Both the market players and the regulators have for very long been engaged in the idea of setting up the derivatives market in India. When the Indian economy is trying to become global in nature, the fluctuations in the rate of foreign exchange would be a routine matter, and hence there would be a need for currency, interest, and commodity-based derivatives. Derivatives have now become increasingly important in the field of finance.Futures and options are now traded on many exchanges. Derivative instruments such as Forward Contracts, Swaps and many others are regularly traded both in the exchanges and in the over the counter market.

## 4.11 Significance of Financial Services

The financial services sector plays a very crucial and significant role in a country‟s economy.




**Significance of Financial**

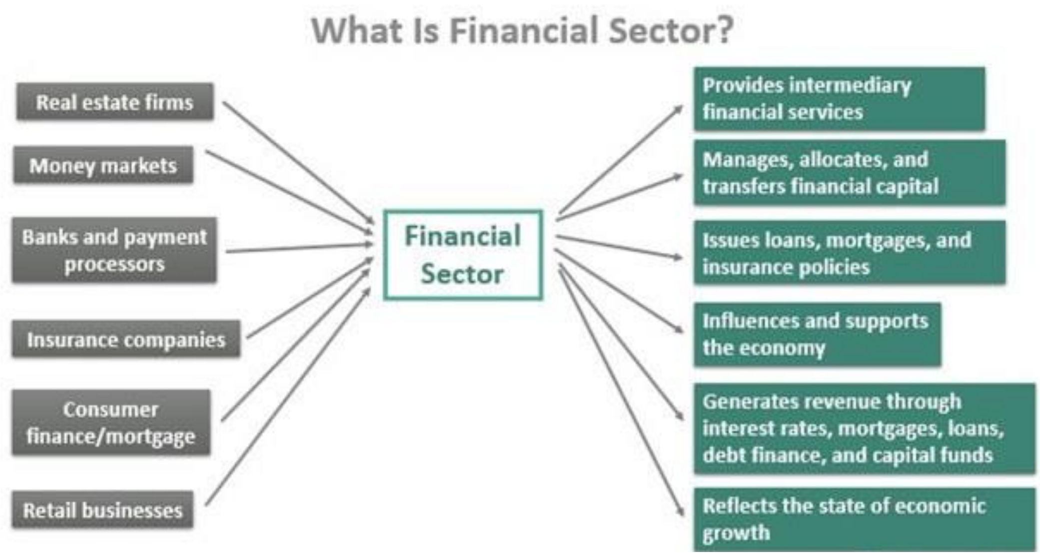
**Growth and Development:**

The financial sector now represents a significant proportion of the total economic activity in most economies. In most developed economies, the financial services sector has grown rapidly over the post-war period. In India, this sector has come up gradually after independence. However, after the liberalisation process initiated by the government, this sector saw a considerable growth.

When one examines the structure of most economies over the last few decades, the most striking feature is the growth of the services sector as compared to the manufacturing sector. This is well reflected in the employment statistics for the respective countries. Employment is just one of the measures of significance of each group of activities within the economy as a whole.

In UK, at the beginning of 1970"s the employment in services sector was 53% against 36% in the manufacturing sector, but towards the beginning of 1990"s it has risen to 73% whereas the employment in the manufacturing sector has gone down to 20%. Banking/Insurance/Finance, in the UK at the beginning of 1970"s represented around 11% of total employment within the services sector which has raised to over 17% by the 1990"s.

In Indiaat the beginning of the 1970"s the employment in services sector was 6% against 9.4% in the manufacturing sector, but towards the beginning of the 1990"s the employment in the services sector has risen to 7.3% whereas in the manufacturing sector it was only 10%. Banking/ Insurance in Indiaat the beginning of 1970"s represented 0.3% of the employment within services sector which has raised to 0.6% by the 1990"s.

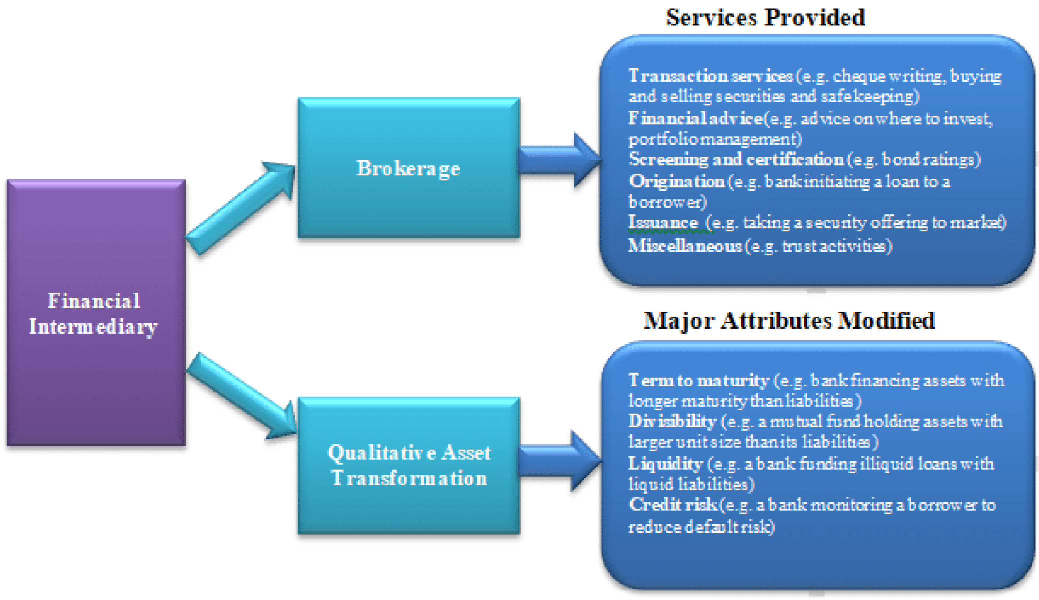



**Sector in Finance**

It may be true that technology had a stronger effect on the manufacturing sector than on the services sector during the earlier days. But it"s equally true that the market for manufactured goods has tended towards saturation in the postindustrial economies whereas services have experienced acceleration in demand for their products as income and wealth grew. Another reason for this change, in developed economies like UK could be due to shifting of the manufacturing of more standard goods from high wage economies towards developing economies with lower labour cost. In developing economies like India, however there is an increase in both the sectors, but it"s quite evident that the rate of growth is more in the services sector. Thus, the rate of growth of the size of the financial services sector as a proportion of the overall economy is significant.

**Role of Financial Intermediation**

The financial services sector is made up of financial institutions such as banks, insurance companies, trusts, loan companies, credit unions, securities dealers and exchanges, etc. which act as financial intermediaries. Financial institutions carry out the process of financial intermediations by acting as a channel through which the financial surpluses of some groups in society (e.g. households) are collected and then distributed to other groups in society (e.g. firms) which has a deficit.



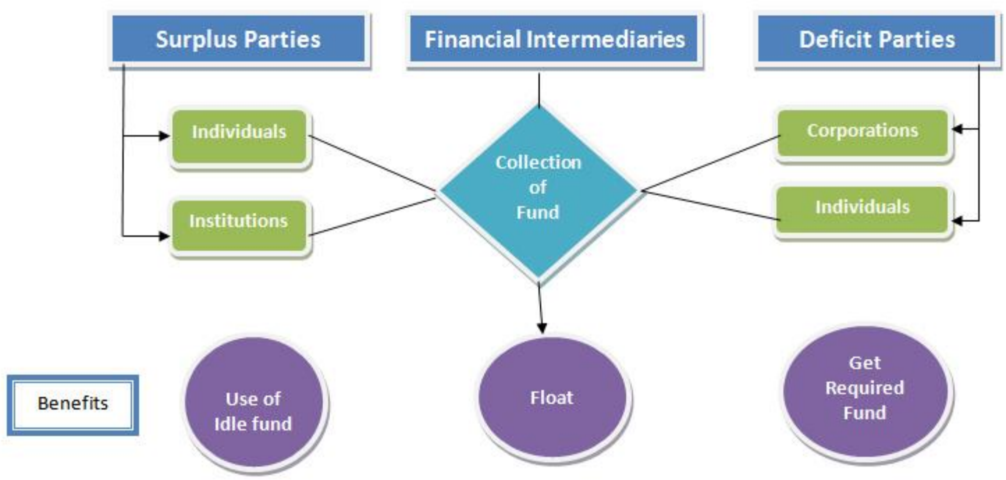

## Role of Financial Intermediation

It is well known that banks perform the role of taking in deposits from customersand lending it to other customers. Similarly, the insurance companies, particularly those involved in long-term life assurance business, collect premiums from policy holders and invest these surpluses in industrial/commercial activity viathe stock market.

The growing size of the financial activity relative to the overall economic activity in a closely integrated world has implied that disruptions in the financial markets in any economy can engender contagion which can spread rapidly and have adverse economic ramifications. So the financial intermediations role played by the financial services sector is crucially important in mobilizing savings for investment purposes.

**Unique Features:**

Financial services are unique in themselvesbut they do share many of the features of the products of other services. Financial services are intangible and perishable in nature. The institution providing these services may succeed only if they have a good image and confidence of the clients, and at the same time ensuring that demand and supply go hand-in-hand. The focus of these institutions has to be continuously on the quality and innovativeness of their services in order to gain the trust of their client"s thereby building their credibility




**Features of Finance**

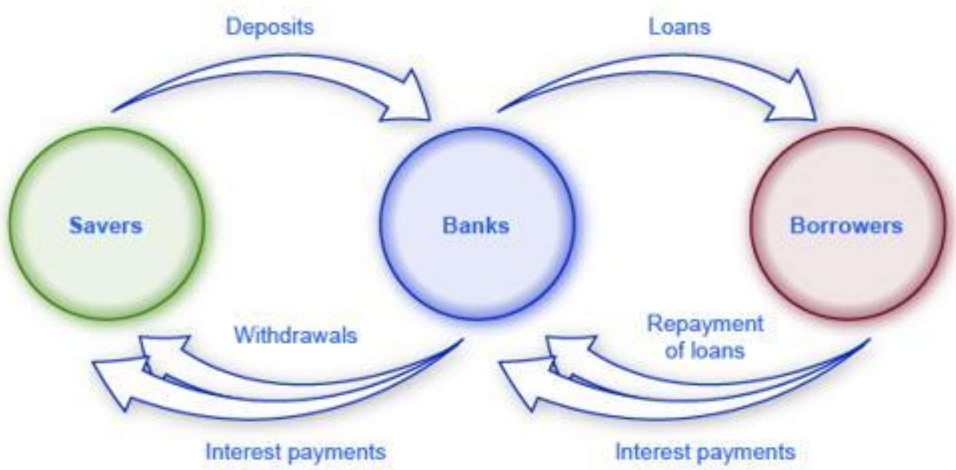
The products of the financial services sector are usually long-term in nature and hence there is a great deal of uncertainty in the mind of the customer as to whether, he had made a right choice. Owing to the nature of these products, the consumer needs to seek external advice. However, much of this advice comes from the institution itself, mostly through their agents. They usually provide advice on product suitability, quality and price either directly or viaan agent/broker that is paid commission by the sellers of the services.

The functions of producing and supplying financial services have to be performed simultaneously for which there has to be a perfect understanding between the financial services firmsand their clients. Even the marketing of these services, needs to have, not only people-orientation, but also process-orientation. Financial services are usually customer-oriented. Financial services institutions study the needs of the customers in detail to suggest financial strategies which give due regard to costs, liquidity and maturity considerations. The providers of financial services remain in constant touch with the market offering new products much ahead of need impending legislation. Financial services have to be constantly redefined and refined on the basis of socio-economic changes such as disposable income, standard of living and educational changes related to the various classes of customers. Financial services institutions while evolving new services could be proactive in visualising in advance what the markets want, or reactive to the needs and wants of customers.

**Creation of Credit:**

The financial services sector particularly the banking sector is very important to the operation of the economy and to the conduct of the government economic policy. The major liability of banks is the customer‟s deposit, which is a significant element of the country‟s money supply. It is through their lending activities, that banks are able to create new bank deposits and hence the country‟s money supply.

Let us understand what this means with the help of a simple example. The assumption that we are making here is that cash advances are always repaid in the banking system as fresh deposits. Suppose Mr. X, who is a customer of abank, deposits Rs. 1000 with the bank. The bank in turn lends Rs. 500 by way of cash advance to customer Y. The customer Y spends this cash, i.e. Rs. 500, with customer Z, who in turn deposits it with the banking system. Further, suppose that the bank lends you Rs. 1000 by making a loan, and crediting your current account. You, in turn, write a cheque on your account in favour of IGNOU, who deposits the cheque in its account. However, the net effect of lending is that there is no change on the overall banking system balance sheet, but the banking system now owes IGNOU Rs. 1000 rather than you. From this example, it could be seen that the banking system has thus increased its deposits and hence the money supply to 25% of its initial deposit.




**Financial Intermediaries**

This process of deposit creation continues indefinitely, but in practice, the bank needs to retain a reasonable percentage of its deposits in cash or liquid assets. We may not go into these details here, but the point that needs to be emphasized upon is that the banks through their lending activities are able to create new bank deposits and hence increase the country"s money supply.

## 4.12 Types of Financial Services

Although there is no such scheme of classification of financial services which may satisfy everyone or which is able to cover all the subtleties of this industry. However, in order to understand the functioning of the financial services industry in abetter perspective we have tried to organize our discussion of the financial services industry by classifying the financial services under three broad categories, i.e. Fee Based Services, Fund Based Services and Insurance Services.

**Fee Based Services:**

Fee based financial services are those services wherein financial institutions operate in specialised fields to earn a substantial income by way of fees, dividend, commission, discount and brokerage on operations. The major fee based financial services are as follow:

a) Issue Management

b) Corporate Advisory Services

c) Credit Rating d) Mutual Funds

e) Asset Securitisation

**a) Issue Management**

Issue management refers to management of securities offerings of the corporate sector to public and existing shareholders on right basis. In simple words Issue Management refers to managing issues of corporate securities like equity shares, preference shares and debentures or bonds. Issue Managers in capital market parlance are know as Merchant Bankers or Lead Managers, although the term Merchant Banking covers a wide range of services such as project counselling, portfolio management, investment counselling, mergers and acquisitions, etc. Issue Management constitutes perhaps the most important and sizeable function within it, so Much so, that very often the terms Merchant Banking and Issue Management are almost used synonymously.

Issue management involves marketing of capital issues, of existing companies including rights issues and dilution of shares by letter of offer, and merchant bankers give advice on decisions concerning size and timing of the public issue in the light of the market conditions. They also provide assistance to the corporate units on the designing of a sound structure acceptable to the financial institutions and determining the quantum and terms of the public issues of different forms of securities. Merchant Bankers also advise the issuing company whether to go for a fresh issue, additional issue, bonus issue, right issue or a combination of these. The various aspects of issue management are dealt.

**b) Corporate Advisory Services**

Corporate Advisory Services are needed to ensure that a corporate enterprise runs efficiently at its maximum potential through effective management of financial and other resources. The services which come in the ambit of corporate advisory services, for abusiness enterprise, include services such as providing guidance in areas of diversification based on the Government‟s economic and licensing policies, appraising product lines and analyzing their growth and profitability, consultancy for rehabilitation of sick industrial units, advice on capital structuring and restructuring, etc. These services are usually provided by merchant bankers.


**Financial Services**

Corporate advisory services constitute an important component of the portfolio of the activities of merchant bankers. It covers any matter worth the benefit for a corporate unit involving financial aspects, governmental regulations, policy changes and business environmental reshuffles, etc. Thus, the scope of the corporate advisory services is very vast ranging from managerial economics, investment and financial management to corporate laws and the related legal aspects. We have discussed at length most of the corporate advisory services.

### c) Credit Rating

The origin of this service lies in the financial crisis of the US in 1837. The first mercantile credit rating agency was set up in New York in 1841 to rate the ability of the merchants to pay financial obligations. In India, credit rating came in much later. The first credit rating agency viz. the Credit Rating and Information Services of India Ltd. (CRISIL) was set up in 1987, followed by ICRA in 1994.

The term „Credit Rating‟ comprises of two words „credit‟ and „rating‟. Credit is trust in a person‟s ability and intention to pay or reputation of solvency and honesty. Rating means estimating worth or value of, or to assign value to classifying a person‟s position with reference to a particular subject matter. Rating is usually expressed in alphabetical symbols. Thus, Credit Rating can be defined as an expression of an opinion through symbols about credit quality of the issue of securities or company with reference to a particular instrument.

In India, the scope of credit rating is limited to debt instruments, i.e. debentures, bonds, fixed deposits, commercial paper, etc. However, in developed countries equity shares are also rated. Credit rating is thus an important device in the hands of investors to analyse the instruments floated by issuers. To know more about the typology of credit rating, the credit rating process.

**d) Mutual Funds**

Mutual fund is a trust that pools the savings of a number of investors who share a common goal. Thus, it offers a common man an opportunity to invest in adiversified, professionally managed basket of securities at a relatively low cost. In other words, mutual funds invest the money collected from the investors, with the help of professional managers, in capital market instruments, such as shares, debenture and other securities.

Mutual fund is usually a long-term investment with a certain level of risk. Of course, the open-ended feature of mutual funds ensures that you get money whenever you want at a short notice, i.e. the scheme on behalf of the unit holders invests in securities, collects the interest payments and dividends from these securities and sells them when you need money. At the time of initial public issue investors can invest in close-ended funds, but afterwards they can either buy or sell the units of the scheme on the stock exchanges where they are listed. In some schemes there is an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices.

As per SEBI Regulations at least one of the two exit routes is to be provided to the investor. The tax-saving Equity Linked Saving Schemes (ELSS) and pension schemes give added benefit of tax rebate.

**e) Asset Securitisation**

Asset Securitisation is a process whereby loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities. The assets which can be securitised include receivables from the government, trade related receivables, credit card receivables, automobile loans, real estate loans, housing loans etc. Securitisation can be defined as the process which takes place when a lending institution‟s assets are removed in one way or the other from the balance sheet of that lending institution and are funded instead by investors who purchase a negotiable instrument evidencing this indebtedness without recourse or with limited recourse to the original lender.

Under Asset Securitisation a financial institution pools and packages individual loans and receivables, creates securities against them, gets them rated and sells them to the investors at large through public offerings or private placements (Trustee). The asset cash flow is remitted to the trustee who in turn pays scheduled interest and principal payment to the investors. Thus, “Securitisation is a synthetic technique of converting assets into securities, securities into liquidity, liquidity into assets and assets into securities on anongoing basis” thereby providing flexibility of yield, pricing pattern, size risks and marketability of instruments used to the advantage of both borrowers and lenders/investors.

**Fund Based Services:**

In fund-based services the firm raises funds through equity, debt, and deposits and invests these funds in securities or lends to those who are in need of capital. We will be discussing here some of these fund-based services such as:

a) Leasing and Hire Purchase

b) Housing Finance

c) Credit Cards

d) Venture Capital

e) Factoring

f) Forfaiting

g) Bill Discounting

**a) Leasing and Hire Purchase**

The growth of leasing industry cans be traced to the formation of First Leasing Company of India in 1973 by Mr. Farouk Irani and remained the only company in the country till 1980. By 1981, a few more companies, i.e. 20th Century Finance Corporation, Shetty Investment and Finance, Jaybharat Credit and

Investment, Sundaram Finance, etc. joined the leasing game. During the late 1982, numerous financial institutions and commercial banks started joining in. Since then the industry leapt into prominence and today we find it as a flourishing business.

Leasing refers to a contract under which the owner of an asset allows another person or party to use the assets in return for some rent. The owner of the asset is referred to as the „lessor" and the person using the asset in return for a payment is referred to as the „lessee". However, the lessee is responsible for the maintenance of the asset. In leasing the cost of capital is usually recovered from multiple serial rentals and the final sale of the asset. All financial leases virtually fall under one of the four types of lease financing viz. capital lease, operating lease, sale and lease back and leveraged lease.

According to the International Finance Corporation (IFC) hire purchase is a hybrid instrument that provides an alternative to bank financing for purchasing an asset. A hire purchase involves, in essence, the purchase of an asset on theunderstanding that the purchaser (called the hirer) will pay in equal periodic instalments spread over a length of time. This service is usually used for financing consumer durables. Now-a-days it is more popular with automobile financing business. Leasing and hire purchase have emerged as a supplementary source of intermediate to long-term finance. These services are provided mainly by nonbanking financial companies, financial institutions and other organisations.

**b) Housing Finance**

Housing is one of the basic needs of the society. It is closely linked with the process of overall socio-economic development of a country. This sector remained neglected for quite some time. It was only in the Seventh and Eighth Five-Year Plans that it was paid heed to. However, today it is a growing industry with the banking sector evincing keen interest, which in turn could have been fuelled by the lack of preferable alternative avenues for investment.

Presently, funds required per dwelling shelter are so high that the individual‟s saving is not adequate to meet the expenditure of house building. As a result, there is a great demand for external housing finance. To take advantage of this situation, the lending institutions are competing with each other for a market share by offering very attractive terms to the customers in the form of lower rate of interest, liberal collateral requirements, longer payment period etc. These institutions have also introduced the floating rate products besides the fixed rate ones, with the option made available to the borrower for conversion against a nominal payment. The other tactics of market acquisition are speedier processing and disbursement; efficient advisory services, waiver or reductions in associated up front fees etc. We have also discussed therein the housing finance schemes offered by various housing finance institutions.

**c) Credit Cards**

Credit cards generally known as plastic money, is widely used by consumers all around the world. The convenience and safety factors add value to these cards. The changes in the consumer behaviour led to the growth of credit cards. It is a document that can be used for purchase of all kinds of goods and services in the world. Credit card identifies its owner as one who is entitled to purchase things without cash, purchase services without money and be eligible to get credit from a number of establishments.

The card issuer issues credit cards depending on the credibility of the customers. The card issuer also enters into a tie-up with merchant establishments which are engaged in various fields of business activities. The issuer for itsconvenience and for proper scrutiny sets up a credit limit for its card holders and a floor limit for its merchant establishments The credit card offers the individual an opportunity to buy rail/air tickets, makes purchases from shops and stay at hotels when they need.

Credit card is a card which enables an individual to purchase certain products/ services without paying immediately. He needs to only present the credit card at the cash counter and has to sign some forms. In short he can make purchase against credit card without making immediate cash payment. Therefore credit cards can be considered as a good substitute for cash and cheques. In order to know the details of this financial service, you may go through the unit on credit cards

**d) Venture Capital**

The concept of Venture Capital was introduced in Indiaby the all India Financial Institutions with the inauguration of Risk Capital Foundation (RCF) sponsored by the Industrial Finance Corporation of India (IFCI) to supplement promoters‟ equity, with a view to encouraging technologistsand professionals to promote new industries. Venture capital implies long-term investment generally in high risk industrial projects with high reward possibilities. This investment may be at any stage of implementation of the project between start-up and commencement of commercial production. Thus, Venture Capital is defined as the organised financing of relatively new enterprises to achieve substantial capital gains. A high level of risk is implied by the term „venture capital‟ and is implicit in this type of investment.

**e) Factoring**

Factoring service caters to the requirements of the Indian Industries in the changed business environment.Its origin can be traced back to the fifteenth century. England and France used the services of specialised agents for exporting goods to their colonies. These agents later came to be known as factoring organisations.

Factoring is an arrangement between the financial institution or banks (factor) and the business concern (the supplier) which provides goods or services to its customers on credit, wherein the factor buys out clients (suppliers) book debts.

There is always a difficulty of foreign languages, customs and laws, fear of distance, ocean barriers etc. which inhibit entrepreneurs from venturing into export business, consequently affecting the country"s export. Factoring is aservice that relieves the exporters from the fear of credit losses enabling them to offer open account terms to overseas customers. The factor takes over the administration of client"s sales ledger, follow-up with debtors and evaluation of credit risks. The fee charged for these services by the factor are usually a percentage of the value of the receivables factored.

In 1990, RBI issued guidelines for factoring services providing it a statutory framework. Banks are permitted to invest in factoring companies to a certain limit but they cannot act as promoters of such companies. Investment of abank in the shares of factoring companies including its factoring subsidiary cannot exceed in the aggregate 10% of the paid-up capital and reserve of the bank.

**f) Forfeiting**

Forfeiting is a financial tool for exporters, enabling them to convert their „credit sales" to „cash sales" by discounting their receivables with an agency called forfaitor. Forfeiting denotes the purchase of trade bills or promissory notes by abank or financial institution without recourse to seller. For exporters it is a „Risk Management" tool as well because by selling the export receivables to the forfeiter the exporter is relieved of the inherent political and commercial risks involved in international trade. Thus, all risks and collection problems are fully the purchaser"s (forfeiter"s) responsibility that pays cash to seller after discounting the notes or bills. It is backed by bank guarantee. In India, the Export Import Bank of India (EXIM Bank) facilitates this service with an overseas forfeiter agency for which they charge a commission.

**g) Bill Discounting**

Bill Discounting, just as factoring and forfeiting, is short-term trade finance, also known as acceptance credit where one party accepts the liability of trade towards third party. Bill discounting is used as a medium of financing the current trade and is not used for financing capital purposes. Trade bills are negotiable money market instruments and these are bought by the intermediaries at a discount before their maturity. Discount houses act as intermediary"s between the central bank and the banking system, providing liquidity and ensuring efficient operations of money market. Discount houses play an important role throughout the universe in the whole system of banking.

**Insurance Services:**

Insurance, as we all know, is the most preferable method of handling risks and hence is also called as „risk cover". Risk is nothing but an uncertainty ofoccurrence of a loss viz. loss of lives, accidents causing permanent disability, loss of houses due to floods etc. Insurance is a contract between two parties – the insurer (the insurance company) and the insured (the person or entity seeking the cover) – wherein the insurer agrees to pay the insured for financial losses out of any unforeseen events in return for a regular payment of "premium". In insurance the actual loss is substituted by average loss by spreading the losses of unfortunate few over the entire group. This is a financial service wherein the insured is re-established to his or her approximate financial position prior to the occurrence of loss. Thus, insurance provides a unique sense of security that no other form of investment provides.

Insurance is an attractive investment option as well. These products yield more compared to regular investment options, and this is besides the added incentives offered by insurers. It serves as an excellent tax saving mechanism too. An individual is entitled to a rebate of 20% on the annual premium payable on his/her life and life of his/her children or adult children as per section 88 of the Income Tax Act 1961. In order to nationalise the life assurance business in India, the government had set up the Life Insurance Corporation of India in 1956. Since then it remained the monopoly of the public sector, until 2001 when private players were allowed to operate in this sector. However, before opening up this sector for the private players, an autonomous insurance regulator was set up in 2000. The „Insurance Regulatory and Development Authority" has extensive powers to oversee the insurance business and regulate it in a manner so as to safeguard the interest of the insured. Block V of this course is completely devoted to this sector wherein life insurance, non-life insurance and the broking services are given in detail.

# UNIT V

## EMERGING TRENDS AND FUTURE OF FINANCIAL MARKETS

The financial markets are evolving rapidly due to technological advancements, regulatory changes, and global economic shifts. Here are some key emerging trends shaping the future:

1. Digital Transformation and FinTech Innovation

Blockchain & Cryptocurrencies: Increasing institutional adoption of digital assets like Bitcoin and Ethereum, along with central bank digital currencies (CBDCs).

Decentralized Finance (DeFi): Growth in peer-to-peer lending, decentralized exchanges, and smart contract-based financial services.

Artificial Intelligence & Big Data: AI-driven trading algorithms, robo-advisors, and predictive analytics for investment decisions.

2. Rise of Sustainable and ESG Investing

Investors are prioritizing Environmental, Social, and Governance (ESG) factors in portfolio management.

Green bonds, carbon credits, and impact investing are gaining traction.

Regulatory bodies are enforcing stricter ESG disclosure requirements.

3. Evolution of Market Structure and Trading

Fractional Investing: Allows retail investors to buy partial shares of expensive stocks.

Algorithmic and High-Frequency Trading (HFT): Increased reliance on automated trading strategies.

Tokenization of Assets: Real-world assets like real estate and commodities being represented as digital tokens on blockchain.

4. Regulatory and Compliance Changes

Stricter regulations around cryptocurrency, AI in finance, and cybersecurity.

Global financial watchdogs increasing scrutiny on cross-border capital flows.

More transparency requirements for hedge funds and private equity firms.

5. Changing Investor Behavior

Younger generations (Millennials & Gen Z) favor mobile investing, social trading, and digital assets.

Increased interest in alternative investments like private equity, venture capital, and collectibles.

Greater demand for customized and thematic portfolios (e.g., tech-focused, space exploration, healthcare innovations).

6. Geopolitical and Macroeconomic Influences

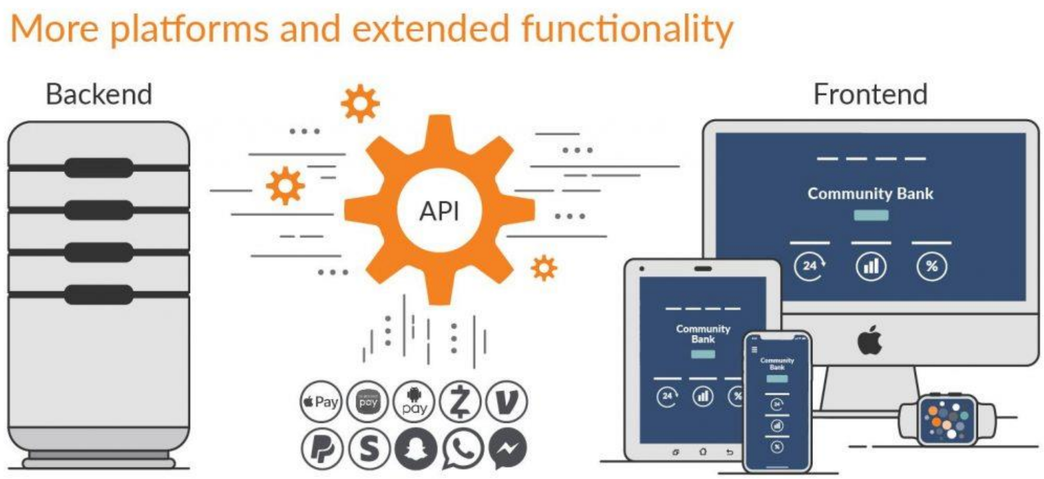
De-dollarization efforts by emerging economies leading to diversification in reserve currencies.

US-China trade tensions and regional conflicts impacting global supply chains and investment flows.

Inflation & Interest Rate Uncertainty affecting monetary policy and market volatility.

### 5.1 Digital Transformation and FinTech Innovation

The landscape of traditional financial services has undergone a profound transformation, courtesy Digital Technologies, which are reshaping payments, lending, insurance, and wealth management. This process was accelerated during COVID-19 pandemic. The digital transformation has led to improvement in the efficiency of delivery of financial products and services by way of making it cost effective, swifter, efficient, more diverse, inclusive and with the enhanced customer experiences. Now if we look at the enablers of digital transformation, it is a result of a delicate interplay between underlying digital public infrastructure (viz. JAM Trinity- Jan Dhan- 78% have access to bank account – up from 31% in 2011; Aadhaar- As on 30th September 2023, Unique Identification Authority of India has issued 139.08 crore Aadhaar numbers, and Mobile-1.2 billion in 2022; UPI – 117.60 Billion in 2023; 12 Bn in Feb 2024 – It has also spurred innovations in payment space- Apps, financial services, value added services etc.- mostly created by Government, Regulators and Public Sector Entities), institutional arrangement and the policy initiatives.




**Digital Transformation**

These key elements help foster an environment that helps in digitalisation, nurturing creative ideas, use of transformative technologies, and leading to beneficial and meaningful innovations in the financial industry. Here, I would also like to highlight a DPI developed by RBI in association with RBIH and which are currently under pilot run, named as “Public Tech Platform for Frictionless Credit (PTPFC)”. This platform enables lenders who connect to it to seamlessly use data from across multiple entities in separate systems, thus obviating the need for multiple bilateral 2 integrations between lenders and data providers.

This end-to-end digital platform is expected to bring in greater efficiency to the entire process of delivery of credit in terms of reduction of costs, improving Turn Around Time, greater scalability, and further expanding the reach of financial services. Once stabilized, this public good would be revolutionary in credit delivery system. As regards the impact of digitalisation and innovations relating to financial processes, transactions, and services, they have unleashed a wave of efficiency, accessibility, and convenience, which was previously unimaginable. Today, consumers wield the power of financial management at their fingertips. From mobile banking apps to contactless payments, digitalization has democratized financial access, empowering individuals, regardless of location or socio-economic status, to participate actively in the financial system.

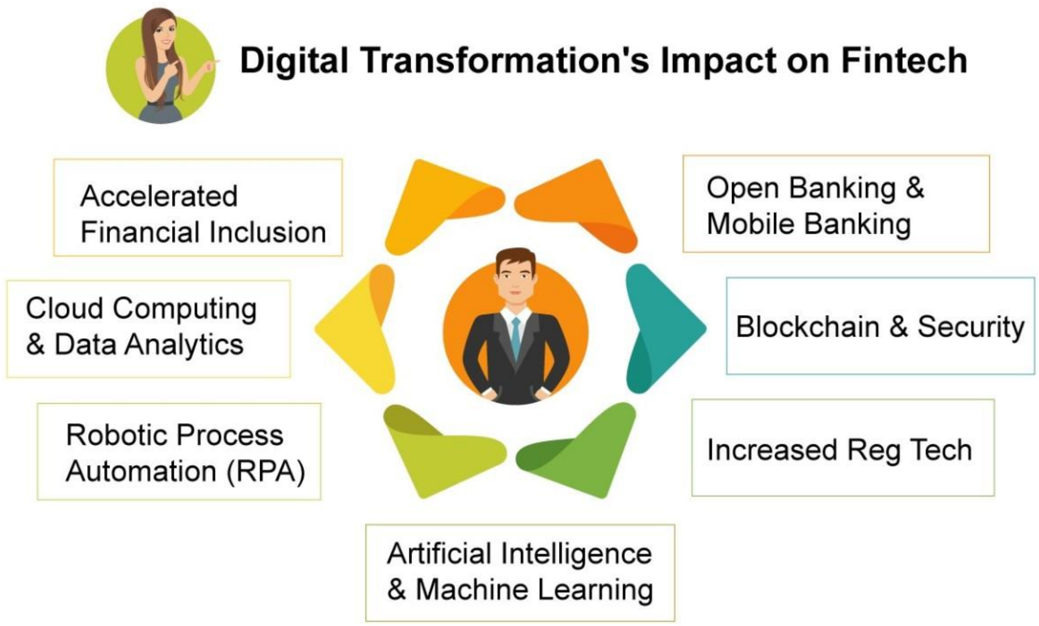
Fintech innovation has been particularly significant on the payments front, supported by enabling digital public infrastructure such as the Unified Payments Interface, the interoperable UPI QR Code, and the Aadhaar-Enabled Payment System (AEPS), thus helping formal finance reach billions. NPCI, Banks and Fintechs are quietly revolutionizing the way we navigate our daily routines. Imagine the smooth glide through toll booths with FASTag, the quick tap of your RuPay card at the grocery store, the effortless hop onto the metro with National Common Mobility Card (NCMC), or the contactless instant peer-topeer / peer-to-merchant payments with UPI on your phone. It's not just about transactions; it's about the seamless integration of technology into our lives, making every moment more convenient, every task more manageable, and every experience more delightful. They are guiding us through the intricacies of modern living, making the journey smoother, faster, secure, and altogether more enjoyable. The rise of UPI stands as a testament to the transformative power of digitalization and fintech innovations. Launched in 2016, UPI has emerged as one of the world's most advanced real-time payment systems, facilitating seamless peer-to-peer and peer-tomerchant transactions with unparalleled speed and convenience. With its open architecture and interoperability, UPI has transcended traditional banking, enabling users to link multiple bank accounts and access many of third-party fintech services through a single interface. UPI today has over 350 million unique consumers and close to 50 million merchants enabled across the length and breadth of the country into real-time payment 3 system. 550+ member banks and 100+ Apps (including 22 Third Party App Providers) are part of UPI ecosystem.


**API in Fintech**

In February 2024, UPI processed transactions totalling 12.10 billion, with a transaction value over Rs. 18 lakh crore. NPCI is now also looking at cross-border collaboration and harmonization to support development of robust payment system wherever required, ensure interoperability, and facilitate seamless global transactions in an interconnected world. Further, by providing a platform for aspiring Indian Fintechs to showcase their ideas and collaborate with industry stakeholders, NPCI is fuelling the next wave of start-up innovations that will shape the future of finance in India and beyond. While the adoption of newer technologies and innovation hold promises to bring a lot of benefits, at the same time they have the potential for significant disruption. It is essential that they should be applied and used in a responsible manner and ensure that associated risks are well understood and adequately mitigated. Now in this context, if we look at the possible role of FinTech innovations- possibly it should be to develop sustainable FinTech ecosystem and contribute towards a sound financial world.

Sustainability, in any sphere, is about balancing the wants of future against the needs of today. Sustainability of financial system, in this sense, is no different.

There is thus a need to look closely at the ingredients of this required balance - The balance that can help the Fintech Sector in scaling the heights consistently and sustainably. Therefore, the challenge is to maximise the benefits of fintech while minimising potential risks for the financial system. Achieving a balance between policy objectives such as fostering innovation on one hand while ensuring that risks relating to consumer protection, market conduct, data privacy and robust cyber security, Integrity of financial system, stability of financial sector, and proper development and use of artificial intelligence (AI) models to avoid any issue on fair treatment and anti-discrimination in extension of credit, are well understood and mitigated. Having highlighted the need for balance in the sustainable growth of FinTech sector, I believe, be it in life or in business, balance comes from focusing on the right things. Therefore, my prescription for the Technological innovation in the financial sector would be to focus on two key elements, one is customer centricity and other is governance. In 4 any scenario, customer centricity should always be central to any innovation. Being the more informed, it is pertinent that the responsibility of customer protection falls on the shoulders of the industry and the participants should ensure that all key information is disclosed in a clear and timely manner to customers. One also needs to ensure to avoid any losses to customers, especially by not meeting the suitability and appropriateness criteria as also due to inadequate cyber security system.




**Impact on Fintech**

As regards the governance, we ought to inculcate the values of accountability, fairness, transparency and independence in the processes and people within the organization. The organizational culture itself should reinforce appropriate norms and culture for responsible and ethical behavior. We may also like to add that realizing the full potential of digitalization and fintech innovations for sustainable development requires a concerted effort to address the digital divide, promote digital literacy, and ensure equitable access to technology and digital infrastructure. It also necessitates commercial viability that further foster innovation while safeguarding consumer protection, data privacy, and cybersecurity. In conclusion, the convergence of digitalization and fintech innovations represents a watershed moment in the history of finance, heralding a new era of financial transformation and empowerment. As organizations navigate this tumultuous landscape, embracing digitalization and fostering a culture of innovation, customer centricity and good governance will be key to unlocking the full potential of this paradigm shift. For NPCI, the journey towards a digital-first future is not just an aspiration but a mandate, as it continues to spearhead the charge towards a more inclusive, efficient, and resilient financial ecosystem for all. Once again, I extend my sincere gratitude for the invitation to share my thoughts on such an exciting topic. It's an honour to be among esteemed colleagues and industry leaders.

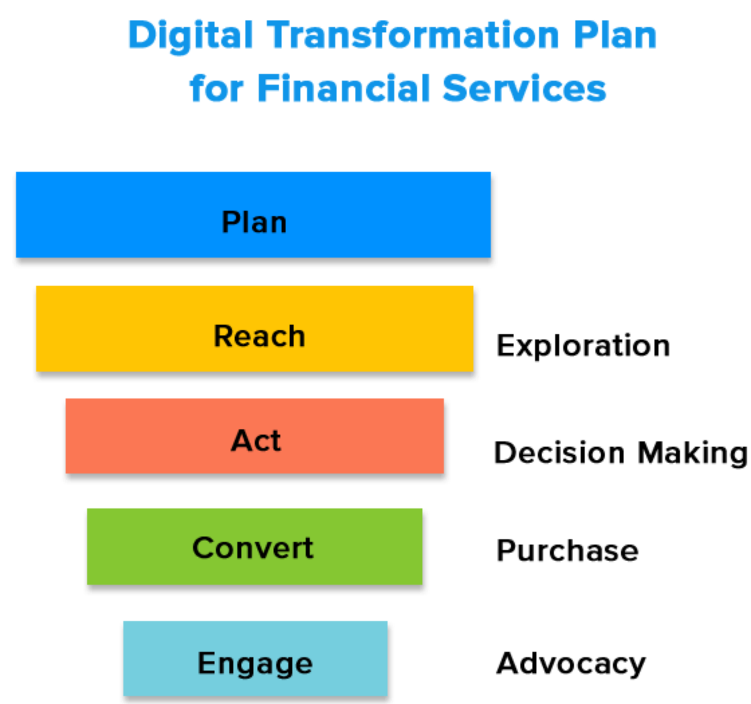

**Digital Transformation**

## 5.2 Fintech and Digital Transformation in Investing

Finance is undergoing a profound transformation. Digital technologies are reshaping payments, lending, insurance and wealth management – a process that the COVID-19 pandemic has accelerated. While this is making financial services in many economies more diverse, competitive, efficient, and inclusive, it may also increase concentration in markets. Moreover, new risks may arise to a range of key public policy goals. This paper draws on the underlying economics of financial services and their industrial organization to examine – with recent empirical evidence – the implications of digital innovation for market structure and attendant policies, including financial and competition regulation.

The key organizing framework for the discussion is economic frictions such as information asymmetries and economic forces such as economies of scale and scope. These frictions and forces give rise to financial intermediaries and shape market structure. We show that while technological advances are not new to finance, digital innovation has brought major improvements in the connectivity of systems and in computing power and cost, which have resulted in large volumes of newly created and usable data. For example, mobile phone usage has surged globally, social and economic activity has shifted online (often to platform-based businesses), and new technologies like cloud computing have become widely adopted.

These improvements have alleviated frictions, blurred firm and industry boundaries, and given rise to new business models. New, often smaller and specialized financial technology (fintech) players have unbundled services (see definitions below). However, classic economic forces remain relevant. Economies of scale and network effects are strong in digital platforms and cloud computing. These scale effects, alongside economies of scope encourage re-bundling, and allow large technology (big tech) firms and other new players to deepen their inroads into core financial products. Available evidence shows that big tech firms in particular are rapidly expanding their footprint in finance, and can use big data in ways that reduce the need for collateral. Meanwhile, incumbent financial institutions have adapted by adopting new technologies and disaggregating their production of financial services to improve efficiency.




**Digital Transformation in finance service**

Digital innovation could drive a range of industrial organization outcomes. On the one hand, digital technology enables niche providers to reach a target customer base and be economically viable. On the other hand, customer acquisition, funding, “assembly,” and switching costs tend to favour larger providers of digital financial services. One possibility is a “barbell” outcome composed of a few large players and many niche players. The large, multi-product players could include traditional financial institutions, fintechs and big techs – thus both incumbents and new entrants. Small players may include fintechs as well as geographically or sector focused incumbents.

While a ‘‘barbell’’ is not the only potential outcome, it is a central case given the economic forces at work. It is a potential steady-state market structure as some participants leverage scale economies and network effects to grow larger, while innovation continues to result in new entrants. There will be a tendency for players to either hyper-focus or to aim for the large, multi-product space. However, continued atomization, stalled re-aggregation, or limits on entry could result in a different configuration.

This analysis gives rise to important policy issues regarding competition, regulatory perimeters, and ensuring a level playing field. Concentration risks may increase in the provision of financial services to end-users, and in the provision of infrastructure to financial institutions. Market structures that concentrate data and supercharge network effects could reduce intermediation costs and broaden inclusion. In many markets, however, the resulting market power might be seen as detrimental. Competition regulators will have to strike a balance appropriate to the needs of their markets, since different societies will attach different preferences to market structure outcomes.


**Lead in Finance**

At the same time, financial regulatory authorities are working to manage policy trade-offs among

(i) stability and integrity,

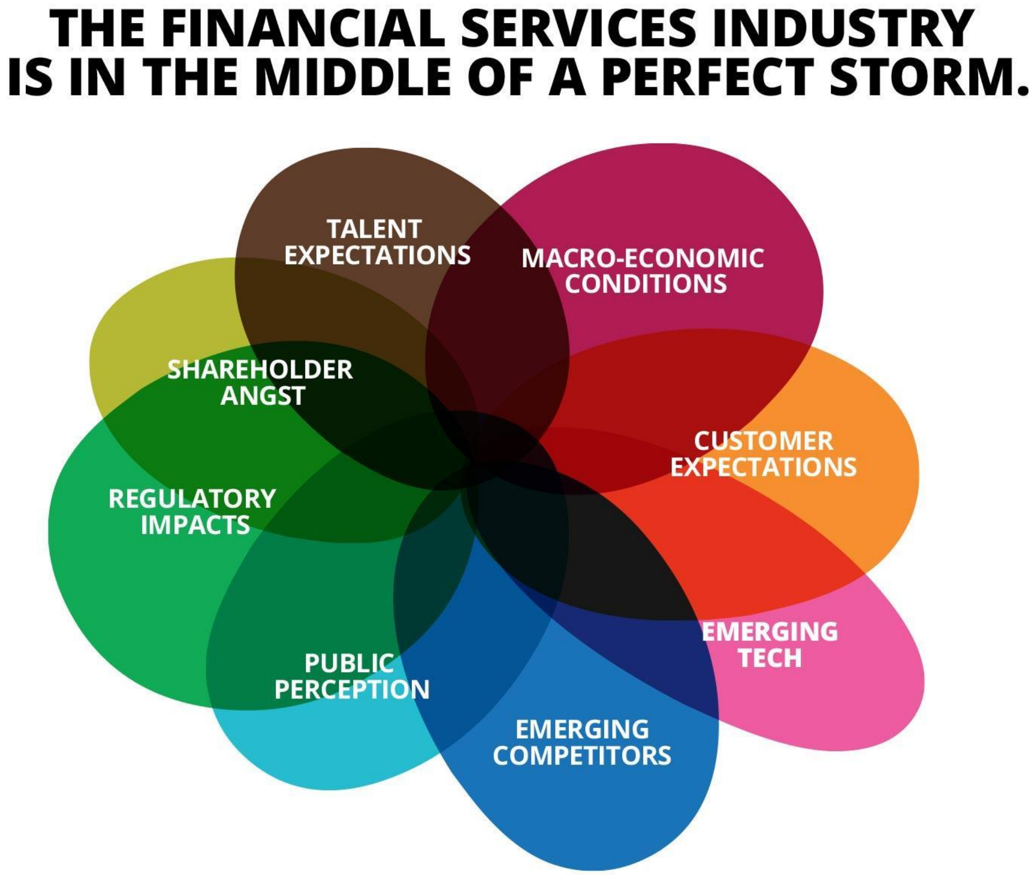
(ii) competition and efficiency, and

(iii) consumer protection and privacy.

The barbell outcome, for example, could present challenges in terms of stability with respect to both large and small payers. Widespread access to data raises privacy concerns. Regulators need to balance the innovation and efficiency brought by new entrants with the potential challenges for oversight, enforcement and consumer protection. Emerging policy approaches – such as new anti-trust rules for the digital era, data mobility requirements and data protection laws – may help to mitigate the policy trade-offs. Yet the responsibility for these changes generally lies with different public authorities, and with legislatures. To navigate this new territory effectively, and to balance the necessary policy goals, authorities will need to collaborate. This will need to occur both domestically – with cooperation between central banks, financial sector regulators, other industry regulators, and competition and data protection authorities – and across borders. Such collaboration can help to ensure regulatory consistency and peer learning within and between countries, and ultimately better development outcomes for the country.

### 5.3 Economic frictions and forces in financial services

Fundamentally, financial firms, like other firms, owe their existence to transaction costs (Baltensperger 1980). In the absence of complete trust between parties, market interactions on the production side and the customer side are characterized by risks, due eg to principal-agent challenges and incomplete or asymmetric information. Solving these to reduce risk and create trust imposes costs on both institutions and consumers, including contracting, search, and verification costs. For example, lending is characterized by information asymmetries ex ante, as lenders need to determine the risk profile of potential borrowers, and ex post, as they need to monitor the repayment capacity of borrowers (Dewatripoint and Tirole 1994). A fundamental feature of payment markets is the need to keep track of payment obligations, and to verify the identity of account holders or the veracity of payment tokens (Kahn and Roberds 2009). Different actors in the payment processing chain must trust that the other links will not expose them to fraud or liability, and customers require trustworthy counterparties with which to lodge funds and reliable processes for their delivery. Financial market investment and insurance are subject to uncertainty around future outcomes, adverse selection, and moral hazard.




**Financial Services in 2025**

Those creating investment products rely on sound underwriting and execution services to be able to offer a quality product to their customers. Customers in turn must be able to trust the soundness of the investments and of the operations that underlie their ability to buy and sell. As in other industries, internalization of activities within a single financial services firm overcomes principal-agent and asymmetric information challenges, to align interests and monitor actions. This ensures trusted interactions across teams. Linking deposit taking to lending enables close coordination of asset and liability management. Combining payments execution with account management allows the provider to confirm availability of funds before transfer instructions are balance sheet. Cross-selling loan products and insurance, and offering both asset and liability products, can create synergies and reduce costs. Economies of scope are further enforced by the demand side as many customers prefer a conveniently offered suite of products. This also reinforces the institution's role of gatekeeper to the customer.

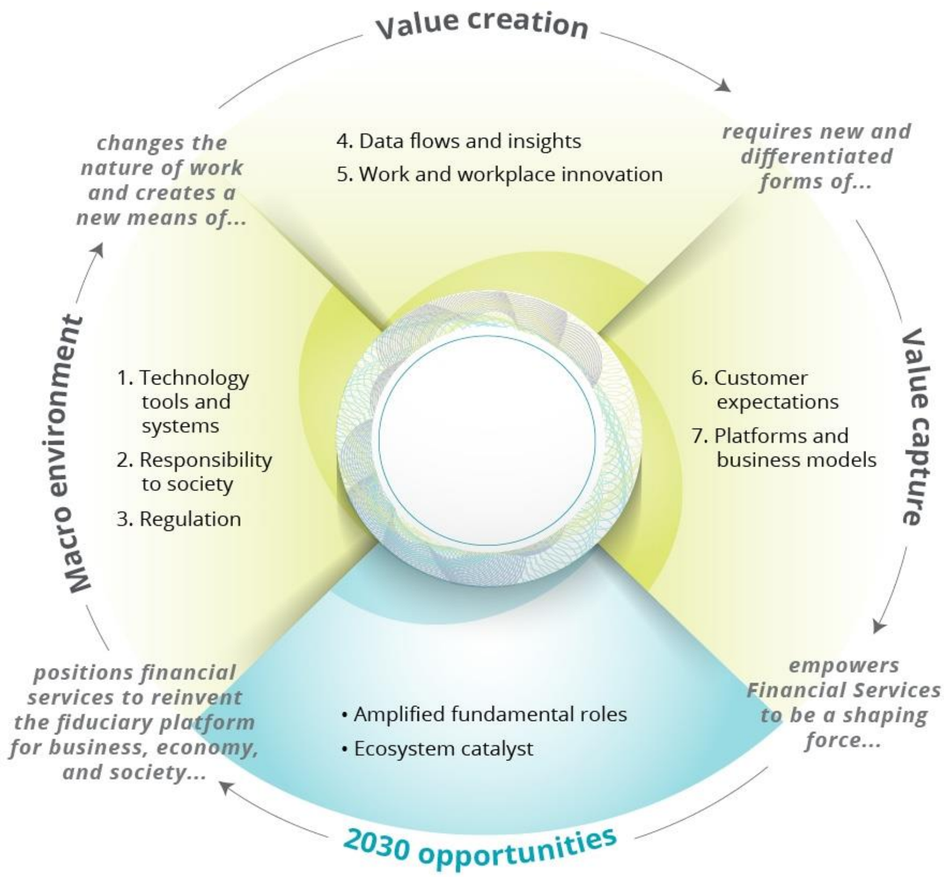
• Network effects. On the demand side, network effects (or "externalities") are significant in financial services such as payments, where the value of the network to all users (both payers and payees) increases when the number of connected users increases. A bank serving a business, suppliers and as well as its customers, could more efficiently connect counterparties to quickly transfer payments and provide working capital. Given the available technology and prevailing regulation, these forces have historically conferred advantages to "first movers" and large, vertically and horizontally integrated players. This has been particularly true for capital-intensive products such as lending, for institutions that put consumers' savings at risk such as deposit taking, and for capital and network-intensive areas such as payments.

## 5.4 The Impact of digital innovation on key economic frictions

The adoption of technology is not new in the financial sector, but a number of constraints had defined the operating environment until recently. In the late 20th century, the industry was already characterized by a relatively high degree of computerization since most financial services were dematerialized.3 Only payments frequently required physical cash or a check, and onboarding for new products and services often required in-person or paper-based processes. Still, reaching and connecting to customers routinely required physical infrastructure such as branches and automated teller machines (ATMs). Customers wishing to transact with counterparties using other banks had to use expensive and sometimes slow or risky processes such as wire transfers. Even after the advent of digital payment systems and the dematerialization of securities, connectivity remained a barrier to entry – an institution typically had to be licensed and part of the consortium of banks or brokerage houses to participate in a transactional network. Furthermore, data processing and storage were expensive, requiring the operation of bespoke mainframes and data centres. This limited the volume of information that could be gathered, stored, analysed, and exchanged to improve efficiency, better price risk, and tailor products to customer needs. Technology advances in connectivity, data processing, and storage Significant technology advances have taken place in two key areas that have contributed to the current wave of technology-based finance:

• Increased connectivity.

Internet and mobile technology have rapidly increased the ability to transfer information and interact remotely, both between businesses and directly to the consumer. Through mobile and smartphones, which are near-ubiquitous, technology has increased access to, and the efficiency of, direct delivery channels and promises lower-cost, tailored financial services.




**Future of financial**

This included data centres, front and back-office connectivity to core banking systems, branch automation, and interoperable payments networks connecting financial firms, including wire services, automated clearing houses (ACH), and ATM networks As of late 2019, GSMA estimated that there were more than 5 billion mobile subscriptions worldwide. Building on this user base, there were nearly one billion registered mobile money accounts. In principle, most financial services can be now delivered directly and digitally, vastly increasing access to finance. An emerging class of services and assets could in principle even be delivered without the need for an intermediary. At the same time, the rapid increase in connectivity has enabled large network effects and strengthened the position of established intermediaries offering mobile networks and subscriptions, such as telecom companies, particularly in some emerging market and developing economies (EMDEs).

Furthermore, the development of widely used applications and services like social media, search and social communication have enabled more peer-to-peer casual interactions. These are increasingly being tapped for economic interactions, as well. This has strengthened the position of the companies providing these services.

## 5.5 Implications for the industrial organization of the financial sector

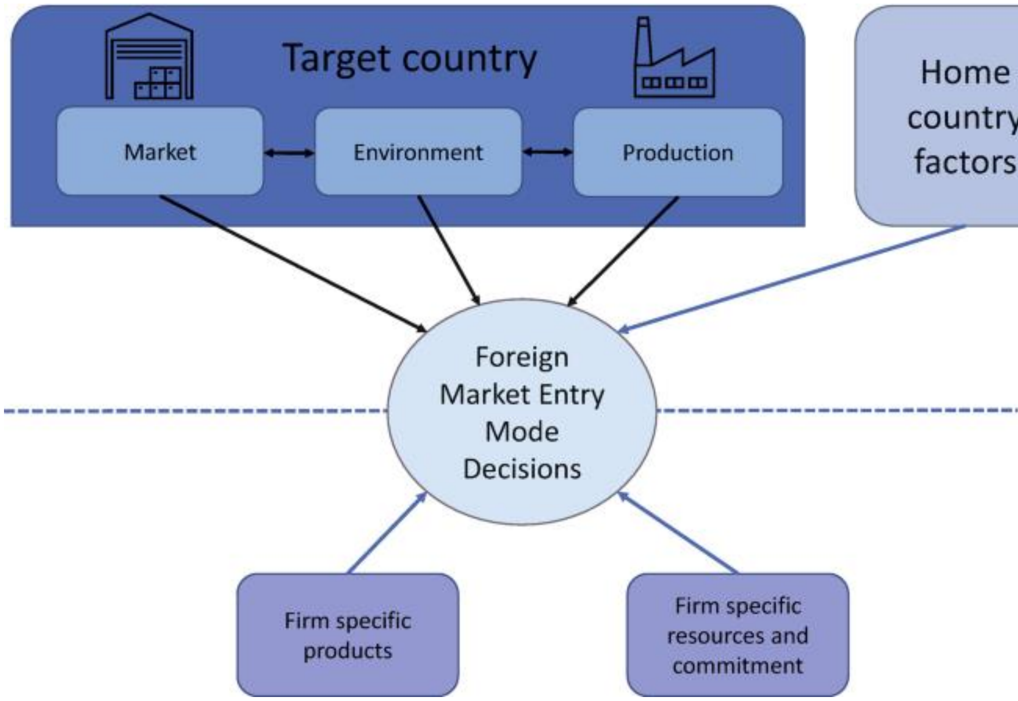
### Implications for market entry

Digital innovation has reduced cost barriers, allowing new and smaller players to enter. The elimination of many fixed costs and a reduction in variable and switching costs makes it possible for low-cost providers to enter the market, subject to local regulation. Although a trusted reputation must still be developed, small providers are more likely than in the past to be economically viable. Such new providers may strip away particular customer segments and revenue bases from traditional providers, or broaden access to finance for previously underserved segments, without needing to achieve large scale and scope. Apps and cloud-based computing and software platforms have enabled entrepreneurs to quickly bootstrap without the need to raise huge amounts of capital to finance massive upfront investments. APIs and open banking initiatives have the potential to further accelerate this trend, since a new service need not wrench the customer completely away from the incumbent, and can therefore build trust by layering a service on top of the safety net provided by legacy institutions.

Infrastructure connectivity and a reduced need for physical branches allow established companies from other sectors to offer financial services as well. These entrants can deploy automated processes in lieu of hiring a specialized workforce, connect to the financial transactions infrastructure, and leverage cloud-based infrastructures to reduce the cost of cross-market entry. For many of these new providers, such as digital platform companies and some telecoms, consumer trust and a customer base are already established in their core markets and potentially transferable to the financial sector (Oliver Wyman 2019). Some are able to combine financial services with other products or core capabilities as part of a platform offering. This is particularly relevant in EMDEs where the financial system is less developed and access to financial services is more limited. This affords fintechs and big techs more room to expand their financial activities and compete with incumbents (FSB 2020).


**Marketing Method**

Entry into financial services is accelerated by the ability to turn regulatory compliance into a technology integration process. Several banks have built BaaS platforms to serve fintechs and even other banks. They can connect these clients to the payment system or a bank balance sheet, thus reducing the need to deal with the complexities of licensing, regulation, and developing their own core banking systems. Leveraging BaaS, new entrants can tap into existing – and already regulated – financial transactions and balance sheet providers. Where open banking is in force, they can also leverage the data, and sometimes functionality, of existing financial accounts. This allows a wider range of use cases into which finance can be embedded; in particular, a range of commercial platforms or transactional situations can layer on a financial service from a BaaS provider without much of the systems and compliance overhead previously required. While increasing competition, this multi-faceted and multi-tiered access to the regulated banking sector introduces new challenges for regulators and supervisors, as discussed below.




**Foreign Market entry**

**Shifting economies of scale and scope**

However, basic economic forces remain relevant. Economies of scale and scope remain, even as the minimum efficient scale for service delivery is lower for the individual user and for most financial services providers. That has been accomplished in part by shifting the scale effects to the infrastructure providers; scale remains highly relevant in areas of cloud computing and data processing and software platforms. In fact, new forms of scale have emerged in connectivity and computing, along with previously present economies of scale in capital, including reputation, or ”trust capital.”

In the digital finance era, economic frictions have not disappeared, but take on new forms. The costs of services have been reduced in many cases, but certainly not eliminated. Financial services providers, particularly new non-bank providers, face two important costs in the unbundled marketplace:


**Digital Marketing Methods**

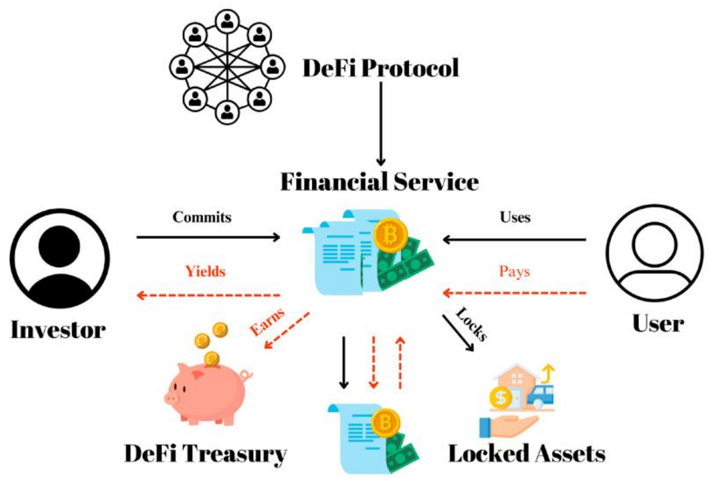
• Customer acquisition costs. Customer acquisition costs, comprising marketing, onboarding, KYC, and initial credit assessment, remain significant relative to revenues, especially for retail financial services. This is partly due to regulatory requirements, but marketing and other onboarding costs remain pertinent even when remote interactions are possible (eg leveraging e-KYC). While technology has made it easy to directly reach users digitally, the cost to acquire new customers remains high because of user inertia, which is particularly present in retail and SME business lines. Customer acquisition costs are also significant for wholesale customers, as systems integration and business process changes may be cumbersome, and initial credit assessment is more complex. Amortizing these and other fixed costs across more customers and products allows for economies of scale and scope. This naturally puts larger incumbents and big techs at an advantage.

• Funding costs. As noted above, some products have natural complementarities that reduce the cost of providing one or the other product if offered in tandem. Most clearly, offering loans is more economical if there is a cheap source of funding in the form of deposits. There are other complementarities in derivatives, stock lending, insurance, etc. Size, and the diversification it brings, can provide a funding advantage due to lower risk, and greater liquidity of traded funding instruments (bonds, shares) issued at scale. In general, big tech firms have a higher overall cost of funding than global systemically important financial institutions (G-SIFIs) because they use more equity and have no deposits. However, when analysing similar funding components (ie bonds) big techs tend to have a lower cost at issuance

### 5.6 Decentralized Finance (DeFi) and Cryptocurrencies

Decentralized finance (DeFi) is an emerging model for organizing and enabling cryptocurrency-based transactions, exchanges and financial services.

DeFi's core premise is that there is no centralized authority to dictate or control operations. It's a different approach than the traditional models of finance for fiat currency or centralized finance (CeFi) within the cryptocurrency markets. With centralized models, there is a core foundational authority that can influence and control the flow of transactions. The central authority often is also responsible for custody of assets.




**DeFi Structure**

With DeFi, there is no central authority. Instead, authority is distributed in a decentralized approach that is intended to provide more power and control to individuals. In the DeFi model, all transactions for buying, selling, loans and payments with cryptocurrency can occur without a central authority in a peer-to-peer (P2P) approach.

Custody of assets is a fundamental component of any financial model. In the DeFi approach, individual traders have control over the private cryptographic encryption keys, which enable custody of cryptocurrency assets. Financial transactions within the DeFi model are enabled with smart contracts that are often supported on Ethereum-based blockchains.

### *How does DeFi work?*

DeFi relies on the use of a blockchain, which is often based on Ethereum in many DeFi operations.

A blockchain is a form of immutable distributed ledger that cryptographically secures entries, which are used for transactions. Blockchains are also the basis of cryptocurrencies, which are tokens that are created in a blockchain that have value.

With an Ethereum-based blockchain, smart contracts help the DeFi model work. A smart contract is an application that runs on a blockchain using the inherent distributed ledger and cryptographic encryption capabilities. The smart contract specifies terms and conditions for the execution of a given operation.

Instead of a central authority enabling a transaction to occur, a smart contract is programmatically enabled to perform the financial transaction that is specified in the contract. A smart contract can hold cryptocurrency assets that can be sent from one entity to another.

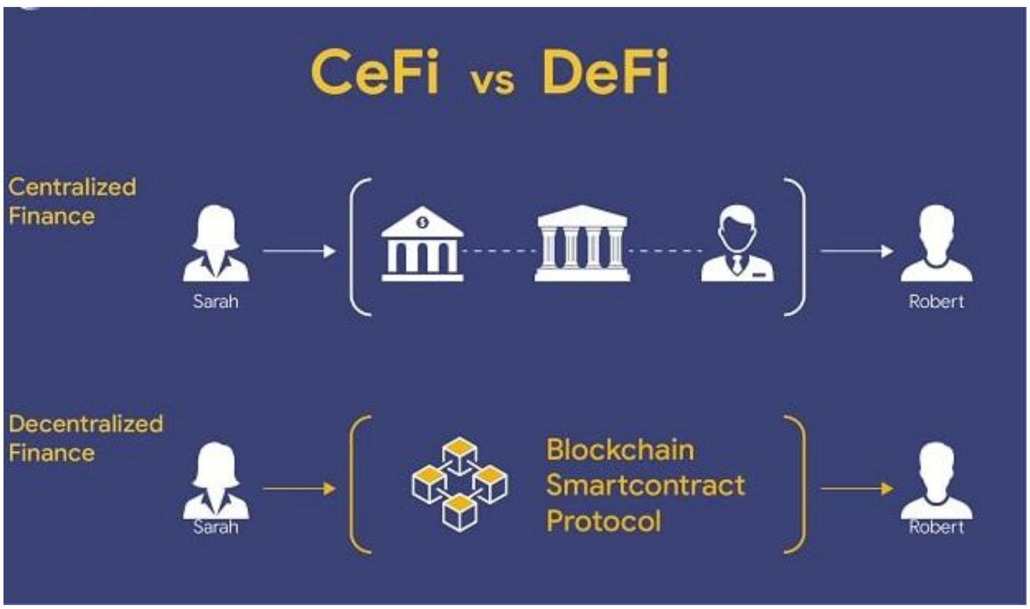
With DeFi smart contracts, the terms and conditions of a transaction are also transparent and available as code, which means they are viewable by others to audit and analyze. There is no need for a central authority to enable a smart contract with DeFi as the system works in a P2P model. As such, if two peers can agree to execute a transaction, it can be done without the need for a third-party central authority.

Within the DeFi model and its usage of smart contracts, there is an emphasis on empowering the individual user. Cryptocurrency asset custody relies on control of both private and public encryption keys. With the decentralized approach, custody in the form of the private cryptographic encryption keys are held by the individual.

*CeFi vs. DeFi*

With cryptocurrency-related financial services, there are two prevailing models in use today with CeFi and DeFi. When comparing CeFi vs. DeFi, it's important to note that there are similarities and differences between the two approaches.

Both models enable traders to buy, sell and loan cryptocurrency assets and have a concept of an exchange that can help to facilitate transactions. Blockchain-based technologies are also central to both CeFi and DeFi models.



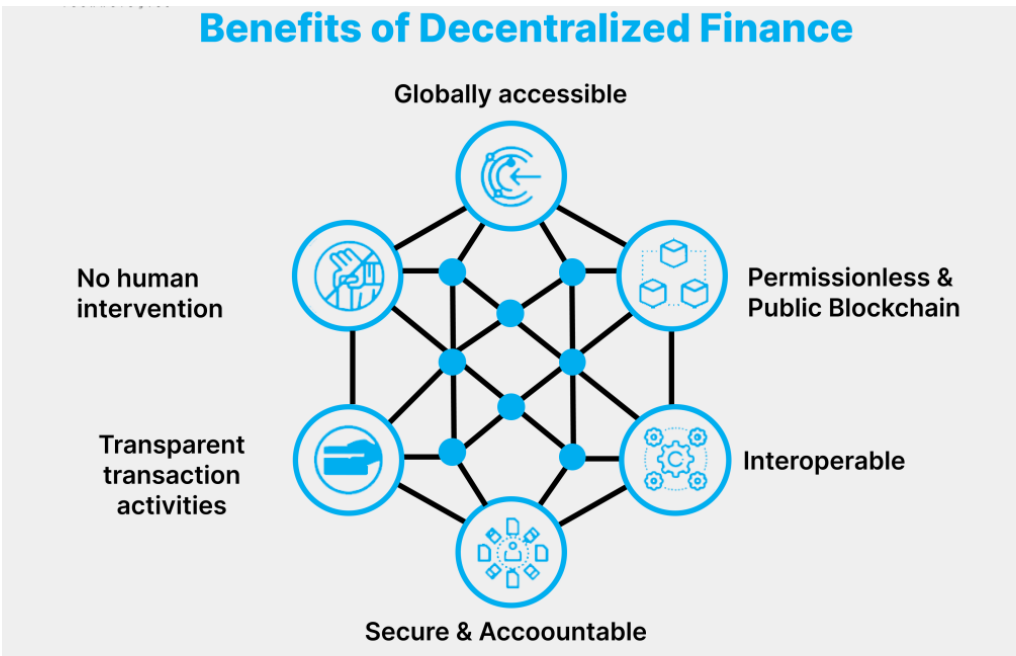

CeFi vs. DeFi

The two approaches differ with dramatic results in organization and management. The CeFi model relies on a central authority to govern transactions. The central authority also holds custody over assets.

In contrast, the DeFi approach relies on smart contracts and a P2P decentralized approach to enable financial services. Instead of asset custody being the responsibility of the centralized exchanges, it is the individual users that hold custody of their own cryptocurrency assets.

### *Benefits of DeFi*

DeFi offers users a number of benefits that can help to improve confidence, security and trust in cryptocurrency-based transactions and applications, including the following:




**Benefits of DeFi**

**Decentralized.** Because it's decentralized, DeFi is not subject to the inherent risks with CeFi, where the failure of an exchange can lead to a complete collapse and loss of user funds and accounts.

**Permissionless.** As a decentralized model, there is no need for a central authority to approve or enable a transaction. Instead, the model is permissionless as the programmatic logic of smart contracts defines what is possible.

**Transparency.** The smart contract model can enable users to understand the terms and logic of a transaction in a transparent model without hidden code.

**Anonymity.** While smart contracts can be transparent on the blockchain, there is no need or requirement for users to be identified. With DeFi, Know Your Client requirements, which are common with centralized and regulated models, do not specifically apply.

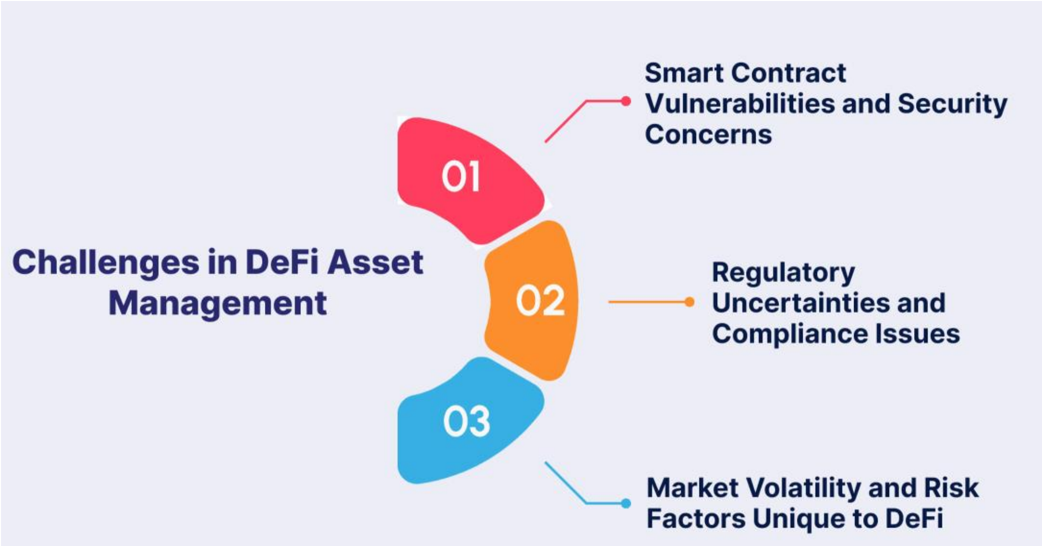
**Custody.** In DeFi, users control assets, and custody of the cryptographic private key for cryptocurrency tokens is held by the user.

**DApps.** DeFi supports dApps, in which users can benefit from financial services applications and other use cases, such as gaming and social media.

**Fees.** Without a central authority, DeFi provides users with the promise of lower fees than transactions executed in the CeFi model.

***Challenges of DeFi***

While DeFi has its fair share of benefits, it also has several potential challenges, including the following:




**Challenges of DeFi**

**Complexity.** The perceived complexity of DeFi is likely the model's biggest challenge. DeFi works in a P2P model, with smart contracts and sophisticated algorithms that can be difficult to fully understand for the uninitiated. That complexity can also lead to confusion about how a service or application works.

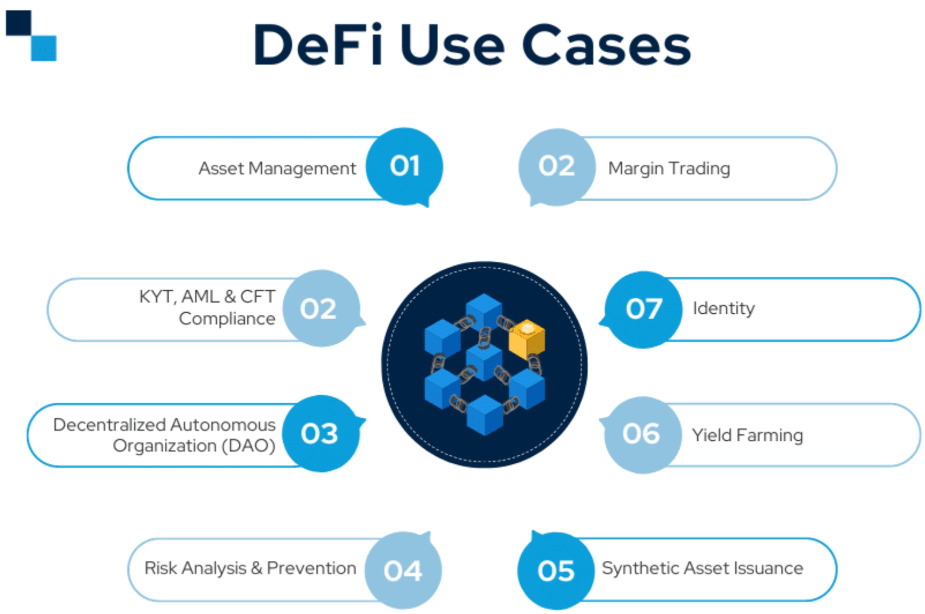
**Customer service.** Without a central authority or service to ask for help, customer service with DeFi can often be a challenge.

**Volatility.** There can potentially be more volatility in DeFi approaches as there is no moderating central authority to control or limit transaction or market momentum.

**Security.** In recent years, DeFi platforms have increasingly been targeted by attackers. A Federal Bureau of Investigation alert issued in August 2022 warned that over $1 billion in assets had been stolen in just a three-month period.

***Uses of DeFi***

There are a broad range of use cases where DeFi is being implemented today, including the following:




**Uses of DeFi**

**Payments.** DeFi can enable P2P payments without the need for a central authority.

**Lending.** The ability to lend and borrow cryptocurrency assets is a common use case for DeFi.

**NFTs.** Non-fungible tokens enable users to own tokens that can be traded.

**Stablecoins.** An increasingly common use of DeFi is stablecoins. The purpose of a stablecoin is to help limit the volatility of cryptocurrency by pegging the value of a coin to another asset, commodity or currency.

**Yield farming.** For those using DeFi as an investment vehicle, yield farming enables individuals to gain interest income on cryptocurrency assets.

**DApps.** DApps run on DeFi and enable multiple types of use cases, including financial services and gaming.

There are multiple DeFi services and platforms available today, including the following:

**Avalanche.** Avalanche is a proof of stake blockchain for supporting DeFi smart contracts. It also has its own token with the AVAX cryptocurrency.

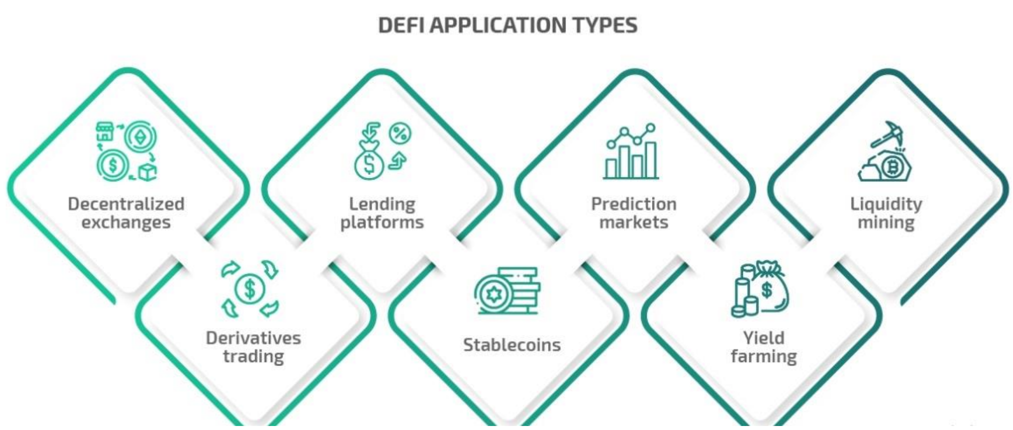
**DYdX.** DYdX is a DEX that enables cryptocurrency trading.

**Index Cooperative.** Index provides several capabilities, including the DeFi Pulse Index, which tracks the performance of DeFi assets and cryptocurrencies.

**MakerDAO.** MakerDAO is a decentralized autonomous organization for governing cryptocurrency operations and created the Dai stablecoin, which is linked to the U.S. dollar.

**TrueFi.** TrueFi provides a lending credit protocol, as well as the TRU token.


**Use Cases of DeFi**




**Application of DeFi**


**Benefits of DeFi**

## 5.7 ESG (Environmental, Social, Governance) and Ethical Investing

ESG Investing (also known as “socially responsible investing,” “impact investing,” and “sustainable investing”) refers to investing which prioritizes optimal environmental, social, and governance (ESG) factors or outcomes. ESG investing is widely seen as a way of investing “sustainably”—where investments are made with consideration of the environment and human wellbeing, as well as the economy.1 It is based upon the growing assumption that the financial performance of organizations is increasingly affected by environmental and social factors.

The principles of ESG investing are nothing new. Hundreds of years ago, religious and ethical beliefs influenced investment decisions. Muslims established investments that complied with Sharia law, which included prohibitions on weapons. The first ethical unit trusts in the US and UK were developed by Quakers and Methodists.Today, the growing prominence of corporate social responsibility (CSR) and social sustainability has led to increased investor awareness about ethical participation in the market. ESG investing may have officially entered mainstream investing discourse following the release of the Principles for Responsible Investments (PRI)4 in 2006 – a set of United Nations guidelines for the incorporation of ESG factors into business policy and strategy. The PRI have over 2,000 signatories and are widely considered the official point of reference for all things ESG investing.

### *The ESG Investing Boom*

Recent years have seen a significant expansion of ESG investing around the globe as organizations and individuals increasingly recognize the interdependencies between social, environmental, and economic issues.6 The COVID-19 pandemic encouraged this trend notably.7 Market disruption and uncertainty caused by the pandemic in 2020 led many investors to turn to ESG funds for increased resiliency. In fact, the first three months of 2020 saw $45.6 billion USD flow into these funds globally.8 $30.7 trillion currently sits in sustainable investment funds worldwide, and it is predicted this could rise to around $50 trillion in the next two decades.9 More investors are looking to fund organizations and products that support and promote sustainability, and comply with emerging regulations such as climate change regulations. This demand has been met with increased action on ESG issues in the business world, as well as progressively higher returns on investment for ESG funds due to their resilience against conventional market disruptions.10 Portfolios incorporating ESG and sustainability also frequently perform better in the long-term than those that don’t.11 For example, US financial services firm Morningstar found that over a period of 10 years, 80% of blend equity funds investing sustainably outperform traditional funds.12 They also found that 77% of ESG funds that existed 10 years ago have survived, compared with 46% of traditional funds.

This boom in ESG investing can be attributed to a range of factors. As supply chains become more complex, there is a wider awareness of social, labor, and human rights issues and risks for the business world.13 Growing concern for environmental issues such as climate change also influence investor decisions. The heightened engagement of groups previously less involved in traditional investing—particularly young people and women—is also thought to have contributed to the ESG investing boom.14 To reflect these evolving societal values and norms, it is important that organizations adopt forward-looking ESG practices if they want to remain competitors in their industry and contribute to the common good.

Industries that are slow to uptake these changes receive increasing criticism and pressure from stakeholders, investors, and concerned citizens alike. Legal obligations are also expected to progressively tighten for these industries. In May 2021, a Dutch court ruled that Royal Dutch Shell cut greenhouse gas emissions by 45% by 2030.15 In the same week, ExxonMobil and Chevron faced pressure from their shareholders to reduce the companies' contributions to climate change. It is likely these events will spark further transformations within these industries.

***What topics fall under ESG and how are they rated?***

ESG issues cover a variety of topics that are applicable to all industries and organizations in one way or another. While the avoidance of "sin stocks" was traditionally considered central to investing ethically, ESG investing entails a broader scope of issues, including:


**ESG**

Organizations' efforts to mitigate climate change and other environmental disasters such as biodiversity loss. For example, have they achieved or are they on the way to achieving net-zero emissions?

Human rights issues within an organization's supply chain. For example, have they published a Modern Slavery Statement or disclosed supply chain details within annual reports?

Workplace diversity and equal opportunities. For example, what proportion of the organization's employees identify as underrepresented groups? How diverse is management? Is there equal representation at the executive and C-suite levels?

It is important to note, however, that sustainable investing has been around for years. In fact, our firm has deployed some aspects of these strategies for more than two decades. If ESG factors are utilized in a balanced and structured way, they supplement fundamental analysis to help investors make better investment decisions.

Utilizing ESG factors is consistent with being an active owner of capital, because ESG factors:

- ✓ Promote corporate accountability
- ✓ Expand decision-making information
- ✓ Increase attention on the long-term
- ✓ Incorporate the importance of ethical business practices
- ✓ Our Sustainable Investing Approach

While the nomenclature has become more streamlined, the terms used to describe the ways in which investors can align their investments with their values has changed over the years. Today, the broadest term is "sustainable investing," which describes the entire spectrum of strategies that seek to make a positive impact in the workplace, community, society, or the planet.

We offer four ways to engage within the sustainable investing framework:

**ESG Integrated Portfolios** are diversified across asset classes and focused on investments and funds with high ESG ratings and proactive ESG strategies. They are designed for clients interested in pursuing a proactive ESG strategy while also achieving investment returns consistent with standard benchmarks. These portfolios span a range of risk profiles and have historically produced returns consistent with our standard portfolios.

**Exclusionary Screening** allows investors to eliminate certain investments from consideration in their portfolios, such as companies that may be negatively impacting the environment or society. Depending upon their preferences, investors who do not want to invest in such companies can utilize these negative screens to avoid businesses involved in activities such as fossil fuels, tobacco, alcohol, firearms, and gambling.

**Thematic Investing** enables investors to proactively support specific issues that are important to them while also generating investment returns. Investors seeking to make a positive change on a particular issue can choose thematic investing to create a strategy highlighting issues such as energy efficiency, clean water, or improving access to healthcare, educational opportunities, or housing.

**Impact Investing** seeks to ensure that investment capital is not only aligned with the investor's values but is also producing tangible positive environmental or social impact. Examples of impact investments can include micro-financing to minority-owned small businesses or owning social impact bonds, where the return on investment will vary based on the achievement of an agreed-upon and measurable outcome.

***How ESG aligns with our principles***

Given the potential for ESG factors to impact investment returns, we incorporate ESG factors in all our investment decisions. Our investment process is predicated on several core beliefs, and we believe sustainable investing fits neatly within these principles:

**Managing Risks**

A central tenet of our philosophy holds that investment success is not about what you make, but what you keep. This principle can be achieved through careful construction of a client's portfolio to maximize returns relative to the level of risk that is most appropriate for them, and ESG factors can play a meaningful role in managing that risk.

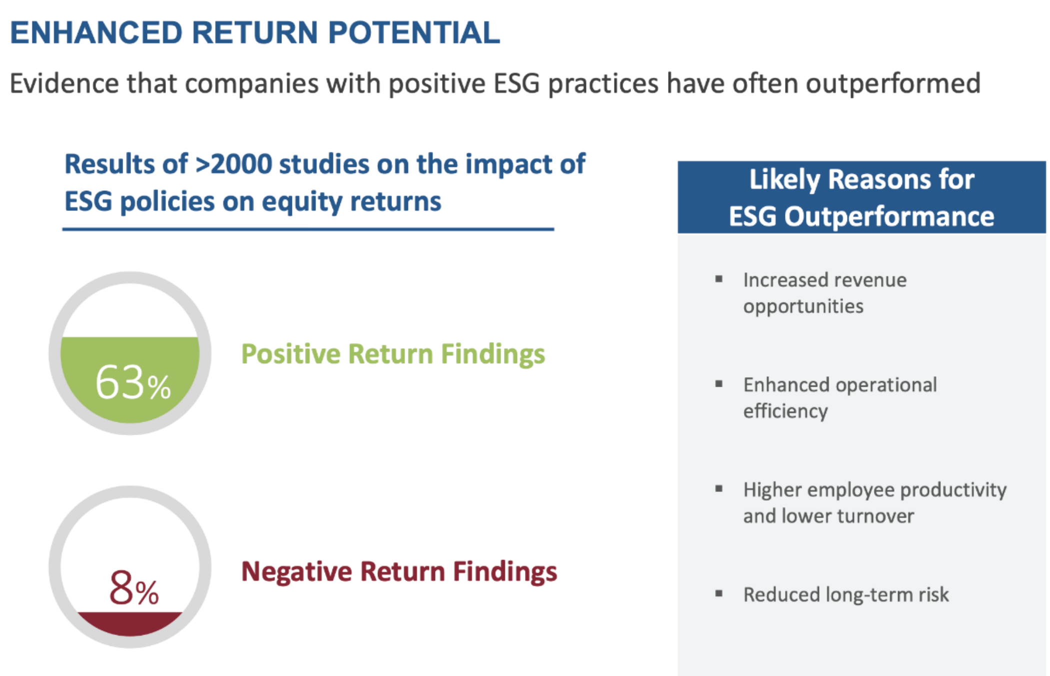
When it comes to risk management, the more data we can access, the better. While traditional analysis helps identify risks at an economic, industry, and company level, ESG factors can measure long-term risks associated with owning assets that may be vulnerable to climate change, for example. This is particularly useful in helping assess companies with long-lived assets, such as industrial and infrastructure companies; as well as long-term obligations, such as insurers and other financial institutions. The growing frequency of floods, droughts, and extreme weather associated with global warming is something that must be considered by insurers, utilities, real estate and logistics companies, and even tech and pharmaceutical manufacturers having physical plants in regions affected by storms.

By weighing such factors, companies can account for contingent liabilities, mitigating surprises owing to future asset impairments caused by environmental or governance issues.

**Prioritizing Financial Returns**

During the early years of sustainable investing, there was a misconception that seeking to make a positive environmental or social impact required compromising on financial returns. Today, however, it is widely understood that ESG strategies do not necessarily require investors to sacrifice competitive returns. A meta study found that 90% of the more than 2,200 individual studies conducted on this subject found no negative relationship between sustainability goals and financial returns.4 In fact, the majority of this research — 63% — found a positive relationship between sustainable strategies and investor returns.

Why might prioritizing environmental and social impact lead to better investment performance? There are several theories: first, environmental factors are, by definition, long-term considerations, as global warming risks unfold over the span of years, not quarters. As a result, managers and investors focusing on the "E" in ESG tend to be long-term minded. At the same time, companies that adhere to fair treatment of workers and customers — the "S" in ESG — are likely to experience lower employee turnover and greater productivity, potentially leading to greater operational efficiencies. And companies that focus on the "G," higher governance standards, are likely to embrace greater corporate accountability and transparency, reducing risks associated with unethical behavior or limited perspective.




Source: Gunnar Friede et al., "ESG and financial performance: Aggregated evidence from more than 2000 empirical studies," *Journal of Sustainable Finance & Investment,* October 2015, Volume 5, Number 4, pp. 210-33: Deutsche Asset & Wealth Management Investment, McKinsey analysis, Fiduciary Trust Company

## Prioritizing Financial Returns

An organization's performance against ESG issues helps stakeholders make key decisions, and there are many tools available to measure or report on ESG performance. Some of the most popular include CDP, the Global Reporting

Initiative (GRI), the Task Force on Climate-related Financial Disclosures (TCFD), and EcoVadis. These groups help companies measure and report on performance in a range of areas including governance, climate-related risks and opportunities, emissions, resource management, procurement, engagement strategy, and many others.


**ESG Metrics**

Some other platforms commonly used by investors to determine company ESG ratings include the Dow Jones Sustainability Index (DJSI), Morgan Stanley Capital International (MSCI), FTSE4Good, and ISS ESG solutions. These indices tend to be more investor-oriented, providing succinct metrics about a company's financial performance. However, there are an abundance of ESG indices, frameworks, and standards; organizations can choose to report or align to, and each should perform its own assessment of which best suit their goals and investor preferences to optimize their ESG reporting.

## 5.8 Impact of Global Events and Economic Policies

Global events and economic policies play a crucial role in shaping financial markets, influencing investor sentiment, asset prices, and overall market stability. Here’s how different factors impact the markets:

### *1. Global Events and Their Market Impact*

a) Geopolitical Events (Wars, Conflicts, and Trade Wars)

**Stock Market Volatility**: Political tensions and conflicts often lead to market downturns due to uncertainty.

**Commodity Price Fluctuations**: Wars and trade disputes can impact oil, gold, and other commodities (e.g., Russia-Ukraine war causing oil price surges).

**Currency Instability**: Sanctions and economic blockades can weaken national currencies.

b) Pandemics and Health Crises

**Economic Slowdowns**: COVID-19 caused global recessions, supply chain disruptions, and increased government debt.

**Tech and Healthcare Boom**: Sectors like pharmaceuticals and digital services saw rapid growth.

**Central Bank Interventions**: Interest rate cuts and stimulus packages were used to stabilize economies.

c) Natural Disasters and Climate Change

**Insurance and Infrastructure Costs**: Increased spending on disaster recovery impacts financial planning.

**Shift Towards ESG Investing**: Investors prioritize green investments to address climate risks.

**Supply Chain Disruptions**: Hurricanes, floods, and wildfires affect global production and trade.

***2. Economic Policies and Their Market Influence***

a) Monetary Policy (Central Bank Actions)

**Interest Rate Adjustments**:

Higher rates → Costlier borrowing, stock market decline.

Lower rates → Cheaper loans, stock market growth.

**Quantitative Easing (QE)**:

Central banks inject liquidity → Boosts asset prices (e.g., post-2008 financial crisis).

**Inflation Control Measures**:

High inflation → Market corrections, decreased purchasing power.

Low inflation → Stable economic growth, steady markets.

b) Fiscal Policy (Government Spending and Taxation)

**Stimulus Packages**:

Increases consumer spending, boosts corporate earnings (e.g., US COVID-19 relief programs).

**Tax Policies**:

Higher corporate taxes → Reduced profits, lower stock prices.

Tax cuts → Business growth, investor confidence.

c) Trade Policies and Tariffs

**Trade Wars & Sanctions**:

Disrupt global supply chains (e.g., US-China tariffs affecting tech & manufacturing sectors).

**Free Trade Agreements**:

Boost market confidence, encourage cross-border investments.

d) Currency and Exchange Rate Policies

**Strong Dollar vs. Weak Dollar**:

Strong dollar → Hurts exports, benefits imports.

Weak dollar → Boosts exports, increases inflation risks.

**Foreign Exchange Reserves**:

Countries adjusting forex policies can impact capital flows (e.g., China's yuan management).

***3. Future Considerations***

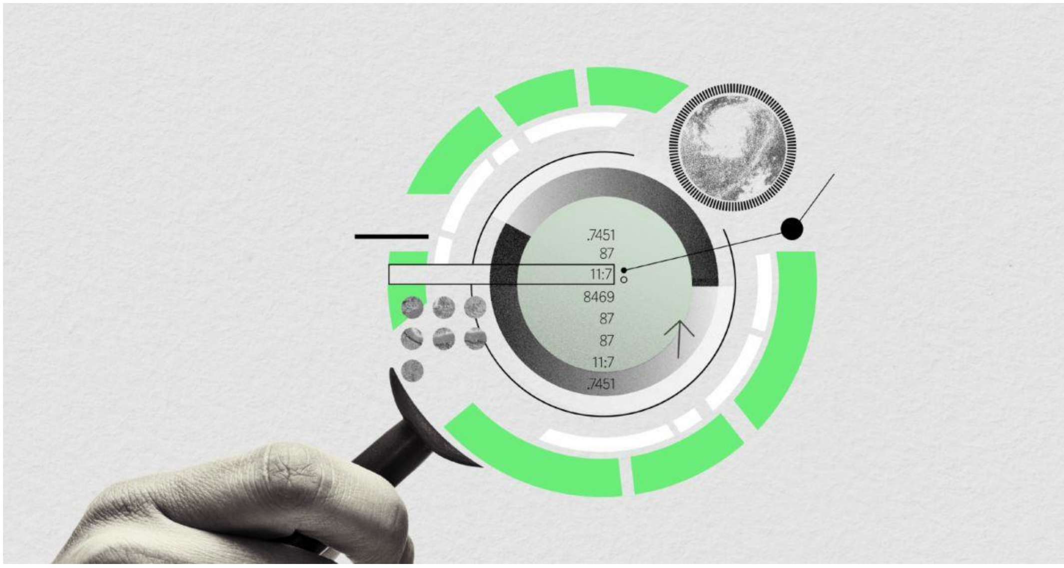
**AI & Automation in Financial Markets**: Faster reactions to global events through algorithmic trading.

**Rise of Digital Currencies**: Central Bank Digital Currencies (CBDCs) could reshape monetary policies.

**Global Debt Crisis Risks**: High government debt levels could lead to future financial instability.

**Socio-**


**Economic Impacts and Challenges**




**Global Weekly Economic Update**

In today's interconnected world, global events have a significant impact on Indian policies. Understanding this connection is crucial for UPSC aspirants, as it helps them grasp how international dynamics shape national decisions. This article explores various aspects of global events and their influence on Indian policies, providing insights that are essential for effective preparation for the UPSC exams.

## Key Takeaways

- ✓ Global economic trends heavily influence India's financial strategies.
- ✓ International relations play a key role in shaping India's foreign policy.
- ✓ Environmental challenges prompt India to adopt sustainable practices.
- ✓ Technological advancements drive policy changes in various sectors.
- ✓ Social movements globally affect policy reforms in India.

## Impact of Global Economic Trends on Indian Economic Policies

### Influence of Global Recession on Indian Economy

The global recession has a significant impact on the Indian economy. During economic downturns, India often faces reduced demand for its exports, which can slow down growth. For instance, when global markets shrink, Indian industries may see a drop in orders, leading to lower production and job losses. This situation forces the government to adjust its economic policies to stimulate growth and protect jobs.

**Role of International Trade Agreements**

International trade agreements play a crucial role in shaping India’s economic policies. These agreements help India access new markets and attract foreign investment. For example, agreements with countries like the USA and Japan have opened doors for Indian businesses. Such partnerships are vital for enhancing trade and boosting the economy.

**Adaptation to Global Financial Regulations**

As the world becomes more interconnected, India must adapt to global financial regulations. This includes complying with standards set by organizations like the International Monetary Fund (IMF) and the World Bank. Adapting to these regulations helps India maintain its credibility in the global market and ensures that it can attract foreign investments.

**Environmental Challenges and Indian Policy Responses**

**Global Climate Change Agreements and India**

India is a key player in global efforts to combat climate change. The country has signed various international agreements aimed at reducing greenhouse gas emissions. India’s commitment to the Paris Agreement showcases its dedication to sustainable development. The government has set ambitious targets to increase the share of renewable energy in its energy mix.

**India’s Renewable Energy Initiatives**

India is rapidly expanding its renewable energy capacity. The government aims to achieve 500 GW of non-fossil fuel capacity by 2030. Some key initiatives include:

- ✓ Solar Energy: The National Solar Mission aims to promote solar power generation.
- ✓ Wind Energy: India is one of the top countries in wind energy production.
- ✓ Hydropower: Investments in hydropower projects are increasing to harness water resources.

**Policy Measures for Biodiversity Conservation**

Biodiversity is crucial for ecological balance. India has implemented several policies to protect its rich biodiversity, including:

- ✓ Wildlife Protection Act: This act aims to protect endangered species and their habitats.
- ✓ National Biodiversity Action Plan: A comprehensive strategy to conserve biological diversity.
- ✓ Protected Areas Network: Establishing national parks and wildlife sanctuaries to safeguard ecosystems.

The aim of these policies is to ensure that India’s natural resources are preserved for future generations while promoting sustainable development.

In conclusion, India is actively responding to environmental challenges through various policies and initiatives. The focus on renewable energy and biodiversity conservation reflects the country's commitment to a sustainable future.

**Highlight: environmental issues and challenges**

**Technological Advancements and Policy Shifts in India**

**Impact of Global Tech Trends on Indian IT Sector**

India is experiencing a significant transformation in its information technology sector. The rise of artificial intelligence (AI), the Internet of Things (IoT), and 5G technology is reshaping the landscape. These advancements are not just changing how businesses operate but also influencing government policies. The Indian government is focusing on creating a robust digital infrastructure to support these technologies.

**India's Approach to Cybersecurity**

As technology evolves, so do the threats associated with it. India is prioritizing cybersecurity to protect its digital assets. The government has introduced various initiatives to enhance cybersecurity measures, including:

- ✓ Establishing a national cybersecurity policy.
- ✓ Promoting awareness and training programs.
- ✓ Collaborating with international organizations to strengthen defenses.
- ✓ Role of Innovation in Policy Making

Innovation plays a crucial role in shaping policies in India. The government encourages startups and research institutions to develop new technologies that can address local challenges. This focus on innovation is essential for sustainable development. The following points highlight the importance of innovation in policy making:

- ✓ Encourages economic growth through new job creation.
- ✓ Enhances efficiency in public services.
- ✓ Fosters a culture of research and development.

The integration of technology in governance is vital for improving transparency and accountability in public services.

In conclusion, as India navigates through the technological advancements, it is essential for policies to adapt and evolve to harness the full potential of these innovations. The connection between global tech trends and Indian policies is crucial for the country’s growth in the digital age.

## Global Health Issues and Indian Healthcare Policies

### Response to Global Pandemics

India has faced several global health challenges, especially during pandemics like COVID-19. The government implemented various measures to control the spread of the virus. These measures included lockdowns, vaccination drives, and public awareness campaigns. The response was crucial in managing the health crisis and ensuring the safety of citizens.

### India’s Participation in International Health Initiatives

India actively participates in international health initiatives, collaborating with organizations like the World Health Organization (WHO). This involvement helps India align its health policies with global standards and practices. For instance, India has been part of initiatives aimed at combating diseases like tuberculosis and malaria, showcasing its commitment to global health.

**Policy Reforms in Indian Healthcare System**

The Indian healthcare system has undergone significant reforms to address both local and global health issues. Key reforms include:

- ✓ Strengthening public health infrastructure to better respond to health emergencies.
- ✓ Increasing funding for healthcare to improve access and quality of services.
- ✓ Implementing digital health solutions to enhance healthcare delivery.
- ✓ Cultural Globalization and Its Influence on Indian Society

Cultural globalization refers to the worldwide exchange of ideas, values, and cultural elements. This phenomenon has a significant impact on Indian society, leading to both positive and negative effects.

**Preservation of Indian Cultural Heritage**

Cultural heritage is vital for maintaining India's identity. Efforts are being made to preserve traditional art forms, languages, and customs.

Organizations and communities are working together to promote local festivals and crafts, ensuring they are not overshadowed by global trends.

Educational programs are being introduced to teach younger generations about their cultural roots.

**Impact of Westernization on Indian Youth**

The influence of Western culture is evident in various aspects of life, including fashion, music, and lifestyle choices.

Many young people are adopting Western values, which can lead to a shift in traditional family structures and social norms.

This shift can create a sense of identity crisis among youth, as they navigate between traditional Indian values and modern global influences.

**Role of Media in Cultural Exchange**

Media plays a crucial role in shaping perceptions and facilitating cultural exchange. It can promote both local and global cultures.

Social media platforms allow for the rapid spread of cultural trends, making it easier for Indian youth to connect with global peers.

However, this can also lead to the homogenization of culture, where unique Indian traditions may decline as global symbols and customs become more widespread.

In conclusion, while cultural globalization brings opportunities for exchange and growth, it also poses challenges to the preservation of India's rich cultural diversity. Balancing these influences is essential for maintaining a unique cultural identity in a globalized world.

**Global Security Dynamics and Indian Defense Policies**

**India's Defense Strategy in a Global Context**

India's defense strategy is shaped by various global factors. The country aims to enhance its military capabilities while also focusing on international cooperation. This includes:

- ✓ Strengthening ties with allies like the United States and Russia.
- ✓ Participating in joint military exercises.
- ✓ Engaging in defense technology transfers.
- ✓ Role of India in Peacekeeping Missions

India has a long history of participating in peacekeeping missions under the United Nations. The country has contributed troops to various missions worldwide, showcasing its commitment to global peace and security. Key points include:

- ✓ Over 200,000 Indian troops have served in UN missions since 1950.
- ✓ India is one of the largest contributors to UN peacekeeping forces.
- ✓ The country emphasizes the importance of multilateralism in addressing global security challenges.

**Impact of Global Terrorism on Indian Security**

Global terrorism poses a significant threat to India's security. The government is creating 'adaptive defense' strategies to counter these challenges. This includes:

- ✓ Enhancing intelligence-sharing with other nations.
- ✓ Strengthening border security.
- ✓ Developing counter-terrorism capabilities.

In response to the evolving landscape of warfare, India is focusing on adaptive defense mechanisms to address multifaceted challenges in security.By understanding these dynamics, India aims to navigate the complex global security environment effectively.

**Globalization and Its Effects on Indian Agriculture**

## Impact of International Trade on Indian Farmers

Globalization has changed how Indian farmers operate. Farmers now face both opportunities and challenges due to international trade. They can access larger markets, but they also compete with foreign products. This has led to:

- ✓ Increased exposure to global prices
- ✓ Greater demand for quality produce
- ✓ Need for better technology and practices
- ✓ Policy Measures for Sustainable Agriculture

To support farmers, the Indian government has introduced several policies aimed at sustainability. These include:

- ✓ Subsidies for organic farming
- ✓ Support for water conservation techniques
- ✓ Promotion of crop diversification

These measures help farmers adapt to the changing global landscape while ensuring environmental protection.

## Role of Technology in Modernizing Agriculture

Technology plays a crucial role in modernizing Indian agriculture. With globalization, farmers are encouraged to adopt new technologies such as:

- ✓ Precision farming
- ✓ Use of drones for monitoring crops
- ✓ Mobile apps for market information

These innovations help farmers increase productivity and reduce costs.

Globalization has significantly reshaped India's agrarian class structure, leading to profound socio-economic changes in rural areas.

In conclusion, globalization has a mixed impact on Indian agriculture. While it opens up new markets and opportunities, it also requires farmers to adapt quickly to survive in a competitive environment. The government's role in supporting these transitions is vital for the future of agriculture in India.

**Social Movements and Policy Changes in India**

Social movements in India have played a crucial role in shaping the country's policies. These movements often arise from the need for social justice, equality, and rights for various groups. The influence of global human rights movements has been significant in this context.

**Influence of Global Human Rights Movements**

Global human rights movements have inspired many social movements in India. They have brought attention to issues such as:

- ✓ Women's rights
- ✓ Dalit rights
- ✓ Environmental justice

These movements have led to important policy changes, including laws aimed at protecting marginalized communities.

**Role of Social Media in Advocacy**

Social media has become a powerful tool for advocacy in India. It allows activists to:

- ✓ Raise awareness about social issues.
- ✓ Mobilize support for various causes.
- ✓ Engage with a wider audience beyond traditional methods.

This has resulted in increased visibility for social movements and has pressured the government to respond to public demands.

- ✓ Policy Reforms Driven by Social Movements
- ✓ Social movements have led to several key policy reforms in India, such as:
- ✓ The Right to Information Act
- ✓ The Protection of Women from Domestic Violence Act
- ✓ The Scheduled Castes and the Scheduled Tribes (Prevention of Atrocities) Act
- ✓ These reforms reflect the changing dynamics of Indian society and the impact of collective action.

Social movements are essential for democracy, as they ensure that the voices of the marginalized are heard and considered in policy-making.

In conclusion, social movements in India are not just reactions to local issues; they are also influenced by global trends and have led to significant policy changes that aim to create a more just society. The ongoing dialogue between these movements and the government continues to shape the future of Indian policies.

**Education Reforms in India in the Context of Global Trends**

**Adoption of International Education Standards**

India has been working to improve its education system by adopting international standards. This means that schools and colleges are trying to match the quality of education found in other countries. This helps students gain skills that are recognized worldwide. Some key points include:

- ✓ Introduction of global curricula in schools.
- ✓ Collaboration with foreign universities for degree programs.
- ✓ Emphasis on English language proficiency.
- ✓ Impact of Globalization on Indian Curriculum

Globalization has changed what students learn in India. Schools are now including subjects that are important in the global job market. This includes:

- ✓ Technology and digital skills.
- ✓ Environmental studies and sustainability.
- ✓ Soft skills like communication and teamwork.

**Role of Technology in Education**

Technology plays a big role in modern education. With the rise of online learning, students can access resources from anywhere. Some benefits of technology in education are:

- ✓ Increased access to information through the internet.
- ✓ Use of educational apps and platforms for learning.
- ✓ Online classes that allow flexibility in learning.
- ✓ Education is the most powerful weapon which you can use to change the world.

In conclusion, education reforms in India are influenced by global trends. By adopting international standards, updating curricula, and using technology, India aims to prepare its students for a competitive world. This is essential for the future of the Indian education system: reforms and future prospects.

## 5.9 Future Trends in Financial Markets and Investment Strategies

1. Cryptocurrency

After smashing records with the successful launch of the first spot Bitcoin ETFs in 2024, the crypto market has entered a new era. Many institutional investors, hedge funds and investment advisors have dived into crypto ETFs, and this growing adoption is poised to create steady, long-term demand for digital assets.

Looking ahead, the spotlight is shifting to the potential approval of spot ETFs for tokens like XRP, Solana, Litecoin, and Hedera in the U.S. However, cryptocurrency exchange Coinbase predicts that institutional demand will likely remain concentrated on a few ETFs, such as Bitcoin and Ethereum, in the near term

This year could bring even more changes to the crypto ETF landscape. With a new appointee selected to run the Securities and Exchange Commission (SEC), there have been rumblings of introducing staking, which could boost rewards for ETF holders, making these products even more appealing to investors.

Meanwhile, after years of regulatory uncertainty, the U.S. is welcoming its most crypto-friendly Congress ever. With bipartisan, pro-crypto majorities in both the House and Senate, Coinbase anticipates that favorable regulations could fuel crypto’s momentum in 2025.

Despite these tailwinds, cryptocurrency remains a risky asset class, and experts recommend allocating no more than 5 to 10 percent of your portfolio to it.

### 2. Energy stocks and ETFs

Artificial intelligence has been the stock market's darling for over two years, with companies like Nvidia and Broadcom delivering explosive growth and massive returns for investors. But while AI grabs the headlines, powering this technological revolution is an equally compelling investment story.

JPMorgan predicts that companies in the industrial and utilities sectors — those supplying the physical infrastructure and energy needed for AI — are poised for significant growth. As AI's demand for power continues into 2025, these sectors may offer long-term opportunities for investors seeking exposure to the AI-driven economy.

For investors eager to tap into this growth, broad infrastructure funds and power generation companies — along with the best-performing energy stocks and energy ETFs — may be strategic plays to consider as the energy sector powers up for the next phase of AI expansion.

**3. Small-cap stocks**

High-profile large-cap tech stocks such as Nvidia and Microsoft got all the attention in 2023 and 2024, helping to drive the Nasdaq and S&P 500 indexes to new all-time highs. While investors scrambled to own these momentum stocks, they mostly shunned small-cap stocks, leading to lackluster performance from these smaller companies.

Now with more attractive relative valuations, small-cap stocks have caught investors' interest again. Some of the best small-cap stocks offer high growth and attractive markets, even if they don't have the deep pockets and established markets of the large caps. So investors are again looking into these lesser-known names for opportunity.

Investing in individual small caps requires a long-term perspective and a lot of research to understand the industry and the opportunity. Plus, small caps tend to be riskier than larger companies because they just don’t have the same level of resources. So investors looking to ride the small-cap wave may be well served by buying some of the best small-cap ETFs instead.

**4. REITs**

While interest rates remain elevated for now, investors are anticipating them to decline in the year ahead. And this means that sectors that have been hurt by higher rates, such as real estate investment trusts (REITs), may be poised for a rebound in the year ahead as rates fall.

REITs offer the ability to own real estate without all the headaches of actually managing it yourself. REITs enjoy significant tax advantages, most notably the ability to avoid tax at the corporate level in exchange for paying out most of their income as dividends. So REITs often offer among the highest dividends of any industry.

Publicly traded REITs are among the best types of REITs to invest in, because they offer high yields, low overall management costs and the scrutiny of public investors. As mentioned, with interest rates likely to fall in 2025, a key cost for REITs is poised to fall, too.

Those looking to own a fund instead of digging into the details of individual REITs should check out the best REIT ETFs and be sure to avoid some of the worst REIT investing mistakes.

### 5. Dividend stocks

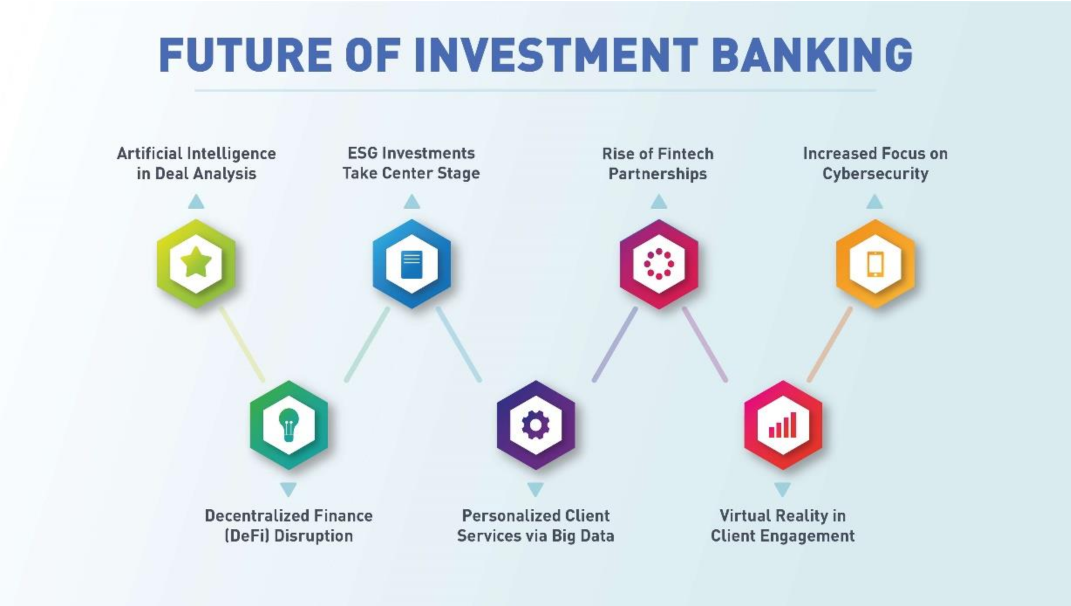
Heading into 2024, many experts expected interest rates to drop — and they did. The federal funds rate now sits at 4.25 percent, down from its high of 5.25 percent during the first half of 2024. In 2025, more rate cuts are likely on the horizon.

While cash can be a safe haven and even a solid income source in a high-interest-rate environment, its appeal dims as rates fall.

As cash and Treasury bill yields decline, many investors will seek new income streams. One opportunity in 2025 that can still provide income is dividend-paying stocks.

These equities, often trading at a discount to the broader market, also tend to be less volatile — exhibiting about 80 percent of the market's overall volatility, according to JPMorgan. That makes dividend stocks and dividend ETFs a compelling option for investors aiming to balance risk and reward.

Cash remains essential for daily needs, but it's not built to outpace inflation or generate long-term growth. For that, stocks shine. Low-cost index funds are an easy way for investors to gain exposure to stocks of the country's largest companies.




**Future Investment**

### 1) Generative AI in Finance Market

Generative AI is revolutionizing the finance industry, ushering in a transformative era where financial services are tailored to individual needs and operational efficiency is optimized. This technology offers deep insights into consumer spending habits, delivers personalized financial advice, and streamlines processes, marking a significant shift in financial institutions' operations.

This surge underscores the technology's potential to enable banks and financial institutions to analyze vast datasets, gaining insights into individual customer preferences and behaviors. This deeper understanding allows tailored financial products and services to be developed, enhancing the overall customer experience. For instance, AI-powered systems could recommend personalized investment strategies, optimize saving plans, and even forecast future expenditures to prevent overdraft fees, significantly improving customer satisfaction and loyalty.

### 2) Blockchain and Cryptocurrencies

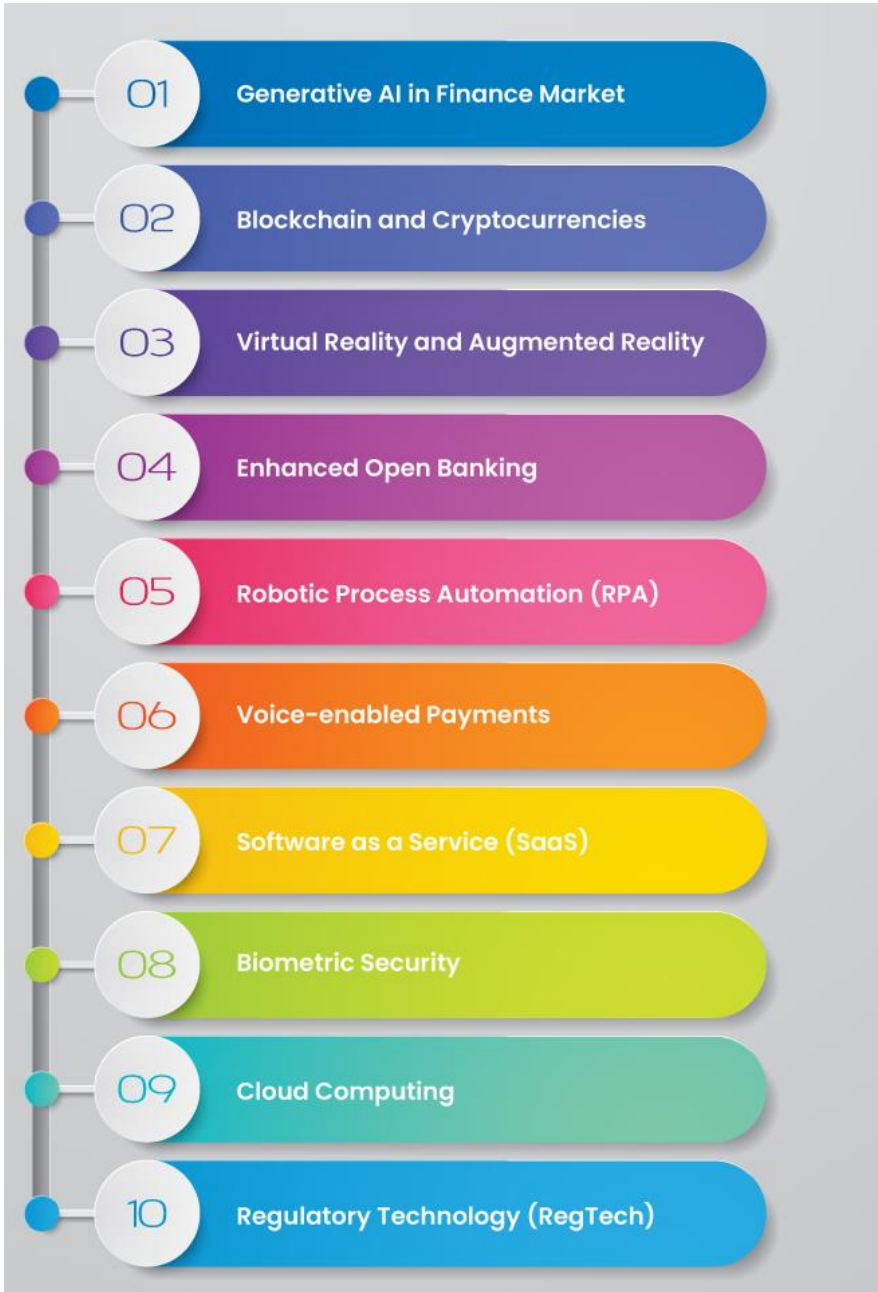
Blockchain technology and cryptocurrencies are revolutionizing the finance industry. With its secure and decentralized ledger system, blockchain reduces the need for intermediaries like banks in transactions, offering heightened security and efficiency. Meanwhile, cryptocurrencies like Bitcoin have emerged as viable alternatives to traditional currencies, witnessing substantial growth in value over recent years. These innovations are reshaping financial transactions and challenging conventional banking systems.

Furthermore, blockchain technology is not limited to just financial transactions. Its decentralized nature and tamper-proof features make it applicable across various industries, including supply chain, IT investment management, healthcare, and voting systems. The transparency and immutability of blockchain offer unparalleled trust and security, driving its adoption beyond finance. As for cryptocurrencies, their increasing acceptance as a medium of exchange and store of value is prompting governments and businesses to explore their integration into mainstream financial systems. This evolution underscores the transformative potential of blockchain and cryptocurrencies in reshaping the future of finance and beyond.

### 3) Virtual Reality and Augmented Reality

Virtual Reality (VR) and Augmented Reality (AR) are making significant strides in the financial sector, introducing immersive solutions that aid in making informed financial decisions and monitoring real-time market changes. These technologies enhance user experiences and transform how investors engage with their portfolios.

VR and AR empower investors to gain deeper insights and navigate complex market dynamics with greater precision and clarity by providing 3D visualization and manipulation of financial data. This innovation heralds a new interactive and intuitive IT investment management era, offering users unprecedented engagement and understanding.




**Future of IT Financial Management**

## 4) Enhanced Open Banking

Based on recent analyses, the open banking market is poised for growth, with projections indicating a staggering value of USD 164 billion by 2032. Enhanced open banking represents a fundamental transformation within the financial services industry, aiming to redefine the sharing and utilization of financial data.

This technology is focused on delivering exceptional payment experiences through the API-driven financial services industry, signaling a paradigm shift. Its evolution is fueled by the increasing demand for faster, more secure, and customer-centric financial solutions.

**A) API Driven Financial Ecosystem**

Open banking relies on utilizing Application Programming Interfaces (APIs) to securely facilitate the exchange of financial data between banking institutions and third-party providers. This technological framework is the cornerstone of the open banking ecosystem, enabling the development of pioneering financial services industry and products. According to McKinsey insights, integrating banking APIs can significantly enhance customer experience, generate fresh revenue streams, and redefine the competitive field within the industry.

**B) Data Security and Consumer Protection**

As data sharing becomes more prevalent, there is a heightened emphasis on upholding consumer protection and data security standards. Forbes underscores that the trajectory of open banking's evolution is intricately linked to establishing and sustaining consumer trust. This necessitates robust encryption techniques, secure data storage infrastructures, and transparent privacy protocols. Moreover, adherence to regulatory frameworks such as the GDPR (General Data Protection

Regulation) is imperative to safeguarding personal data and maintaining compliance with legal requirements.

### C) Customer Demand

The impetus for innovation within open banking is predominantly driven by evolving customer expectations, characterized by a demand for swifter, more convenient, and personalized banking experiences. A study conducted by PwC underscores this trend, projecting that 71% of small and medium-sized enterprises (SMEs) will embrace open banking by 2024 to enhance their service offerings. This evolution is poised to manifest in many ways, encompassing real-time payment capabilities, augmented IT investment management, more competitive lending rates, and bespoke insurance solutions.

As the open banking landscape progresses, it holds the potential to redefine the contours of the financial services industry. However, its realization is contingent upon establishing a robust regulatory framework and a steadfast commitment to security and consumer protection. Furthermore, the industry's capacity to innovate and effectively respond to customer demands will be pivotal in shaping its trajectory.

## 5) Robotic Process Automation (RPA)

Robotic Process Automation (RPA) is the fourth trend, offering automation solutions for repetitive tasks within the financial industry. By leveraging software robots, RPA streamlines operations, liberates resources, and enhances precision. Its application is especially advantageous in back-office functions, enabling personnel to redirect their efforts toward more innovative and value-centric endeavors.

### A) Enhanced Efficiency

RPA optimizes operational efficiency by automating mundane and time-consuming tasks, accelerating processes, and reducing errors. For financial industries, this efficiency gain translates into significant time and cost savings, allowing them to allocate resources strategically.

**B) Empowering Human Capital**

By delegating routine tasks to automated systems, RPA empowers human capital to focus on tasks that require creativity, critical thinking, and complex problem-solving. This shift enhances employee satisfaction and fosters a culture of tech innovation and continuous improvement within the organization.

**6) Voice-enabled Payments**

Another notable trend is voice-enabled payments, which use digital assistants such as Siri, Google Assistant, and Amazon Alexa to facilitate financial transactions through voice commands. This technology presents a unique opportunity for users, offering a convenient and efficient method for making payments and transferring funds. Moreover, it is an inclusive solution, providing enhanced accessibility for individuals with visual impairments.

**A) Seamless Transaction Processing**

Voice-enabled payments streamline transaction processing, enabling users to initiate payments and transfers through natural language commands. This seamless integration of voice technology into financial services enhances the user experience and reduces friction in the payment process, leading to greater customer satisfaction and loyalty.

**B) Accessibility Enhancement**

For individuals with vision impairments or disabilities, voice-enabled payments represent a significant leap forward in accessibility within the financial sector. By offering a hands-free and voice-driven interface, this technology ensures that all users can easily manage their finances, promoting inclusivity and equal access to financial technology trends.

**7) Software as a Service (SaaS)**

Software as a Service (SaaS) emerges as a transformative solution for enterprises seeking operational optimization. This innovative approach provides organizations with IT cost optimization strategies and means to access cutting-edge technologies, enabling them to utilize software solutions without requiring substantial resource investments.

**A) Streamlined Operational Efficiency**

SaaS facilitates streamlined operational efficiency by offering on-demand access to software applications, eliminating the need for extensive infrastructure setup and maintenance. This model empowers businesses to deploy scalable solutions rapidly, driving agility and flexibility in their operations while minimizing overhead costs.

**B) Access to Advanced Technologies**

By embracing SaaS, organizations gain access to diverse advanced technologies and functionalities without the burden of upfront capital expenditures. This democratization of technology enables businesses of all sizes to harness the power of innovation, fostering competitiveness and driving digital transformation across industries.

**8) Biometric Security**

Biometric technology is progressively vitalizing identity authentication processes. Using fingerprint scanners, facial recognition software, and other sophisticated methods, these contemporary security measures are revolutionizing traditional approaches and eliminating the reliance on passwords and PINs for authentication.

### A) Enhanced Identity Verification

Biometric security measures offer enhanced accuracy and reliability in verifying individuals' identities compared to traditional authentication methods. By analyzing unique biological traits such as fingerprints or facial features, these systems provide a highly secure means of confirming user identity, mitigating the risks of unauthorized access and identity theft.

### B) Elimination of Passwords and PINs

One of the most notable advantages of biometric security is its ability to eliminate the need for passwords and PINs, which are susceptible to vulnerabilities such as theft, interception, and unauthorized use. By replacing these traditional credentials with biometric data, organizations can bolster security measures and enhance user convenience, streamlining the authentication process while minimizing the risk of security breaches.

## 9) Cloud Computing

Cloud computing is a pivotal asset for financial organizations seeking operational optimization and cost reduction. Providing flexible access to storage and robust computing services facilitates streamlined operations and empowers businesses to adapt swiftly to evolving market dynamics.

### A) Operational Streamlining

Cloud computing enables financial organizations to streamline their operations by offering scalable and on-demand access to computing resources. This flexibility allows businesses to adjust their infrastructure and capacity according to fluctuating demands, optimizing resource utilization and enhancing operational efficiency.

**B) Cost Reduction**

Cloud computing provides cost-effective options to traditional on-premises infrastructure by eliminating the need for extensive hardware investments and maintenance expenses. By leveraging cloud services, financial organizations can significantly reduce operational costs while benefiting from enhanced scalability, reliability, and performance, maximizing their return on investment.

**10) Regulatory Technology (RegTech)**

Regulatory Technology (RegTech) is revolutionizing compliance processes within the financial industry. RegTech solutions empower financial firms to navigate the intricate regulatory field with IT cost optimization strategies, efficiency, and precision by facilitating accurate monitoring and timely reporting of compliance data.

**A) Enhanced Compliance Monitoring**

RegTech solutions leverage advanced technologies such as artificial intelligence and data analytics to enable real-time monitoring of regulatory requirements. Automating compliance checks and assessments enhances the accuracy and effectiveness of monitoring processes, ensuring adherence to regulatory standards and mitigating compliance risks.

### B) Streamlined Reporting

RegTech streamlines the reporting process by automating data collection, aggregation, and analysis tasks. This automation reduces the time and resources required for compliance reporting and enhances the accuracy and consistency of regulatory disclosures. By providing timely and comprehensive reporting capabilities, RegTech enables financial technology trends firm to fulfill their regulatory obligations efficiently and proactively address compliance challenges.

A convergence of transformative financial services trends and cutting-edge technologies is shaping the future of IT financial planning management. From integrating generative AI and blockchain to adopting VR/AR and voice-enabled payments, the financial services domain is shifting profoundly towards more personalized, efficient, and secure offerings. Enhanced open banking, Robotic Process Automation (RPA), Software as a Service (SaaS), biometric security, cloud computing, and regulatory technology (RegTech) are driving operational optimization, cost reduction, and regulatory compliance across financial institutions.

As organizations embrace these advancements, they are better positioned to meet evolving customer needs and navigate complex regulatory requirements. Financial institutions can confidently navigate these technological shifts with Veritis, a distinguished Stevie and Globee Business Awards winner, offering comprehensive solutions and expertise, including AIOPS Services. By partnering with Veritis, organizations can capitalize on emerging financial services trends while maximizing operational efficiency and regulatory compliance and ultimately driving success in the dynamic domain of IT financial planning management.