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**Sub: Financial Services**

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**UNIT 1: Introduction to Financial Services**

Q. **What are the various kinds (types/ forms/ categories) of financial services provided by banks and financial institutions?**

**Or**

**Distinguish between fund based (asset based) and fee based (advisory based/ non-fund based) financial services. Discuss the fund based (asset based) and fee based (advisory based/non-fund based) financial services in detail. 10marks.**

**Answer:** In economic sense, a service is a transaction in which no physical goods can be transferred from the seller to the buyer. Here, the seller may be termed as service provider and the buyer as service user. Financial services refer to economic services that are non-physical, intangible (which cannot be touched or handled), and heterogeneous parts of an economy.

Withthe passage of time, the importance of financial services sectors has been developed and the need for more effective marketing management strategies of the financial services has been felt. The financial services sector takes every step to provide the best services at the door step of its customers.

The various types of financial services provided by the banks and financial institutions are broadly classified into two categories:

FINANCIAL SERVICES

Fee based or Advisory based

Fund based or Asset based

1. **Fund based or asset based:** The fund based or asset based services provided by banking and non-banking financial institutions are discussed below briefly:
2. **Equipment Leasing or Lease Financing:** Leasing is a type of **long-term and intermediate financing** in which a finance company is the legal owner of the asset (equipment) for the duration of the lease, while the borrower of the asset (equipment) has operating control over the asset and has to bear the economic risk and returns from the change in the value of the asset leased. **The finance company is known as the lessor and the customer (borrower) of the asset is known as the lessee.** It is an agreement between the lessor and lessee where the lessee will select an asset (equipment) and lessor will purchase the asset. The lessee will have to use the asset for a specified time period. For this, the lessee will have to pay a series of rent termed as **lease rentals**. The lessor will recover a large part or the entire cost of the asset plus earn interest from the lease rentals paid by the lessee. However, the lessee has the option to buy the asset at the end of the lease and having paid the last lease rental.
3. **Hire-Purchase and Consumer Credit:** Hire-purchase is **an agreement or arrangement between two parties i.e. the hire vendor (seller) and hire purchaser (buyer).** It is a financial transaction where **consumer goods** are purchased and sold at an initial down payment made by the hire purchaser and pays the balance amount plus interest of the goods in **installments**. The hire purchaser has the possession of the goods immediately but the hire vendor remains the owner of the goods till the hire purchaser makes payment of the last installment. The hire vendor can repossess the goods in case of default in payment of any installment and each installment is treated as hire charges till the **last installment is paid**. Usually, the interest is charged on **flat rate.**
4. **Bill Discounting:** Bill discounting means **discounting of bills of exchange**. It is a trade related **negotiable instrument**. It is a method that is used to finance working capital by the seller or the exporter of goods. It is an attractive and profitable fund based financial service without any collateral security. Suppose the buyer has purchased the goods on credit then, the seller draws a bill of exchange on the buyer of goods on credit. The bank purchases the bill of exchange payable on demand and credits the customer’s account with the amount mentioned in the bill of exchange less discount. At the maturity of the bill, bank presents the bill to its acceptor for payment. In case, the bill discounted is dishonoured for non- payment; the bank will recover the full amount of the bill from the customer along with expenses in that connection.
5. **Factoring:** Factoring is a financial transaction and a type of debtor finance in which a business sells its **accounts receivables (i.e. invoices) to a third party (termed as factor) at a discount.** It is a method of raising short-term finance through account receivable credit offered by commercial banks and factors. A commercial bank may provide finance by discounting the bills or invoices of its customers. Therefore, a firm gets immediate payment for credit sales. A **factor is a financial institution** which offers services relating to management and financing of debts arising out of credit sales.
6. **Insurance services:** Insurance is an **agreement between two parties i.e. the insurance company and the customer (policy holder)** where the insurance company agrees to shoulder the risks of the customers against certain **consideration or payment called premium.** The insurance company provides insurance cover for life, fire, property, etc. The property that is insured is called subject matter; the insurance company is called **insurer** and the policy holder is called **insured.**
7. **Housing Finance:** Housing finance emerged as a fund based financial service in India with the setting up of **National Housing bank (NHB) by the Reserve Bank of India (RBI) in 1988**. NHB is an apex (principal) housing finance institution in India. It is a **fully owned subsidiary of the RBI.**

At present, a number of specialized financial institutions in the public, private and joint sectors have entered in the field of housing finance such as HDFCs, SBIHF, Canfin Home, LIC Housing Finance, Ind Bank Housing, Citi Home, Gujrat Ambuja, and ICICI Housing. These financial institutions have designed suitable schemes for individuals, corporate, builders and promoters. The HUDCO and commercial and co-operative banks have designed schemes specifically for lower and middle income group people.

1. **Venture Capital:** Venture capital refers financial investment in **highly risky projects** with the objective of **earning a high rate of return.** It involves **high degree of risk**. Venture capital financing is one of the most recent entrants in the Indian capital market. Some of the venture capital financing agencies are;
2. Venture capital scheme of IDBI;
3. Venture Capital Scheme of ICICI;
4. Risk Capital and Technology Corporation Ltd. (RCTC);
5. Infrastructure Leasing and Financial Services Ltd. (IL and FS).

**B. Fee based or Advisory Based Financial Services:**

1. **Merchant Banking:** Merchant banking is a banking service dealing in commercial loans and investment. Merchant bank is also termed as **“accepting and issuing houses”.** It refers to marketing of corporate and other securities. In the process, the merchant banker performs a number of services concerning various aspects of marketing viz. organization, underwriting and distribution of securities.

2. **Credit Rating:** A credit rating is an evaluation of the credit risk of a prospective debtor (individual/ business company/ government) predicting their ability to pay back the debt. A Credit Rating Agency (CRA) is also termed as **ratings service**. It is a company that assigns credit ratings, which rate a debtor’s ability to pay back debt by making timely principal and interest payments and the likelihood of default. It rates the creditworthiness of issuers of debt obligations of debt instruments.

**Three major Credit Rating Agencies (CRAs) are**:

a) Credit Rating Information Services of India Ltd. (CRISIL);

b) Investment Information and Credit Rating Agency of India Ltd. (ICRA) and

c) Credit Analysis and Research in Equities (CARE).

3. **Stock Broking:** Stock Broking refers to the function of buying and selling of financial securities such as shares, debentures, bonds, stock, warrants, etc. in a stock market **through a dealer (stock broker) who acts as an agent on behalf of the clients** who wish to buy or sell financial securities.

4. **Portfolio Management:** Portfolio management is defined as the **art and science** of making decisions about the investment mix and policy, prioritizing projects, matching investments to objectives, asset allocation for individuals and institutions and balancing risk against performance.

5. **Depository Services:** Depository service is a fee based financial service where the securities of investors are kept in an electronic form. The process of buying and selling financial securities in an electronic form is known as depository service. It is also termed ad **scripless or paperless** trading of financial securities. This service is performed through an account termed as **Demat Account**. The investor, who wants to avail the services of a depository, has to open a **Beneficiary Account** with the **Depository Participant (DP).**