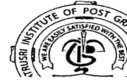

PREPLACEMENT TRAINING
FINANCE MODULE

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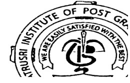
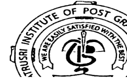
Nadergul (P.O) Hyderabad - 501 510.

Organised by
Department of Business Management
3-5, February 2011



Compiled by

Prof. M. Basawaraja
Dr. K.Sriharsha Reddy
Mr.MNR Manohar



ACCOUNTING TERMS

ACCOUNTING TERMS

Definition of Accounting: “The art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least of a financial character and interpreting the results there of”.

Book Keeping: It is mainly concerned with recording of financial data relating to the business operations in a significant and orderly manner

Concepts of accounting:

- Separate entity concept
- Going concern concept
- Money measurement concept
- Cost concept
- Dual entity concept
- Accounting period concept
- Periodic matching of costs and revenue concept(Matching concept)
- Realization concept

Conventions of accounting

- Conservatism
- Full disclosure
- Consistency
- Materiality

Systems of book keeping

- Single entry system
- Double entry system

Systems of account

- Single entry system
- Mercantile systems of accounting

Principles of accounting

- Personal a/c: Debit the receiver
Credit the giver
- Real a/c Debit what comes in
Credit what goes out
- Nominal a/c: Debit all expenses and losses
Credit all gains and incomes

Meaning of journal: Journal means chronological record of transactions.

Meaning of Ledger: Ledger is a set of accounts. It contains all accounts of the business enterprise whether real, nominal, personal.

Posting: It means transferring the debit and credit items from the journal to their respective accounts in the ledger

Trial balance: Trial balance is a statement containing the various ledger balances on a particular date.

Credit note: The customer when returns the goods get credit for the value of the goods returned. A credit note is sent to him intimating that his a/c has been credited with the value of the goods returned.

Debit note: When the goods are returned to the supplier, a debit note is sent to him indicating that his a/c has been debited with the amount mentioned in the debit note.

Contra entry: Which accounting entry is recorded on both the debit and credit side of cashbook is known as the contra entry.

Petty cash book: Petty cash is maintained by business to record petty cash expenses of the business, such as postage, cartage, stationery, etc.

Promisory note: An instrument in writing containing an unconditional undertaking signed by the maker, to pay certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

Cheque: a bill of exchange drawn on a specified banker and payable on demand.

Stale of cheque: a stale of cheque means not valid of cheque that means more than six months the cheque is not valid.

Bank reconciliation statement: It is a statement reconciling the balance as shown by the bank passbook and the balance as shown by the cash book. Obj:to know the difference and pass necessary correcting, adjusting entries in the books.

Matching concept: Matching means requires proper matching of expense with the revenue.

Capital income: the term capital income means an income which does not grow out of or pertain to the running of the business proper.

Revenue income: the income, which arises out of and in the course of the regular business transactions of a concern

Capital expenditure: It means an expenditure which has been incurred for the purpose of obtaining a long term advantage for the business.

Revenue expenditure: an expenditure that incurred in the course of regular business transactions of a concern

Differed revenue expenditure: An expenditure, which is incurred during an accounting period but is applicable further periods also. Eg: Heavy advertisement.

Bad debts: Bad debts denote the amount lost from debtors to whom the goods were sold on credit.

Depreciation: Depreciation denotes gradually and permanent decrease in the value of asset due to wear and tear, technology changes, laps of time and accident.

Fictitious assets: These are assets not represented by the tangible possession or property. Examples of preliminary expenses, discount on issue of shares, debit balance in the profit and loss account when shown on the assets side in the balance sheet.

Intangible assets: Intangible assets means the assets which is not having the physical appearance. And its have the real value, it shown on the assets side of the balance sheet.

Accrued income: Accrued income means income which has been earned by the business during the accounting year but which has not yet been due and, therefore, has not been received.

Outstanding income: Outstanding income means income which has become due during the accounting year but which has not so far been received by the firm.

Suspense account: the suspense account is an account to which the difference in the trial balance has been put temporarily

Depletion: it implies removal of an available but not replaceable source, such as extracting coal from a coal mine.

Amortization: the process of writing of intangible assets is terms as amortization.

Dilapidations: the term dilapidations to damage done to a building or other property during tenancy

Capital employed: the term capital employed means sum of total long term funds employed in the business i.e.

> (Share capital+reserves & surplus + long terms loans-(non business assets + fictitious assets)

Equity shares:those shares which are not having preference rights are called equity shares.

Preference shares: Those shares which are carrying the preference rights is called preference shares. Preference rights in respect of fixed dividend. Preference right to repayment of capital in the event of company winding up.

Joint venture: A joint venture is an association of two or more the persons who combined for the execution of a specific transaction and divide the profit or loss their of an agreed ratio.

Partnership: partnership is the relation between the persons who have agreed to share the profits of business carried on by all or any of them acting for all.

Capital reserve: the reserve which transferred from the capital gains is called capital reserve.

General reserve: the reserve which is transferred from normal profits of the firm is called general reserve.

Free cash: the cash not any specific purpose free from any encumbrance like surplus cash.

Minority interest: minority interest refers to the equity of the minority shareholders in a subsidiary company.

Capital receipts: capital receipts may be defined as “non-recurring receipts from the owner of the business of lender of the money crating a liability to either of them

Revenue receipts: Revenue receipts may be defined as “A reccurring receipts against sale of goods in the normal course of business and which generally the result of the trading activities.

Meaning of company: A company is an association of many persons who contribute money or money’s worth to common stock and employs it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company.

Types of a company.

- Statutory companies
- Government company
- Foreign company
- Registered companies
    - Companies limited bys hare
    - Companies limited by guarantee
    - Unlimited companies
    - Private company
    - Public company

Private Company: A private company is which by its AOA: Restricts the right of the members to transfer of shares limits the no. of members 50. Prohibits any invitation to the public to subscribe for its shares or debentures

Public company: A company, the articles of association of which does not contain the requisite restrictions to make it a private limited company, is called a public company.

Characteristics of a company

- Voluntary association
- Separate legal entity
- Free transfer of shares
- Limited liability
- Common seal
- Pertpetual existence.

Formation of company

- Promotion
- Incorporation
- Commencement of business

Equity share capital: The total sum of equity shares is called equity share capital.

Authorized share capital: it is the maximum amount of the share capital, which a company can raise for the time being.

Issued Capital: It is that part of the authorized capital, which has been allotted to the public for subscriptions.

Subscribed capital: It is the part of the issued capital, which has been allotted to the public

Called up capital: It has been portion of the subscribed capital which has been called up by the company.

Paid up capital: It is the portion of the called up capital against which payment has been received.

Debentures: Debentures is a certificate issued by a company under its seal acknowledging a debt due by it to its holder.

Cash Profit: Cash profit is the profit it is occurred from the cash sales.

Deemed public ltd. Company : A private company is a subsidiary company to public company it satisfies the following terms/conditions Sec 3(1) 3:

- Having minimum share capital 5 lakhs
- Accepting investments from the public
- No restriction of the transferables of shares
- No restriction of no. of members
- Accepting deposits from the investors

Secret reserves: Secret reserves are reserves the existence of which does not appear on the face of balance sheet. In such a situation, net assets position of the business is stronger than that disclosed by the balance sheet: These reserves are created by: Excessive depreciation of asset, excessive over-valuation of a liability. Complete elimination of an asset, or under valuation of an asset.

Provision: Provision usually means any amount written of or retained by way of providing depreciation, renewals or diminutions in the value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy.

Reserve: The provision in excess of the amount considered necessary for the purpose it was originally made is also considered as reserve provision is charge against profits while reserves is an appropriation of profits creation of reserve increase proprietor's fund while creation of provisions decreases his funds in the business.

Reserve fund: The term reserve fund means such reserve against which clearly investment, etc.

Undisclosed reserves: Sometimes a reserve is created but its identity is merged with some other a/c or group of accounts so that the existence of the reserve is not known such reserve is called an undisclosed reserve.

Funds flow statement: It is the statement deals with the resources for running business activities. It explains how the funds obtained and how they used.

Sources of funds:There are two sources of funds internal sources and external sources.

Internal source: Funds from operations is the only internal sources of funds and some important points add to it they do not result in the outflow of funds.

Depreciation on fixed assets.
Preliminary expenses or goodwill written off, loss on sale of fixed assets
Deduct the following items, as they do not increase the funds:
Profit on sale of fixed assets, profit on revaluation of fixed assets.
External sources:
Funds from long-term loans
Sale of fixed assets
Funds from increase in share capital

Application of funds: a. Purchase of fixed assets.

Payment of dividend
Payment of tax liability
Payment of fixed liability

Cash flow statement: It is a statement depicting change in cash position from one period to another.

Sources of cash: Internal sources

Depreciation
Amortization
Loss on sale of fixed assets
Gains from sale of fixed assets
Creation of reserves External sources
Issue of new shares

Raising long term loans
Shortterm borrowings
Sale of fixed assets, investments

Application of cash
Purchase of fixed assets
Payment of long term loans
Decrease in different payment liabilities
Payment of tax, dividend
Decrease in unsecured loans and deposits.

Budget: It is a detailed plan of operations for some specific future period. It is an estimate prepared in advance of the period to which it applies.

Budgetary control: It is the system of management control and accounting in which all operations are forecasted and so far as possible planned ahead, and the actual results compared with the forecasted and planned ones.

Cash budget: It is summary statement of firm's expected cash inflow and outflow over a specified time period.

Master budget: A summary of budget schedules in capsule form made for the purpose of presenting in one report the highlights of the budget forecast.

Fixed budget: It is a budget, which is designed to remain unchanged irrespective of the level of activity actually attained.

Zero-base budgeting: It is a management tool which provides a systematic method for evaluating all operations and programmes, current of new allows for budget reductions and expansions in a rational manner and allows reallocations of source from low to high priority programs.

Goodwill: The present value of firm's anticipated excess earning.

BRS: It is a statement reconciling the balance as shown by the bank pass book and balance shown by the cash book.

Objective of BRS: The objective of preparing such a statement is to know the causes of difference between the two balances and pass necessary correcting or adjusting entries in the books of the firm/

Responsibility accounting: It is a system of control by delegating and locating the responsibilities for costs.

Profit centre: A centre whose performance is measured in terms of both the expense incurs and revenues it earns.

Cost centre: A location, person or item of equipment for which cost may be ascertained and used for the purpose of cost control.

Cost: The amount of expenditure incurred on to a given thing.

Cost accounting: It is thus concerned with recording, classifying and summarizing costs for determination of costs of products or services planning, controlling and reducing such costs and furnishing of information management for decision making.

Elements of cost:
- Material
- Labour
- Overheads

Components of total costs.
- Prime cost
- Factory cost
- Total cost of production
- Total cost

Prime cost: It consists of direct material direct labour and direct expenses. It is also known as basic or first or flat cost.

Factory cost: It comprises prime cost, in addition factory overheads which include cost of indirect material indirect labour and indirect expenses incurred in factory. This cost is also known as works cost or production cost or manufacturing cost.

Cost of production: In office and administration overheads are added to factory cost, office cost is arrived at.

Total cost: Selling and distribution overheads are added to total cost of production to get the total cost or cost of sales.

Cost unit: A unit of quantity of a product, service or time in relation to which costs may be ascertained or expressed.

Methods of costing:A.Job costing B.Contract costing. C.Process costing D.Operation costing E. Operating costing F. Unit costing G.Batch costing.

Techniques of costing: A.Marginal costing B.Direct costing C.Absorption costing D.Uniform costing

Standard costing: Standard costing is a system under which the cost of the product is determined in advance on certain predetermined standards.

Marginal costing: It is a technique of costing in which allocation of expenditure to production is restricted to those expenses which arise as a result of production, i.e. materials, labour, direct expenses and variable overheads.

Meaning of ratio: Ratios are relationships expressed in mathematical terms between figures which are connected with each other in same manner.

Activity ratio: It is a measure of the level of activity attained over a period.

Drawings: Drawings denotes the money withdrawn by the proprietor from the business for his personal use.

Outstanding income: Outstanding income means income which has become due during the accounting year but which has not so far been received by the firm.

Outstanding Expenses: Outstanding expenses refer to those expenses which have become due during the accounting period for which the final accounts have been prepared but have not yet been paid.

Closing stock: The term closing stock means goods lying unsold with the businessman at the end of the accounting year.

Methods of depreciation:

- Uniform charge methods:
  - a.Fixed instalment method
  - b.Depletion method
  - c.Machine hour rate method
- Decline charge methods:
  - a.Diminishing balance method
  - b.Sum of years digits method
  - c.Double declining method
- Other methods:
  - a. Group depreciation method
  - b. Inventory system of depreciation
  - c. Annuity method
  - d. Depreciation fund method
  - e. Insurance policy method

Accrued income: Accrued income means income which has been earned by the business during the accounting year but which has not yet become due and, therefore, has not been received.

Gross profit ratio: It indicates the efficiency of the production/trading operations.

Formula: $\frac{\text{Gross profit}}{\text{Net sales}} \times 100$

Net profit radio : It indicates net margin on sales

Formula : $\frac{\text{Net profit}}{\text{Net sales}} \times 100$

Return on share holders funds: It indicates measures earning power of equity capital

Formula:

Profits available for Equity shareholders
-- X 100
Average Equity Shareholders funds

Earning per Equity share(EPS): It shows the amount of earnings attributable to each equity share.

Formula: Profits available for Equity shareholders

Number of Equity shares

Dividend yield ratio: It shows the rate of return to shareholders in the form of dividends. Based in the market price of the share

Formula: Dividend per share
------------------------- X 100
Mareket price per share

Price earning ratio: It is a measure for determining the value of a share. May also be used to measure the rate of return expected by investors.

Formula: Market price of share(MPS)
-------------------------------- X 100
Earning per share(EPS)

Current Ratio: It measures short-term debt paying ability

Formula: Current Assets

Current Liabilities

Debt-Equity Ratio: It indicates the percentage of funds being financed through borrowings; a measure of the extent of trading on equity.

Formula: Total long-term Debt

Shareholders funds

Fixed Assets ratio: This ratio explains whether the firm has raised adequate long- term funds to meet its fixed assets requirements.

Formula: Fixed Assets

Long-term Funds

Quick Ratio: The ratio terms as 'liquidity ratio'. The ratio is ascertained by comparing the liquid assets to current liabilities.

Formula: Liquid Assets

Current Liabilities

Stock turnover Ratio: The ratio indicates whether investment in inventory in efficiency used or not. It, therefore explains whether investment in inventory within proper limits or not.

Formula: Cost of goods sold

Average stock

Debtors Turnover Ratio: The ratio the better it is, since it would indicate that debts are being collected more promptly. The ratio helps in cash budgeting since the flow of cash from customers can be worked out on the basis of sales.

Formula: Credit sales

Average Accounts Receivable

Creditors Turnover Ratio: It indicates the speed with which the payments for credit purchases are made to the creditors.

Formula: Credit Purchases

Average Accounts payable

Working Capital Turnover Ratio: It is also known as Working Capital Leverage Ratio. This ratio indicates whether or not working capital has been effectively utilized in making sales.

Formula: Net Sales

Woring Capital

Fixed Assets Turnover Ratio: This ratio indicates the extent to which the investments in fixed assets contributes towards sales.

Formula: Net Sales

Fixed Assets

Pay-out Ratio: This ratio indicates what proportion of earning per share has been used for paying dividend.

Formula: Dividend per Equity Share
-------------------------------- X 100
Earning per Equity share

Overall Profitability Ratio: It is also called as “Return on Investment”(ROI) or Return on Capital Employed (ROCE). It indicates the percentage of return on the total capital employed in the business.

Formula: Operating profit
------------------- X 100
Capital employed

The term capital employed has been given different meanings a. Sum total of all assets whether fixed or current b. Sum total of fixed assets. c.Sum total of long-term funds employed in the business, i.e. share capital + reserves & surpluses + long term loans-(non business assets + ficticious assets). Operating profit means 'profit before interest and tax'.

Fixed Interest Cover Ratio: The ratio is very important from the lender's point of view. It indicates whether the business would earn sufficient profits to pay periodically the interest charges.

Formula: Income before interest and tax

Interest Charges

Fixed Dividend Cover Ratio: This ratio is important for preference shareholders entitled to get dividend at a fixed rate in priority to other shareholders.
Formula: Net profit after interest and tax

Preference Dividend

Debt Service Coverage Ratio: This ratio is explained ability of a company to make payment of principal amounts also on time.

Proprietary ratio: It is a variant of debt-equity ratio. It establishes relationship between the proprietor's funds and the total tangible assets.

Formula: Shareholders funds

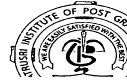
Total tangible assets

Difference between joint venture and partnership: In joint venture the business is carried on without using a firm name. In the partnership, the business is carried on under a firm name. In the joint venture, the business transactions are recorded under cash system. In the partnership, the business transactions are recorded under mercantile system. In the joint venture, profit and loss is ascertained on completion of the venture in the partnership, profit and loss is ascertained at the end of each year. In the joint venture, it is confined to a particular operation and it is temporary. In the partnership, it is confined to a particular operation and it is permanent.

Meaning of Working capital: The funds available for conducting day to day operations of an enterprise. Also, represented by the excess of current assets over current liabilities.

Concepts of accounting:

1. Business entity concepts: According to this concept, the business is treated as a separate entity distinct from its owners and others.



2. Going concern concept: According to this concept, it is assumed that a business has a reasonable expectation of continuing business at a profit for an indefinite period of time.
3. Money measurement concept: This concept says that the accounting records only those transactions which can be expressed in terms of money only.
4. Cost concept: According to this concept, an asset is recorded in the books at the price paid to acquire it and that this cost is the basis for all subsequent accounting for the asset.
5. Dual aspect concept: In every transaction, there will be two aspects-the receiving aspect and the giving aspect; both are recorded by debiting one accounts and crediting another account. This is called double entry.
6. Accounting period concept: It means that final accounts must be prepared on a periodic basis. Normally accounting period adopted is one year, more than this period reduces the utility of accounting data.
7.Rationalization concept: According to this concepts, revenue is considered as being earned on the data which it is realized. i.e. the date when the property in goods passes the buyer and he become legally liable to pay.
8.Materiality concepts: It is a one of the accounting principle, as per only important information will be taken, and un important information will be ignored in the preparation of the financial statement.
9.Matching concepts: The cost of expenses of a business of a particular period are compared with the revenue of the period in order to ascertain the net profit and loss.
10.Accrual concept: The profit arises only when there is an increase in owners capital, which is a result of excess of revenue over expenses and loss.

Financial analysis: The process of interpreting the past, present, and future financial condition of a company.

Income statement: An accounting statement which shows the level of revenues, expenses and profit occurring for a given accounting period.

Annual report: The report issued annually by a company, to its share holders. It containing financial statement like, trading and profit & loss account and balance sheet.

Bankrupt: A statement in which a firm is unable to meet its obligations and hence, it is assets are surrendered to court for administration.

Lease: Lease is a contract between to parties under the contract, the owners of the asset gives the right to use the asset to the user over an agreed period of the time for a consideration.

Opportunity cost: The cost associated with not doing something.

Budgeting: The term budgeting is used for preparing budgets and other producer for planning, co-ordination, and control of business enterprise.

Capital: The term capital refers to the total investment of company in money, tangible and intangible assets. It is the total wealth of a company.

Capitalization: It is the sum of the par value of stocks and bonds out standings.

Over capitalization: When a business is unable to earn fair rate on its outstanding securities.

Under capitalization: When a business is able to earn fair rate or over rate on it is outstanding securities.

Capital gearing: The term capital gearing refers to the rationship between equity and long term debt.

Cost of capital: It means the minimum rate of return expected by its investment.

Cash dividend: The payment of dividend in cash.

Accrued expenses: An expense which has been incurred in an accounting period but for which no enforceable claim has become due in what period against the enterprises.

Accrued revenue: Revenue which has been earned is an earned is an accounting period but in respect of which no enforceable claim has become due to in that period by the enterprise.

Accrued liability: A developing but not yet enforceable claim by an another person which accumulates with the passage of time or the receipt of service or otherwise, it may rise from the purchase of services which at the date of accounting have been only partly performed and are not yet billable.

Convention of Full disclosure: According to this convention, all accounting statements should be honestly prepared and to that end full disclosure of all significant information will be made.

Convention of consistency: According to this convention it is essential that accounting practices and methods remain unchanged from one year to another.

Preliminary expenses: Expenditure relating to the formation of an enterprise. There include legal accounting and share issue expenses incurred for formation of the enterprise.

Meaning of charge: Charge means it is a obligation to secure an indebt ness. It may be fixed charge and floating charge.

Appropriation: It is application of profit towards reserves and dividends.

Absorption costing: A method where by the cost is determine so as to include the appropriate share of both variable and fixed costs.

Marginal cost: Marginal cost is the additional cost to produce an additional unit of a product. It is also called variable cost.

What are the ex-ordinary items in the P&L a/c: The transaction which are not related to the business is termed as ex-ordinary transactions or ex-ordinary items, Egg: Profit or losses on the sale of fixed assets, interest received from other company investments, profit or loss on foreign exchange, unexpected dividend received.

Share premium: The excess of issue of price of shares over their face value. It will be showed with the allotment entry in the journal, it will be adjusted in the balance sheet on the liabilities side under the head of “reserves & surplus”.

Accumulated Depreciation: The total to date of the periodic depreciation charges on depreciable assets.

Investment: Expenditure on assets held to earn interest, income, profit or other benefits.

Capital: Generally refers to the amount invested in an enterprise by its owner, Ex: paid up share capital in corporate enterprise.

Capital work in progress: Expenditure on capital assets which are in the process of construction as completion.

Convertible debenture: A debenture which gives the holder a right to conversion wholly or partly in shares in accordance with term of issues.

Redeemable Preference Share: The preference share that is repayable either after a fixed (or) determinable period(or) at any time dividend by the management.

Cumulative preference shares: A class or preference shares entitled to payment of stimulates dividends. Preference shares are always deemed to be cumulative unless they are expressly made non-cumulative preference shares.

Debenture redemption reserve: A reserve created for the redemption of debentures at a future date.

Cumulative dividend: A dividend payable as cumulative preference shares which it unpaid cumulative as a claim against the earnings of a corporate before any distribution made to the other shareholders.

Dividend Equalization reserve: A reserve created to maintain the rate of dividend in future years.

Opening stock: The term ‘opening stock’ means goods lying unsold with the businessman in the begining of the accounting year. This is shown on the debit side of the trading account.

Closing stock: The term 'Closing Stock' includes goods lying unsold with the businessman at the end of the accounting year. The amount of closing stock is shown on the credit side of the trading account and as an asset in the balance sheet.

Valuation of closing stock: The closing stock is valued on the basis of "Cost or Market price whichever is less "principle.

Contingency: A condition(or) situation the ultimate outcome of which gain or loss will be known as determined only as the occurrence or non occurrence of one or more uncertain future events.

Contingency asset: An asset the existence ownership or value of which may be known or determined only on the occurrence or non occurrence of one more uncertain future events.

Contingency liability: An obligation to an existing condition or situation which may arise in future depending on the occurrence of one or more uncertain future events.

Deficiency: The excess of liabilities over assets of an enterprise at a given date is called deficiency.

Deficit: The debit balance in the profit and loss a/c is called deficit.

Surplus: Credit balance in the profit & loss statement after providing for proposed appropriation & dividend reserves.

Appropriation assets: An account sometimes included as a separate section of the profit and loss statement showing application of profits towards dividends, reserves.

Capital redemption reserve: A reserve created on redemption of the average cost, the cost of an item at a point of time as determined by applying an average of the cost of all items of the same nature over a period when weighs are also applied to the computation it is termed as weight average cost.

Floating charge: Assume change on some or all assets of an enterprise which are not attached to specific assets and are given as security against debt.

Difference between funds flow and cash flow statement. A cash flow statement is concerned only when the change in each position which a fund flow analysis is concerned with a change in working capital position between two balance sheet dates.

Cash flow statement is mearly a record of cash receipts and disbursements. While studying the short-term solvency of a business one is interested not only in cash balance but also in the assets which are easily convertible into cash

Difference between the funds flow and income statement
A funds flow statement deals with the financial resource required for running the business activities. It explains how were the funds obtained and how were they used, where as

Income statement discloses the results of the business activities, i.e. how much has been earned and how it has been spent.

A funds flow statement matches the "funds raised" and "funds applied" during a particular period. The source and application of funds may be of capital as well as of revenue nature. An income statement matches the incomes of a period with the expenditure of that period, which are both of a revenue nature.

Accrual Basis A method of accounting that recognizes revenues and expenses as they accrue, even though cash would not have been received or paid during the accrual period.

Break-even Point The point where the revenues from a business operation equal the total costs (FIXED COSTS = VARIABLE COSTS). Thus, a profit accrues when revenues exceed the break-even point. The break-even volume is computed by dividing the fixed costs (FC) by the difference between the selling price per unit (SP) and variable cost per unit (VC).

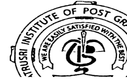
Budget A financial plan that projects receipts and payments of an entity covering a specific period of time, usually one year. Its primary purpose is to achieve financial control. Budgets could be distinguished on the basis of time span, function and flexibility. For instance, budgets may be short-term or long-term; similarly, there are Sales Budgets, Cash Budgets, Capital Expenditure Budgets and other to cover different functions

Cost of Goods Sold Alternatively called the Cost of Sales, it is the sum of total input costs associated with a certain quantity of goods sold. The total input costs include materials used, direct and indirect labour, utilities, and other manufacturing expenses including DEPRECIATION.

Depreciation An accounting process by which the cost of a FIXED ASSET, such as a building or machinery, is allocated as a periodic expense, spread over the depreciable life of the ASSET. The term also means the amount of expense determined by such a process. Sometimes, it is called AMORTIZATION when the ASSET is intangible or 'depletion' when the asset is a natural resource, such as minerals. There are different methods of depreciation such as the Straight Line Method and the Written Down Value (WDV) method.

Semi-Variable Costs The costs that vary with output though not proportionately. Examples are repairs and maintenance expenses.

Variable Cost The expenses that vary proportionately with the level of production activities or volume of output of any business. Examples include materials, electricity, and lubricants. Hence, ordinarily, the MARGINAL COST of a unit of output is the increase in total variable cost entailed by the additional unit, i.e., direct material, direct labour, direct expenses and certain overheads.



FINANCIAL MARKETS TERMS

FINANCIAL MARKET TERMS

ADR An acronym for American Depository Receipt. It is an instrument traded at U.S. exchanges representing a fixed number of shares of a foreign company that is traded in the foreign country. By trading in ADRs, U.S. investors manage to avoid some of the problems of dealing in foreign securities markets. The ADR route enables companies to raise funds in the U.S. financial markets, provided they meet the stringent regulatory norms for disclosure and accounting.

Allotment The acceptance of an application subscribing to the shares or other securities of a company. Such allotment establishes the contractual relationship that underlies an investment through public subscription.

Amortization The reduction f an amount at regular intervals over a certain time period. This term is used to refer to the reduction of debt by regular payment of loan installments during the life of a loan. It is also used to described the accounting process of writing off an intangible ASSET.

Annual Report A yearly publication that contains particulars relating to the operating data of a company, and which is published and distributed by the company to its share-holders, as per the requirement of the Companies Act. The important contents are the profit and loss statement and the BALANCE SHEET. These statements show a company's performance in terms of sales and earnings during a financial year, and also its year-end financial position in terms of ASSETS and LIABILITIES. It also contains the directors' report, a notice to the shareholders about the proposed business agenda of the annual general meeting and the auditor's report.

Arbitrage The simultaneous purchase and sale transactions in a security or a commodity, undertaken in different markets to profit from price differences. For example, an arbitrageur may find that the share of The Tata Iron and Steel Company (TISCO) is trading at a lower price, at the Vadodara Stock Exchange compared to the exchange at Bombay. Hence, he may simultaneously purchase TISCO stock in Vadodara at, say Rs.250, and sell in Bombay at a higher price, say Rs.256, making a profit of Rs.6 per share less expenses.

Asset Management Company (AMC) A company set up for floating and managing schemes of a MUTUAL FUND. An AMC earns fees by acting as the PORTFOLIO manager of a fund. The AMC is appointed by the Board of Trustees, which oversees its activities. Thus, a mutual fund is generally established as a trust by a SPONSOR, which could be a registered company, bank or FINANCIAL INSTITUTION. Also, a custodian and a registrar are appointed to ensure safe keeping of the fund's securities and to deal with investors' applications, correspondence, etc.

At-the-Money The term relates to trading in listed OPTIONS. An option is said to be trading "at-the-money" when the STRIKING PRICE and the market price of the underlying share are equal.

Balance of Payments A statement that contains details of all the economic transactions of a country with the rest of the world, for a given time period, usually one year. The statement has two parts: the Current Account and the Capital Account.

The ‘Current Account’ gives a record of a country’s: (a) Trade Balance which shows the difference of exports and imports of physical goods such as machinery, textiles, chemicals and tea, (b) ‘Invisibles’ that comprise services (rendered and received) such as transportation and insurance and certain other flows, notably private transfers by individuals. When imports of goods exceed exports, it is referred to as a ‘Trade Deficit’. However, the overall current account position depends on both the trade balance and the performance of ‘Invisibles’.

The ‘Capital Account’ contains details of the inward and outward flows of capital and international grants and loans. Examples of such flows are external assistance, foreign (direct and PORTFOLIO) investments, subscription to Global Depository Receipts or EUROCONVERTIBLE BONDS and deposits of non-residents. Inflows on the capital account are helpful in financing a current account DEFICIT. Any gap that remains is covered by drawing on exchange or gold reserves, or by credit from the International Monetary Fund. Depending on the nature of imports, a deficit on the current account indicates an excess of investment over domestic saving in an economy. So long as this deficit is kept in check (evaluated as a percentage of the CROSS DOMESTIC PRODUCT), the DEBT SERVICE RATIO would remain within manageable limits.

A challenge posed to India some years ago was the upward pressure on the Rupee’s exchange rate in the wake of large capital account inflows. So, to maintain the competitiveness of India’s exports, the Reserve Bank of India (RBI) resorted to purchases of foreign exchange. However, this has also caused money supply to increase, and the RBI has had to ‘sterilize’ such monetization by raising the CASH RESERVE RATIO or by engaging in OPEN MARKET OPERATIONS.

Balance Sheet A statement of the financial position of an enterprise, as on a certain date, and in a certain format showing the type and amounts of the various ASSETS owned, LIABILITIES owed, and shareholder’s funds.

Bear A person who expects share prices in general to decline and who is likely to indulge in SHORT SALES.

Bear Market A long period of declining security prices. Widespread expectations of a fall in corporate profits or a slowdown in general economic activity can bring about a bear market.

Beta (b) A measure of the volatility of a stock in relation to the market. More specifically, it is the index of SYSTEMATIC RISK, indicating the sensitivity of return on a security or a PORTFOLIO to return from the market. It is the slope of the regression line, known as the CHARACTERISTIC LINE, which shows the relationship of an ASSET with the market. For measuring market returns, a proxy such as a broad-based index is used. Thus, if b exceeds 1, the security is more volatile than the market, and is termed an ‘Aggressive Security’. For example, a beta of 1.3 implies that a security’s return will increase by 13 percent when the return from the

market goes up by 10 percent. An asset whose beta is less than 1 is termed a ‘defensive security’. Based on this, an aggressive growth strategy would be to invest in high beta stocks when the market is poised for an upswing; similarly, a switchover to low beta stocks is recommended when a downswing is imminent.

Bills of Exchange A credit instrument that originates from the creditor (drawer) on which the DEBTOR (drawee) acknowledges his LIABILITY; after such acceptance, the drawer may get the bill discounted, so as to realize the proceeds immediately.

Blue Chip A share of a company that is financially very sound, with an impressive track record of earnings and DIVIDENDS, and which is highly regarded for its competent management, quality products and/or services. Examples in India are Hindustan Lever, Gujarat Ambuja Cements, and Reckitt & Colman among others.

Bond A long-term debt instrument on which the issuer pays interest periodically, known as ‘Coupon’. Bonds are secured by COLLATERAL in the form of immovable property. While generally, bonds have a definite MATURITY, ‘Perpetual Bonds’ are securities without any maturity. In the U.S., the term DEBENTURES refers to long-term debt instruments which are not secured by specific collateral, so as to distinguish them from bonds.

Bond Insurance A form for credit enhancement, which provides a financial guarantee on the obligations of a debt instrument. The purpose of credit enhancement is to increase the safety of debt securities. Apart from financial guarantees, other forms of credit enhancement include letter of credit, overcollateralization, etc. Overcollateralization involves the provision of additional assets as security.

Bonus Shares The issue of shares to the shareholders of a company, by capitalizing a part of the company’s reserves. The decision to issue bonus shares, or stock DIVIDEND as in the U.S., may be in response to the need to signal an affirmation to the expectations of shareholders that the prospects of the company are bright; or it may be with the motive of bringing down the share price in absolute terms, in order to ensure continuing investor interest. Following a bonus issue, though the number of total shares increases, the proportional ownership of shareholders does not change. The magnitude of a bonus issue is determined by taking into account certain rules, laid down for the purpose. For example, the issue can be made out of free reserves created by genuine profits or by share PREMIUM collected in cash only. Also, the residual reserves, after the proposed capitalization, must be at least 40 percent of the increased PAID-UP CAPITAL. These and other guidelines must be satisfied by a company that is considering a bonus issue.

Book Building: A process used to ascertain and record the indicative subscription bids of interested investors to a planned issue of securities. The advantages of this technique of obtaining advance feedback, are that it results in optimal pricing and removes uncertainty regarding mobilization of funds.

The concept of book building is alien to India's PRIMARY MARKET; so, towards the end of 1995, efforts were under way, to introduce this mechanism as an option in the case of large issues (minimum size: Rs.100 crore). An issue was divided into a 'Placement Portion' and another termed 'Net Offer to the Public'. For the Placement Portion, the exercise of book building enables the issuing company to interact with institutional and individual investors, and collect particulars of the number of shares they would buy at various prices. The procedure is carried out by a lead manager to the issue, called the 'Book Runner'. It commences with the circulation of a preliminary PROSPECTUS and an indicative price band, for the purpose of forming a syndicate of underwriters, comprising FINANCIAL INSTITUTIONS, MUTUAL FUNDS and others. This syndicate, in turn, contacts prospective investors in order to elicit their quotes. These quotes are forwarded to the book runner, who prepares a schedule of the size of orders at different prices. After receiving a sufficient number of orders, the company and the merchant bankers decide the issue price and underwriting particulars. There are some other aspects of book building arising from the guidelines issued by the Securities and Exchange Board of India. A change brought about in 1997 was that the book building process could be applied to the extent of 100 percent of the issue size, for large issues as defined above. Interestingly, the process has been used in India to place debt securities as well.

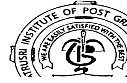
Book Value It is the amount of NET ASSETS that would be available per EUQUITY SHARE, after a company pays off all LIABILITES including PREFERENCE SHARES from the sale proceeds of all its ASSETS liquidated at BALANCE SHEE values.

Bought-out Deal The sale of securities under a negotiated agreement between an issuer and the investing institution, as an alternative to a PUBLIC ISSUE. The intent on the part of the buyer is to offload the securities later in the market at a profit. Bought-out deals are commonplace in issues of the Over the Counter Exchange of India (OTCEI). The advantage to the issuing company is the saving in time and cost that a public issue would entail. It is a big help to unlisted companies and projects, which must see through a gestation period before tapping the PRIMARY MARKET. For institutions and MUTUAL FUNDS, the route is another avenue for investing funds. However, there could be some disadvantages to the issuer such as interference by the INSTITUTIONAL INVESTOR or restrictive CONVENANTS in the initial subscription agreement. On the other hand, the institutional investor or the sponsor in OTCEI deals, bears the risk of capital loss due to a fall in the price of the securities.

Bull A person who expects share prices in general to move up and who is likely to take a long position in the stock market.

Business Risk The risk of business failure, which stems from factors such as the cost structure of a venture (i.e., FIXED COST versus VARIABLE COST), intra-industry competition, and government policies. It is reflected in the variability of profits before interest and taxes

Call Money A term used for funds borrowed and lent mainly by banks for overnight use. This is a market, which banks access in order to meet their reserve requirements or to cover a sudden shortfall in funds and the interest rate is determined by supply



and demand conditions. The situation arises when banks face an unforeseen shortfall in funds, perhaps because they have invested a large amount in other ASSETS, e.g., GOVERNMENT SECURITIES and loans or due to heavy withdrawals by depositors for different reasons. High call money rates are an indication of such a mismatch or of a deliberate policy to substantially borrow short-term and lend long-term. The more stringent requirements relating to the Cash Reserve Ratio from January 1995, particularly the severe penalty for default, has also forced banks to borrow short-term; this explains the sudden but short-lived jumps in the call money rate.

An alternative source for banks would be to do REPOS deals with the Discount and Finance House of India (DFHI) or Securities Trading Corporation of India (STCI), using the excess security holdings. Incidentally, DFHI is also an active intermediary in the call money market. Besides, certain FINANCIAL INSTITUTIONS and corporate entities (through PRIMARY DEALERS) have also been permitted to participate as lenders. The announcement by the Reserve Bank of India (RBI) in April, 1995 to permit private sector MUTUAL FUNDS to lend in the call money/NOTICE MONEY/BILL REDISCOUNTING market may alleviate the situation considerably. Incidentally, this measure also provides these entities a facility for parking short-term funds. Ultimately, though, the RBI intends to make the call money/notice money/term money market into a purely inter-bank market, with the additional involvement of Primary Dealers. Accordingly, the REPOS market is being widened and developed for the benefit of non-bank participants, who may be permitted to do repos deals (i.e., borrowing funds) as well. Further, the underlying eligible securities will include PSU BONDS, corporate BONDS, and others in dematerialized form. Moreover, the participation of non-banks in the call/notice money market is to cease by the end of 1999.

Capital Asset Pricing Model (CAPM): A theoretical construct, developed by William Sharpe and John Lintner, according to which, a security's return is directly related to its SYSTEMATIC RISK, that is, the component of risk which cannot be neutralized through DIVERSIFICATION. This can be expressed as :

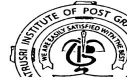
Expected rate of return – Risk-free rate of return + Risk premium

Further, the model suggests that the prices of ASSETS are determined in such a way that the RISK PREMIUMS or excess returns are proportional to systematic risk, which is indicated by the BETA coefficient. Accordingly, the relationship

Risk Return on Risk-free (Beta of premium market portfolio return security)

Determines the risk premium. Thus, according to the model, the expected rate of return is related to the beta coefficient. This relation is portrayed by the SECURITY MARKET LINE.

Capital Market Line This is a graphical line which represents a linear relationship between the expected return and the total risk (standard deviation) for efficient PORTFOLIOS of risky and riskless securities. When lending and borrowing



possibilities are considered, the capital market line becomes the EFFICIENT FRONTIER starting from the riskless rate for the point of tangency on the efficient frontier of portfolios.

Closed-end Fund A scheme of an investment company in which a fixed number of shares are issued. The funds so mobilized are invested in a variety of vehicles including shares and DEBENTURES, to achieve the stated objective, e.g., capital appreciation for a GROWTH FUND or current income for an INCOME FUND. After the issue, investors may buy shares of the fund from the secondary market. The value of these shares depends on the NET ASSET VALUE of the fund, as well as supply and demand for the fund's shares. Examples are Mastershare and Ind Ratna.

Commercial Paper (CP) A short-term, unsecured PROMISSORY NOTE issued by BLUE CHIP companies. Like other MONEY MARKET instruments, it is issued at a DISCOUNT on the FACE VALUE and is freely marketable. Commercial Paper may be issued to any person including individuals, banks and companies. The Reserve Bank of India (RBI) has laid down certain conditions regarding issue of CPs. The issuing company must have a certain minimum tangible NET WORTH, working capital limit, asset classification, etc. and the paper must have a CREDIT RATING of P2, A2 or PR-2. Moreover, the rating must not be over two months old at the time of issue. From November 1996, the extent of CP that can be issued by all eligible corporates has been raised to 100 percent of the working capital credit limit. As for restoration of the limit consequent on redemption of CP, banks have been given freedom to decide on the manner of doing so.

Commodity Futures A standardized contract guaranteeing delivery of a certain quantity of a commodity (such as wheat, soybeans, sugar or copper) on a specified future date, at a price agreed to, at the time of the transaction. These contracts are standardized in terms of quantity, quality and delivery months for different commodities. Contracts on certain commodities such as pepper and coffee are already traded in India. Moreover, the Kabra Committee in 1994 recommended that futures trading be permitted in several other commodities including rice, cotton, Soya bean and castor oil. Further, in an interesting development, a committee appointed by the Reserve Bank of India under the chairmanship of R.V. Gupta has recommended that Indian corporates be allowed to hedge in offshore futures and OPTIONS markets in a phased manner. The committee submitted its report in November 1997.

Consortium A term generally used in banking: it refers to a group of banks associating for the purpose of meeting the financial requirements of a borrower, such as WORKING CAPITAL or a term loan. In business, the term applies to a group of companies, national or international, working together as a joint venture, sharing resources and having interlocking financial agreements.

Contingent Liabilities The liabilities that may arise as a result of some future event which, though possible, is deemed unlikely; for example, a court judgement on a pending lawsuit may impose a financial payment on a company.

Corporate Governance The manner in which a company is managed. The term,

Corporate Governance connotes the importance of responsibility and accountability of a company's management to its shareholders and other stakeholders, viz., employees, suppliers, customers and the local community. Hence it calls for ethics, morals and good practices in running a company. Good corporate governance would be reflected in generally good performance, clean business practices, improved disclosure and sound policies relating to capital expenditure, financing and dividend payment, which will enhance shareholders' wealth.

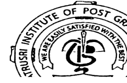
Coupon Rate It is the rate of annual interest on the PAR VALUE of DEBENTURES or BONDS that an issuer promises to pay. In India, till a few years ago, coupon rates were subject to a ceiling stipulated by the Controller of Capital Issues. With the removal of the ceiling, issuers have fixed their coupon rates by taking into consideration, market perceptions and expectations. The rate may be fixed or it may be floating in relation to some benchmark.

Credit Rating The exercise of assessing the credit record, integrity and capability of a prospective borrower to meet debt obligations. Credit rating relates to companies, individuals and even countries. In the case of a company's debt instrument, such formal evaluation with the aid of quantitative and qualitative criteria, culminates in the assignment of a letter rating to the security. The instrument could be a DEBENTURE, FIXED DEPOSIT OR COMMERCIAL PAPER. The rating represents in rating agency's opinion at that time on the relative safety of timely payment of interest and principal associated with the particular debt obligation. This opinion rests on the agency's assessment of the willingness and capability of the issuer to meet the debt obligations. The methodology is to examine key factors like the business, the management, regulatory environment, competition and fundamental aspects including the financial position. A high credit rating can help in reducing the interest cost and also facilitate placement of the debt security. The rating agencies in India are Credit Rating and Information Services of India Limited (CRISIL), ICRA, and Credit Analysis and Research (CARE).

A recent development in India is the rating of fixed deposits of banks, STRUCTURED DEBT OBLIGATIONS and securitized debts. Moreover, performance ratings can now be obtained by real estate developers and LPG bottlers. It is expected that ratings will soon be extended to chit funds and MUTUAL FUNDS, Besides, a general credit rating service not linked to any debt issue may be availed of by a company. This service is already offered by Indian rating firms. CIRSIL, for example, calls it Credit Assessment. This rating can be used in negotiations with new bankers, for performance guarantees, etc. International rating agencies also undertake sovereign rating, i.e. of countries.

Credit appraisal also covers individuals. This type of information is useful to consumer credit firms

Cross Currency Option An instrument that confers a contractual right on the purchaser of the OPTION to buy (call) or sell (put) a currency against another currency, e.g., Yen for U.S. dollar. For this privilege, the purchaser pays a cost termed PREMIUM. Incidentally, the terminology applicable to cross currency options is similar to the one for stock options. For instance, the STRIKE PRICE is the



contracted exchange rate at which the option buyer buys or sells a currency. The advantages with a cross currency option, (introduced in India in January 1994) as compared to forward and futures deals are that the option buyer is under no obligation to exercise the right; moreover, the maximum possible loss, it at all, becomes known to the option buyer at the outset. Thus, when the direction of a currency's movement is uncertain, a cross currency option may be preferable to a FORWARD CONTRACT.

Depository A system of computerized book-entry of securities. This arrangement enables a transfer of shares through a mere book-entry rather than the physical movement of certificates. This is because the scrips are 'dematerialized' or alternatively, 'immobilized' under the system.

A depository performs the functions of holding, transferring and allowing withdrawal of securities through its agents viz., depository participants. For settlement of trades done at an exchange, the depository interacts with a clearing corporation which oversees the payment of funds and delivery of securities.

Under dematerialization, securities in physical form are destroyed, whereas under immobilization, the securities are stored away in vaults. Further, rematerialization is possible, so as to restore securities to physical form.

The system of maintaining ownership records in the form of electronic holdings will help to eliminate problems that are associated with physical certificates such as fake/torn certificates and loss in transit.

Depression An economic condition that is characterized by a severe contraction in economic activity, which is manifested. In numerous business shut-downs, widespread unemployment, and declining investment in plant and equipment on account of falling sales.

Derivative A financial contract that derives its value from another ASSET or an index of asset values. These underlying assets maybe foreign exchange, BONDS, equities or commodities. For example, FORWARD CONTRACTS relate to foreign exchange; futures to commodities, debt instruments, currencies or stock indices; and OPTIONS to equities. Derivatives are traded at organized exchanges and in the over-the-counter (OTC) market.

Derivatives traded at exchanges are standardized contracts having standard delivery dates and trading units. OTC derivatives are customized contracts that enable the parties to select the trading units and delivery dates to suit their requirements. Moreover, there are fewer regulatory restrictions and this facilitates innovation. A major difference between the two is that of counter party risk – the risk of default by either party. With exchange-traded derivatives, the risk is controlled by exchanges through clearing-houses which act as a contractual intermediary and impose margin requirements. In contrast, OTC derivatives signify greater vulnerability. OPTIONS derive their values from shares or stock market indices; an option confers the right without any obligation to buy or sell an asset at a predetermined price on or before a stipulated EXPIRATION DATE. Interest-rate futures are tied to debt instruments.

This contract binds the parties to exchange a debt security against payment e.g., TREASURY BILL, on a future date at a predetermined price. The value of the futures contract is governed by the value of the underlying Treasury Bill. If yields decline, the value of the futures contract will rise because the buyer has locked in a higher interest rate. SWAPS are agreements between two parties to exchange cash flows in the future according to a predetermined formula.

With their universal recognition as risk-management tools, trading in derivatives has registered a phenomenal growth in the Western financial markets. The relationship with other assets and certain other features makes derivatives useful for SPECULATION, HEADGING, ARBITRAGE and PORTFOLIO adjustments.

India may soon see the introduction of exchange-traded derivatives on stock indices and other financial assets if the recommendations of the L.C. GUPTA COMMITTEE are implemented shortly.

Devaluation The lowering of a country's official exchange rate in relation to a foreign currency (or to gold), so that exports compete more favorably in the overseas markets. Devaluation is the opposite of REVALUATION.

Dhanuka Committee A committee headed by Justice D. R. Dhanuka to review securities related Acts, regulations and rules, set up by the Securities and Exchange Board of Indian (SEBI) in March 1997. Some of its recommendations as gleaned from press reports are : 1. The MUTUAL FUND and collective schemes of the Unit Trust of India (UTI) must come under the purview of SEBI.
2. In case of differences, the SEBI Act must prevail over the UTI Act.
3. Self-regulatory organizations in the financial sector such as AMBI and AMFI must register with SEBI.
4. The exemption from payment of stamp duty that is available to beneficial owners of dematerialized shares should also be extended to transfer of shares in physical form.
5. Companies making a public issue of over Rs.10 crore should use the DEPOSITORY option.

Direct Taxes Taxes whose impact and incidence are on the same person. The taxes levied on income, and wealth tax are instances of direct taxes.

Discount This refers to :

1. The margin by which a security's market price is lower than its face value.
2. In security analysis, it means the adjustment in security prices consequent to the assimilation of new information about a company, or news in general. An illustration is the increase in the price of a stock following the news of the company bagging big sale orders.
3. Reduction in the sale price of goods.

Discount Rate The interest rate used in calculating the PRESENT VALUE of future cash flows.

Disinvestments The sale of shareholding by an individual or institution in order to raise cash.

Diversification The process of spreading out investments so as to limit exposure and reduce risk. Individuals do this by investing in shares of different companies or by combining stocks with DEBENTURES, MUTUAL FUND shares, FIXED DEPOSITS and other investment vehicles. Companies achieve diversification by venturing into new and unrelated business areas.

Dividend The payment made by a company to its shareholders. Legal and financial considerations have a bearing on the level of dividend to be paid. For instance, dividends may be paid out of profits alone; so also, a growing company needs funds to finance its expansion and hence may pay only a modest dividend, in order to conserve resources.

Dow Theory A theory to ascertain the emergence of a primary trend (a trend which indicates either a bullish or bearish phase) in the stock market. It seeks confirmation of whether a long-term market advance or decline is under way, by examining the movement of the Dow Jones Industrial Average in conjunction with the Dow Jones Transportation Average. These averages are summary measures of stock prices in the U.S.

Dumping The sale of goods in a foreign market at a price that is below the price realized in the home country, after allowing for all costs of transfer including transportation charges and duties. The motive may be to enhance revenues, offload surplus stocks or a predatory intent of killing foreign competition.

Earnings Per Share (EPS) The net profits of a company expressed on a per (EQUITY) SHARE basis. It is arrived at by dividing the figure of profits after taxes and DIVIDENDS paid on PREFERENCE SHARES, if any, by the number of equity shares outstanding. Therefore, it does not reveal the potential impact of dilution in earnings on account of securities such as convertibles or warrants that may be outstanding. Moreover, an improvement in EPS does not necessarily indicate a more productive use of the total amount of funds available with a firm.

Economic Value Added (EVA) A tool for evaluating and selecting stocks for investment, and also used as a measure of managerial performance. An American consultancy firm, Stern Stewart is credited with the development of this tool in the late eighties. It is calculated by subtracting the total cost of capital from the after-tax operating profits of a company.

EVA = After-tax Operating Profits – Total cost of capital

Operating profits simply mean earnings before interest and taxes. The cost of capital is the composite cost of total equity and debt, which together are deployed in various ASSETS such as land, buildings, machines, INVENTORIES, receivables and cash. Total equity includes reserves and shares PREMIUM, for which an appropriate

OPPORTUNITY COST must be considered. A positive EVA is deemed to be a good sign and the higher it is, the better. EVA expressed on a per share basis facilitates comparison between companies.

EEFC Account This refers to the Exchange Earners' Foreign Currency Account, a scheme introduced in 1992 for exporters and residents receiving foreign exchange. A certain percentage of the earnings may be maintained in this account in order to limit exchange rate risk in case of future imports or for other specified purposes.

Efficient Portfolio A diversified selection of stocks resulting in a least risk PORTFOLIO for a given rate of return. At that level of RISK, no other portfolio provides superior returns. Combining shares from different unrelated industries helps to neutralize the UNSYSTEMATIC RISK inherent in each security.

Equity Grading A service offered by the credit rating agency, ICRA Limited, under which the agency assigns a grade to an equity issue, at the request of the prospective issuer. This symbolic indicator conveys the agency's opinion on the relative quality of equity being offered, on the basis of its in-depth study of the company and all relevant factors. It takes into account the earning prospects, risk and financial strength associated with the issuer, which reflect its managerial competence, industry outlook, competition, etc. credit rating agency, ICRA Limited, under which the agency assigns a grade to an equity issue, at the request of the prospective issuer. This symbolic indicator conveys the agency's opinion on the relative quality of equity being offered, on the basis of its in-depth study of the company and all relevant factors. It takes into account the earning prospects, risk and financial strength associated with the issuer, which reflect its managerial competence, industry outlook, competition, etc. There are 12 grades starting with ERAI (signifying excellent earning prospects with low risk) and ending with ERD3 (representing poor earning prospects and high risk). The agency also offers the service of Equity Assessment, which is at the request of an investor. This appraisal is a one-time exercise and is in the form of a report that is intended to help investors in their investment decisions.

Equity Share A security that represents ownership interest in a company. It is issued to those who have contributed capital in setting up an enterprise. Apart from a PUBLIC ISSUE, equity shares may originate through an issue of BONUS SHARES, CONVERTIBLE securities, WARRANTS, GDRS, etc. An alternative term that is sometimes used is 'COMMON STOCK' or simply, 'STOCK'.

The share of a public limited company can be subsequently sold through stock exchanges or other forums. The claim of equity shareholders on earnings and on ASSETS in the event of liquidation, follows all others. For example, DIVIDEND on equity shares is paid after meeting interest obligations and dividends to PREFERENCE shareholders. Hence, they are also known as 'residual owners'. For bearing such risk, equity shareholders expect handsome returns by way of DIVIDENDS and price appreciation of the share, when their enterprise performs well.

Escrow Cash, securities or other valuable instruments that are held by a third party to ensure that the obligations under a contract are discharged. The escrow mechanism is

a technique of mitigating the risk to lenders and it is used typically in infrastructure projects such as power, roads or telecom. For example, an escrow account can be set up at a bank for depositing the payments of electricity bills.

Euro The common European currency that will come into being with the formation of the European Union. This economic union has given birth to the European Monetary Union tht will be characterized by a common CENTRAL BANK and MONETARY POLICY, besides the common currency. Elimination of exchange rate risk and reduction of transaction costs between members are seen as major benefits of the common currency. The circulation of the Euro is slated to take place in 2002 and it is expected to emerge as an important international currency. More specifically, it will compete with the US dollar as a reserve currency.

Euro Issue An issue of securities to raise funds outside the domestic market. Euro issues by Indian companies have been by way of GDRS or EUROCONVERTIBLE BONDS. The advantages associated with Euro issues are :

1. Reduced cost of capital owing to lower interest rates and floatation costs.
2. Efficient pricing that maximizes mobilization.
3. No immediate dilution of voting control.
4. Greater visibility due to international exposure.
5. Inflow of foreign currency funds.

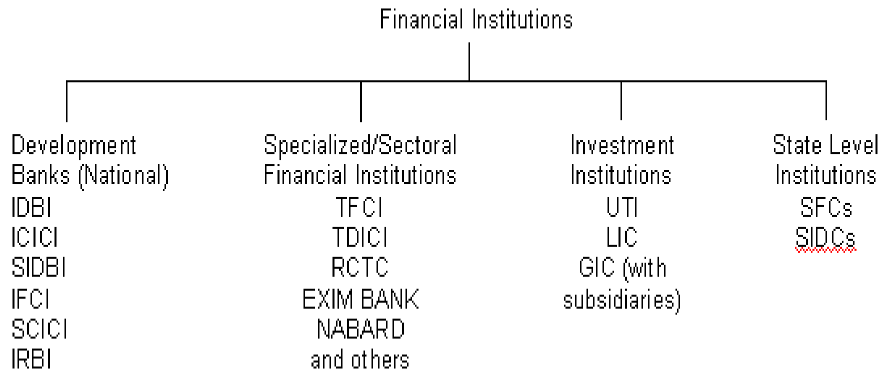
Euro issues must conform to the guidelines issued by the Central Government. Among other thing, prior permission for an issue must be obtained from the Ministry of Finance.

Eurobond A bond denominated in a currency different from that of the country in which it is sold.

Financial Futures These are contracts guaranteeing delivery of specified financial instruments on a future date, at a predetermined price. The financial instruments traded in the U.S. futures markets consist of foreign currencies and debt securities e.g., TREASURY BILLS, long-term U.S. Treasury BONDS, COMMERCIAL PAPER, etc. The futures contracts on debt securities are commonly known as interest-rate futures. They offer companies, banks and institutions a means to insulate themselves from adverse interest rate movements through HEADING. The objective behind hedging is to establish in advance, a certain rate of interest for a given time period. That apart, financial futures offer considerable profit potential which attracts speculators and individual investors too.

Financial Institution A non-banking financial intermediary (company corporation or co-operative society) carrying on any of the activities specified in the relevant section of the Reserve Bank of India Act. These activities include lending, investing in shares and other securities, HIRE-PURCHASE, insurance and CHIT FUNDS.

In general, this term refers to the Development Finance Institutions such as IDBI and IFCI, as well as the Unit Trust of India (UTI) and the Life Insurance Corporation of India (LIC). However, a more specific classification could be as shown below :



SIDBI : Small Industries Development Bank of India.SCICI : SCICI Ltd.

SFCs: State Financial Corporations.

TFCI: Tourism Finance Corporation of India Ltd.

TDICI : Technology Development and Information Company of India Ltd.

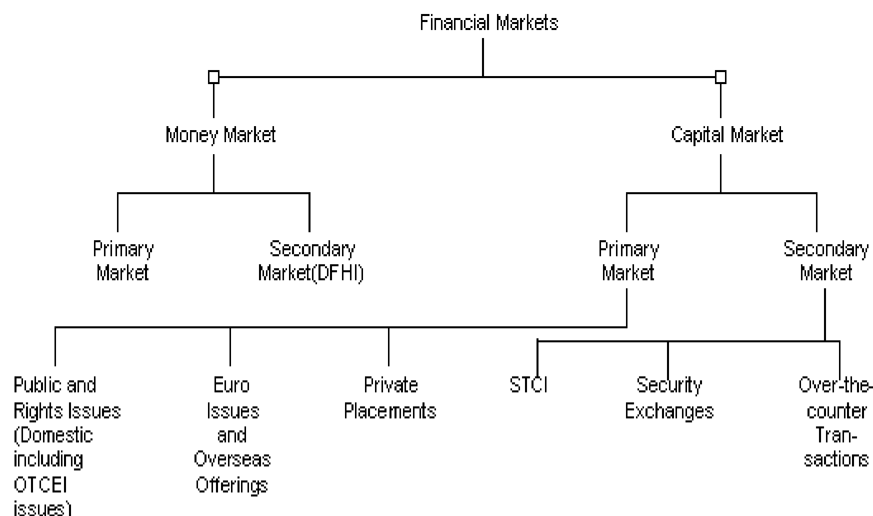
RCTD : Risk Capital and Technology Finance Corporation Limited.

Financial Leverage The ability to magnify earnings available to equity shareholders, by the use of debt or fixed-charge securities. Generally, the higher the amount of debt in relation to total financing, the greater will be the impact on profits available to equity shareholders, other things being equal.

$$DFL = \frac{\text{Percentage change in EPS}}{\text{Percentage change in PBIT}}$$

Though debt finance is tax-deductible, and hence an attractive source of funds, leverage is a double-edged sword, since the firm using leverage attracts not only higher returns but a risk as well. This is because an increase in debt raises fixed interest expenses and, thereby, the chances of financial failure.

Financial Markets The transactions which result in the creation or transfer of financial ASSETS and LIABILITIES, mostly in the form of tradeable securities. The term connotes a vast forum rather than a specific physical location for trading activity. The constituents of financial markets are shown below :



The Money Market is that segment of the financial markets wherein financial instruments having maturities of less than one year are traded. These different instruments are listed below :

Instrument	Typical MATURITY (in days)
CALL MONEY and NOTICE MONEY	1 and up to 14
REPOS	14
INTER-BANK TERM MONEY	15 TO 90
BILL OF EXCHANGE	90
TREASURE BILL	14, 28,91, 182 and 364
INTER-BANK PARTICIPATION	
CERTIFICATE	91 TO 180
CERTIFICATE OF DEPOSIT	90 TO 364
COMMERCIAL PAPER	30 TO 364
INTERCORPORATE DEPOSIT	90

The money market is useful to any entity, whether a government, bank, business or wealthy individuals having a temporary surplus or DEFICIT. Hence, it may be viewed as a forum for adjusting their short-term LIQUIDITY positions. The open money market does not have any physical trading locations. It is essentially a network of the major players and intermediaries linked by telephones and other media. However, the Reserve Bank of India plans to introduce screen-based trading system for this segment. The DISCOUNT AND FINANCE HOUSE OF INDIA LIMITED (DFHI) plays an important role as a MARKET MAKER in money market securities.

The Capital Market is that segment of the financial markets in which securities having maturities exceeding one year are traded. Examples include DEBENTURES, PREFERENCE shares and EQUITY SHARES.

Over-the-Country Exchange of India (OCTEI) offerings may originate as a public

issue or a BOUGHT-OUT DEAL. EURO ISSUES and overseas offerings include GDRs, FOREIGN CURRENCY CONVERTIBLE BONDS, ADRs, FOREIGN BONDS and private placement with Foreign Institutional Investors (FIIs), all of which bring inflow of foreign exchange.

Over-the-counter transactions refer to the trading in securities including shares, that goes on at places other than exchanges, e.g., KERB DEALS or transactions at investors' clubs.

Fiscal Policy The use of tax and expenditure powers by a government. Government all over the world, are vested with the task of creating infrastructure (e.g., roads, ports, power plants, etc.) and are also required to ensure internal and external security. These responsibilities entail government expenditures on various fronts – capital outlays, the defense forces, police, the administrative services and others. Taxes are a major source of revenue to meet these outflows. Thus, the Union Government collects income tax, EXCISE DUTY, customs duty, etc., through its different arms.

An increase in government spending without a matching increase in inflows may cause or exacerbate a DEFICIT. But, government spending also contributes to aggregate demand for goods and services – directly, and indirectly by increasing private incomes which stimulates private demand.

Float The interval between the issuance of a cheque and its payment by the drawer's bank, through the clearing system. The time involved in clearing cheques through the banking system allows greater flexibility in cash management funds need not be deposited in an account as soon as a cheque is issued.

Floating Exchange Rate The exchange rate of a currency that is allowed to float, either within a narrow specified band around a reference rate, or totally freely according to market forces. These forces of demand and supply are influenced by factors, such as, a nation's economic health, trade performance and BALANCE OF PAYMENTS position, interest rates and INFLATION.

Floating Rate Bond A debt security whose COUPON RATE is periodically adjusted upwards or downwards, usually within a specified band, on the basis of a benchmark interest rate or an index. These securities, also termed 'Indexed Bonds', were introduced to offer investors protection from INFLATION and INTEREST RATE RISK that are inherent in a DEBENTURE or BOND bearing a fixed coupon. When interest rates and bond YIELDS go up, the coupon is raised as indicated by the issuer. The disadvantage is when rtes fall, because the bondholder's coupon receipts will fall. Moreover, the downward revision of the coupon would also preclude any CAPITAL GAINS by way of price appreciation, accruing to the holder. In India e.g., the first such instrument was introduced by the State Bank of India in December 1993. The bonds carry a floating rate of interest for 3 percent over the bank's maximum term deposit rate, with a minimum coupon rate of 12 percent per annum; the coupon rate will be adjusted at regular intervals of six months on January 1 and July 1 throughout the tenure of the instrument.

In December 1997, Capital Indexed Bonds of the Government of India were

introduced. These bonds provide investors a complete hedge against inflation for the principal amount of investment, on the basis of the Wholesale Price Index.

Foreign Currency Convertible Bond (FCCB) An unsecured debt instrument denominated in a foreign-currency and issued by an Indian company which is convertible into shares, or in some cases into GDRs, at a predetermined rate. That is, the CONVERSION PRICE and the exchange rate are fixed. The BOND which bears a certain coupon enables the issuing company to economize on interest cost by tapping foreign markets and also to postpone a DILUTION in the EARNINGS PER SHARE. The advantage to the investor is the option of retaining the security as a bond till REDEMPTION, if the stock does not rise to the desired level. Moreover, the interest rate on the security is higher as compared to bonds of foreign companies. Subject to the rules prevailing, put and call OPTIONS may be attached to the instrument. The put enables investors to sell their bonds back to the issuer. The call allows the issuer to undertake REFINANCING or to force conversion. Incidentally, one dimension of FCCBs is that they add to India’s external debt. Moreover, until conversion, the interest is paid in foreign currency. If the option to convert is not exercised, redemption too will entail an outflow of foreign currency. Therefore, the exchange risk, i.e., the depreciation cost, must be taken into consideration. In some respects, an ‘Alpine Convertible’ bond (issued to Swiss investors) scores over others; the issue costs are lower and the placement process is shorter.

Formula Plans These are mechanistic methods of timing decisions relating to the buying and selling of securities. There are different formula plans that include the Constant Dollar Plan and the Constant and Variable Ratio Plans. These methods are for the patient, conservative investor who seeks protection from large losses and is not confident of timing his decisions correctly.

Forward Contract A transaction which binds a seller to deliver at a future date and the buyer to correspondingly accept a certain quantity of a specified commodity at the price agreed upon, which is known as the ‘Forward Rate’. A forward contract is distinct from a futures contract because the terms of the former can be tailored to one’s needs whereas, the latter is standardized in terms of quantity, quality and delivery month for different commodities. In other words, forward contracts are customized contracts that enable the parties to choose delivery dates and trading units to suit their requirements.

Forward Discount The differential by which a currency is less expensive in the forward market as compared to the SPOT MARKET.

Forward Premium The amount by which a currency’s forward rate exceeds the spot market rate.

Fund-based This term is used to describe financial assistance that involves disbursement of funds. Examples include the CASH CREDIT facility, bill DISCOUNTING, equipment leasing, HIRE-PURCHASE and FACTORING. In contrast, non-fund based services involve the issuance of LETTERS OF CREDIT, BANK GUARANTEES, ACCEPTANCE and fee-based services such as security issues management, LOAN SYNDICATION and advisory assistance.

Funding The technique of extending the MATURITY of debt by substituting long-term debt instruments for short-term securities through REFINANCING operations. Sometimes, this is also referred to as 'debt roll-over' or 'conversion'. In India, funding has been applied to Ad hoc TREASURY BILLS held by the Reserve Bank of India. Subsequently, it has been extended to 364-day and 91-day auctioned bills. The consequence of such substitution of 'floating debt' (TREASURY BILLS or WAYS and MEANS ADVANCES) by 'funded debt' (LONG-DATED or undated GOVERNMENT SECURITIES) is an increase in the interest burden as a result of the longer maturity of government debt, even though the quantum has not changed. Funding operations also result in replenishment of the floating stock of Government Securities, which facilitates OPEN MARKET OPERATIONS and statutory investment by banks.

This practice of debt roll-over may be employed during tight LIQUIDITY conditions in the financial markets or alter-natively with the objective of matching outflows to receipts. However, such a change in the MATURITY profile of debt that causes the interest obligations to become more onerous, as stated above, may aggravate the repayment situation. The latter contingency can, however, be overcome if the Government's coffers get filled due to a growing economy,

Futures Market A market in which contracts for future delivery of certain commodities or securities are traded.

GDR An acronym for Global Depository Receipt. It is an instrument denominated in foreign currency that enables foreign investors to trade in securities of alien companies not listed at their exchanges. So, e.g., a dollar-denominated GDR issued on behalf of an Indian company represents a certain number of rupee-denominated equity shares, which are issued by the company to an intermediary termed the 'Overseas Depository Bank' (ODB), in whose name the shares are registered. The shares, however, rest with the local custodian bank. The GDR which is issued by the ODB may trade freely in the security markets overseas; e.g., DGRs of Indian companies are listed on the Luxembourg Stock Exchange and some on the London Stock Exchange. Also, a GDR holder, not wanting a continue holding the instrument, may opt for cancellation of the same after the specified period by approaching the ODB and having the underlying shares released by the custodian in India for sale. The proceeds, adjusted for taxes, and converted into foreign currency will be remitted to the foreign investor subsequently. As an example, the GDR of G.E. Shipping issued in February 1994 at a price of U.S. $ 15.94 has five underlying shares. GDRs are generally issued at a modest DISCOUNT to the prevailing market price. A bigger discount may trigger off widespread ARBITRAGE trading.

The advantage of an issuing company is the inflow of foreign currency funds. Further, DIVIDEND payments are in rupees and, therefore, there is no exchange risk. Moreover, the increase in equity is clearly known unlike with FOREIGN CURRENCY CONVERTIBLE BONDS. Administratively too, in matters regarding dividends, company meetings, etc. it becomes easier for the company to interact with the single ODB that accounts for a large shareholding. The management may enter into a suitable understanding with the ODB as regards the exercise of voting rights.

Besides holding the shares, the ODB also performs the functions of distribution of dividends and issue of GDR certificates to replace those lost, mutilated, etc.

There are no stipulated norms regarding turnover and MARKET CAPITALIZATION. However, prospective issuers are expected to have a minimum turnover of Rs.500 crore and market capitalization in the range of Rs.1200 to 1500 crore.

Gilt-edged Securities A term often used to refer to GOVERNMENT SECURITIES signifying that the securities have the highest degree of reliability. They are, however, vulnerable to INTEREST RATE RISK and INFLATION RISK.

Goodwill The value of intangible facets of a business such as its name, reputation and location, which is reflected in the excess of its acquisition price over the fair value of its tangible assets.

Gross Domestic Product (GDP) This is a comprehensive measure of the economic activity that takes place in a country during a certain period. It is the total value of final goods and services produced in an economy in a year. The computation is on the basis of value added – the contribution of a producing enterprise is the difference between the value of its finished product and the cost of materials used.

Hence, national output is the total value added by all producing enterprises. More specifically, gross domestic product is expressed as
C + I + G + (X – M)
Where
C stands for consumption, which is the expenditure by consumers on consumption goods and services.
I is 'Gross private Domestic Investment' representing the acquisition of new capital goods (e.g., plant and machinery) and inventory additions by business enterprises, as well as construction of factories, houses, etc.
G denotes government expenditure on goods and services.
(X-M) represents the difference between exports (S) and imports (M) of goods and services.

Hedging The action of combining two or more transactions so as to achieve a risk-reducing position. The objective, generally, is to protect a profit or minimize a loss that may result on a transaction.

For instance, a SHORT SALE could be employed to lock in a price gain on a LONG TRANSACTION. As demonstrated in Appendix II, hedging is useful with futures contracts too. A disadvantage with hedging, however, is that it results in less than the maximum profit that could have accrued.

Hot Money This refers to large amount of short-term funds held internationally by banks, institutions and wealthy individuals which quickly move out of or into a country, usually, in anticipation of exchange rate movements or interest rate changes. Hot Money is, therefore, an unstable source of funds.

Hundi An Indian term for a negotiable instrument that is similar to a BILL OF EXCHANGE.

In-the-Money An expression used to indicate that an OPTION has an immediate tangible value because of the difference between the current market price of the share and its exercise price. For example, if a company's share is trading at Rs.110 while its call has an exercise price of Rs.100, the option is said to be in the money.

Income Bond A hybrid debt security which promises interest only if a certain level of net income is earned. This type of security is generally associated with rehabilitation schemes under which no immediate burden is placed upon companies as they gradually return to good financial health. After a few years, the interest LIABILITY may be made cumulative.

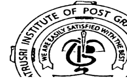
Index Fund This is a MUTUAL FUND whose PORTFOLIO mirrors a market index. The investments of such a fund are in the same stocks as those comprising the selected market index and in the same proportion as their weights in the index. Setting up the portfolio is called 'Indexing'. This innovation in the U.S. sprung up as a result of research findings that the Standard & Poor's 500-stock index (a proxy for a market portfolio) had outperformed many INSTITUTIONAL INVESTORS during 1960s and 1970s. Since the portfolio of an index fund replicates a certain index, the fund saves substantially on research and administrative expenses. The Index Equity Fund launched by the Unit Trust of India in May 1997 is based on stocks figuring in the SENSITIVE INDEX and the NSE-50 of the NATIONAL STOCK EXCHANGE.

Inflation The phenomenon of rising prices of goods and services in general. It can come about due to a scarcity of supplies in relation to demand; this is known as 'demand-pull inflation'. It may also result from an increase in the cost of some critical input, such as steel or petroleum, which then triggers off a gradual rise in prices in general; this is known as 'cost-push inflation'.

Insider A term used for one who has access to information concerning a company, that is not publicly available and is of such a nature that it enables him or her to make substantial profits in share transactions.

Intercorporate Deposit A short-term deposit made by one company with another. The period usually does not exceed six months, and it could be as short as one or a few days. These deposits are essentially ''brokered Deposits'' given the extensive involvement of brokers. The interest rate is influenced by market forces and is, generally, significantly higher than the banks' lending rate of WORKING CAPITAL.

Interest Rate Parity Theorem A theorem that explains how the forward and spot currency exchange rates between two countries are related through their respective nominal interest rates. For example, assume that the spot rate between the U.S. dollar and the Deutsche Mark is $1 – DM2 and that the prevailing annual rates of interest on the dollar and the mark are 18 and 10 percent respectively. Therefore, over a period of 30 days, the interest accruing will be 1 x (18/100) x (30/300) = $0.015 and 2 x (10/100) x (30/360) = DM0.0167. Thirty days hence, $1.015 is equivalent to DM2.0167. Thus, the forward rate should be $1 – 2.0167/1.015 = DM1.968.



Investment Account The PORTFOLIO of long-term securities held by a bank that usually consists of GOVERNMENT SECURITIES, high-grade DEBENTURES and shares.

Junk Bonds The debt securities of companies bearing a considerable degree of risk that is reflected in their mediocre or poor CREDIT RATINGS. Alternatively referred to as 'Low-grade' or 'High-risk' BONDS.

Junk Bonds include a wide spectrum of fixed-income securities, such as, those of
(a) relatively new companies of below INVESTMENT GRADE quality, but likely to be upgraded and
(b) companies whose ratings have fallen owing to financial woes.
Since INSTITUTIONAL INVESTORS would steer clear of Junk Bonds, the market for these securities is thought to be inefficient, thereby offering opportunities for a higher return compared to higher-grade bonds.

Perhaps, the perceived risk is greater than the actual risk. Moreover, low-grade bonds are less sensitive to interest rate changes.

An interesting strategy is to buy Junk Bonds in anticipation of an improvement in rating which would result in price appreciation. Incidentally, some MUTUAL FUNDS in the U.S. have found it worthwhile to specialize in Junk Bond investing.

LIBOR An abbreviation for London Inter Bank Offer Rate, which is an average of the interest rates at which leading international banks are prepared to offer term EURODOLLAR DEPOSITS to each other. The interest rate differs according to the deposit MATURITY and the soundness of borrowing banks. Libor is also used as a reference rate in quoting interest rates on various other loans.

Limited Liability A term which conveys that the responsibility of shareholders, for debts and other LIABILITIES of their company, is limited to the extent of the amount remaining unpaid towards their shares in the company. In other words, each shareholder is liable to pay the full nominal value of shares held by him or her.

Listing The grant of approval for dealings in a certain security (e.g., share or DEBENTURE) at a stock exchange. Consequently, companies must pay their respective exchanges, an annual listing fee which is linked to the PAID-UP CAPITAL.

Listing Agreement A detailed undertaking to be submitted to a stock exchange by a company whose security is to be admitted for trading on the exchange. The provisions contained in a prescribed format relate to, among other things, time-bound registration of shares, issue of new certificates in lieu of torn or defaced ones and timely intimation to the exchange authorities regarding the board of directors' meetings on important matters.

By an ordinance promulgated in January 1995, the Government empowered SEBI to impose punishment for violation of the listing agreement.

Loan syndication The participation by a group of lending institutions as financiers to a single borrower, so that no institution individually has a high exposure.

The borrower may select a bank to arrange for syndication, after reviewing BIDS from different banks. The syndicating bank then invites the participation of other banks, for which a detailed write-up (Information Memorandum) may be circulated. Although the borrowing company signs a common document (containing clauses relating to term, interest, repayment and security), drawn up by the syndicate manager, it has a distinct contractual relationship with each of the syndicate members. In syndication, the interest charged by member banks may differ, unlike in a CONSORTIUM arrangement. Loan syndications can be arranged to finance term requirements or WORKING CAPITAL. The interest rate, which may be fixed or floating, mainly depends on the credit standing of a borrower. Thus, creditworthy borrowers may find syndication more advantageous.

Lock-box A facility used in the U.S. and elsewhere for speeding up collections. A bank collects and arranges for clearance of cheques that are sent by customers to a designated post office box. The advantage of this cash management system is that it eliminates the clerical functions prior to the deposit of the cheques. The company is thereby able to reduce FLOAT and realize sale proceeds faster.

M1 A measure of the stock of money in India, which is also referred to as "Narrow Money". M1 is calculated by adding the net demand deposits of banks and 'Other' deposits with the Reserve Bank of India (RBI) to the sum of currency notes and coins held by the public. 'Net demand deposits' comprise current account deposits and a portion of the savings deposits considered as a demand LIABILTY, all held by the public; 'Other' deposits with RBI refers to funds held by certain institutions like the Industrial Development Bank of India and International Monetary Fund, foreign governments and CENTRAL BANKS,

M2 The sum of M1 and post office savings bank deposits.

M3 A measure of the stock of money in the nation with reference to which monetary targets are set by the Reserve Bank of India. It is the sum of M1 and the net TIME DEPOSITS (together with the portion of savings deposits no included in M1) with banks. It is also called 'Broad Money'. M3 is a function of RESERVE MONEY.

M4 The sum of M3 and total post office deposits.

Malegam Committee A committee set up by the Securities and Exchange Board of India (SEBI) to suggest reforms in the primary market. The committee, headed by Y.H. Malegam, gave its recommendations in the second half of 1995, and these include:

Stricter norms of disclosure of financial information in the prospectuses of companies raising capital.

Draft prospectus filed with SEBI to be treated as a public document.

Permitting companies to undertake BOOK BUILDING, depending on the issue size. Several recommendations of the committee have been accepted by SEBI and implemented through its guidelines.

Market Capitalization The value of equity shares outstanding at prevailing market prices.

Market capitalization = Number of shares x Market price of each share.

Market capitalization may be determined for a company or for the stock market as a whole. Some stock market players attempt to gauge the price appreciation potential of a stock by relating market capitalization to the company's sales,

Market Portfolio A PORTFOLIR whose composition in terms of securities and their proportions is identical to the composition of all the risky securities in the market. The market portfolio is a theoretical construct and it does not exist in reality. Therefore, the practice is to use a PROXY for the market, which is usually a broad-based index.

Marketing-to-Market A process of monitoring and updating the account positions of different parties to a transaction, as for example in a SHORT SALE. By debiting and crediting the different accounts in tandem with security price changes, a broker is able to quickly determine the LIABILITY resulting or the profit accruing to either side. For instance, if the price of a share sold short were to rise, the broker would reduce the short seller'' account and increase the account of the lender of securities. This provides protection to the latter and helps in determining the actual margin in the former'' account.

Merger The combination of two (or more) companies into one entity, usually through the exchange of shares. Three common forms of mergers are :

- Horizontal, uniting similar plants and products.
- Vertical, combining plants in different stages of production.
- Conglomerate, uniting dissimilar plants and products.

MIBOR An acronym for the Mumbai Inter Bank Offer Rate, which is the weighted average interest rate of the rates at which certain banks/ institutions in Mumbai belonging to a representative panel are prepared to lend CALL MONEY.

Mutual Fund An organization that mobilizes the surpluses of savers and invests the same in different securities. Thus, an individual who owns a share in a mutual fund has a proportionate claim on the PORTFOLIO of investment vehicles held by the fund. In financial nomenclature, the term mutual fund refers to the 'Open-end' type of investment company which has no limit on the number of shares that it can issue. The Unit Trust of India's, Units 1964 scheme is a prime example. However, in common parlance, the term mutual fund refers to both the OPEN-END and CLOSED-END types of investment companies.

Managing an open-end fund however, involves some distinct challenges. The portfolio manager must estimate the maximum possible demand for REDEMPTION

and accordingly retain some liquid ASSETS. Moreover, daily calculation of the NAV requires a sophisticated information system.

The SUBJECT-WISE LISTING mentions the different types of mutual funds that are explained elsewhere in this book

NASDAQ An acronym for National Association of Security Dealers Automated Quotations System, which is a nationwide network of computers and other electronic equipment that connects dealers in the over-the-counter market across the U.S. The system provides the latest BID and ASKING PRICES quoted for any security by different dealers. This enables an investor to have his or her transaction done at the best price. Due to NASDAQ, the over-the-counter market in the U.S. is like a vast but convenient trading floor on which several thousand stocks are traded.

National Stock Exchange (NSE) It is a nationwide screen-based trading network using computers, satellite link and electronic media that facilitate transactions in securities by investors across India. The idea of this model exchange (traced to the Pherwani Committee recommendations) was an answer to the deficiencies of the older stock exchanges as reflected in settlement delays, price rigging and a lack of transparency.

Efforts to get the exchange going began with its incorporation in November 1992. The sponsors, mainly FINANCIAL INSTITUTIONS, include IDBI, GIC and LIC with IDBI playing the lead role. In the earlier stages, it was contemplated that the NSE would function primarily as a wholesale debt market (WDM) and that for EQUITY SHARES, it would play a complementary role to the Bombay Stock Exchange (BSE). However, NSE's active operations in stocks have unleashed competitive pressures on the BSE and the latter has consequently streamlined its outmoded trading system. BSE members seek to extend their new on-line system (BOLT) to other towns and cities. The magnitude of NSE's impact can be gauged from the fact that in February 1996, daily turnover in equity shares on the exchange had crossed Rs.1000 crore, albeit temporarily. It WDM segment involves transactions in TREASURY BILLS, GOVERNMENT SECURITIES, PSU BONDS, COMMERCIAL PAPER, CERTIFICATE OF DEPOSIT and DEBENTURES. Other distinct features of the NSE include :

- Separation of the ownership (and management) of the exchange from the right to trade on the exchange.
- Membership of the exchange is based on professional merit and financial soundness.
- A fully automated screen-based trading system that will connect members across the length and breadth of India. The system is 'order driven' and provides flexibility to users as to the kinds of orders that may be placed. Additionally, it furnishes voluminous market information on-line, upon request.

Net Asset Value (NAV) The net value of a MUTUAL FUND'S PORTFOLIO, expressed on a per share basis. Thus NAV per share is :
Total Net Assets

Total number of shares outstanding

To calculate the ‘Total Net Assets’, investments are periodically valued at market prices (although DEBENTURES may be valued at cost or at prevailing yields) and added to other assets; from this figure, LIABILITIES including fund expenses, are deducted, in order to arrive at the total net assets.

A vexatious matter that the Securities and Exchange Board of India (SEBI) has been wrestling with is the need for uniformity in calculation of the NAV. Differences in valuation and accounting policies with respect to quoted and unquoted or unlisted shares, CONVERTIBLES, debentures, interest, DIVIDEND, expenses, etc., make a comparison of net asset values of different funds difficult. An expert committee, set up by SEBI to examine this matter, has suggested specific valuation norms for debt and equity securities. In its report released in January 1996, the committee has made some other suggestions, that include the following :

- Fees payable to an ASSET MANAGEMENT COMPANY to comprise a ‘Basic Annual Fee’ and a performance-linked component.
- Reporting of NAV on a weekly basis.

OPEN-END FUNDS set their sales and repurchase prices on the basis of their net asset values. However, the prices of CLOSED-END FUND shares, as for instance, UTI Mastershare, are determined by the forces of supply and demand operating in securities transactions, besides the NAV.

Odd-lot A lot of shares that is different from a round (marketable) lot. A stock exchanges, transactions are done in lots mostly of 100 or 50 shares and multiples thereof. These conventional trading units are called ‘Round Lots’, Any lot that is different from the prescribed trading unit is deemed an odd-lot. At some stock exchanges, odd-lot trading takes place on Saturdays.

Offshore Financial Centre (OFC) A place that encourages financial activities by having a pragmatic regulatory environment with few exchange controls. Thus, it acts as a conduit for investment activities of international INSTITUTIONAL INVESTORS and other intermediaries. While an OFC can boost the flow of investments and give a fillip to related industries such as tourism, it can also be misused for money laundering and other undesirable activities.

Open-end Fund A mutual fund which continuously issues new shares or units to meet investors’ demand. Simultaneously, it redeems shares for thse who want to sell. Hence, there is no limit on the number of shares that can be issued, and in fact, the number of shares outstanding keeps changing because of the continuous influx and exit of investors. Due to the constant changes in the aggregate portfolio value and the number of shares, the NET ASSET VALUE keeps changing. The purchase and sale prices for redeeming or selling shares are set at or around the net asset value.

Option A contract that gives the holder the right to buy (‘Call Option’) or sell (‘Put Option’) a certain number of shares of a company at a specified price known as the

'Striking Price' or 'Exercise Price'. American options may be exercised during a certain time period, which extends up to what is known as the 'Expiration Date'. Exchange-traded options in the U.S. are in denominations of 100 shares. The attraction of buying options is a potentially large profit on a relatively small investment. The maximum possible loss is the price paid for the option, known as the 'Premium'. The premium is paid by the option buyer to the option writer (seller) who keeps the money, whether the option is exercised or not. The buyer is under no obligation to exercise his right and may simply let the option expire. However, by selling a call or a put, the writer obligates himself to deliver or buy shares if the option is exercised. Importantly though, the buyer or the writer may independently terminate their outstanding positions before the expiration date, by executing offsetting transactions. The value of an option comprises a time value and an INTRINSIC VALUE, the latter resulting from the price of the underlying stock. As the expiration date approaches, the time value converges to zero.

Buying a call option is an alternate to buying the underlying shares. Buying a put is an alternative to a short sales of the underlying shares. Thus, a call buyer's outlook is essentially bullish whereas a put buyer is bearish about the underlying share. The value of a call option rises with the price of the underlying share whereas, the value of a put option increases as the price of the share falls. This is illustrated in the examples (Appendix II contains an illustration of HEADING involving options) given below

- Mr. Joy buys a six-month call on Yummy Ice Cream Ltd. At a striking price of Rs.60, paying a premium of Rs.6 per share. The share is currently trading at Rs.50. Incidentally, since the market price is below the striking price, this call is said to be 'out-or-the-money'. The profit or loss picture at different market prices six months hence, is shown below (brokerage and taxes excluded):

Rupees						
Share Price at expiration date	45	55	65	66	75	85
Call Value(on 100 shares)	0	0	500	600	1500	2500
Premium (on 100 shares)	-600	-600	-600	-600	-600	-600
Net Profit/Loss	-600	-600	-100	0	900	1900

- Expecting the share of Lite Umbrella Ltd. To fall, Mr. Peppy buys a six-month put at a striking price of Rs.30, paying a premium of Rs.4.50 per share. The share is currently trading at Rs.28, which means that the put is 'in-the-money'. How well does Mr. Peppy perform? This performance depends on the share price movement during the life of the option.

Rupees							
Share Price at expiration date	15	20	25	28	30	35	40
Put Value(on 100 shares)	1500	1000	500	200	nil	nil	nil
Premium(on 100 shares)	-450	-450	-450	-450	-450	-450	-450
Net Profit/Loss	1050	550	50	-250	-450	-450	-450

OTC Exchange of India (OTCEI) A floorless national securities exchange with a screen-based system of trading. This modern market characterized by fully computerized operations, was promoted by the Unit Trust of India, ICICI, and SBI Capital Markets Ltd. Among others, in order to overcome problems such as the lack of transparency and delays in settlements that have plagued the older exchanges. Additionally, the prohibitive cost of a PUBLIC ISSUE through the conventional route also spurred the development of this alternative forum. OTCEI's operations began in 1992 and its network consists of counters located all over the country, linked by computers and other electronic media. Companies with a small equity capital and certain permitted securities are traded on it. Each counter is the location of a member or dealer and serves as a trading floor. Members of the OTC Exchange include FINANCIAL INSTITUTIONS, subsidiaries of banks and certain MERCHANT BANKERS. They help in originating issues, i.e., sponsoring companies and also in ensuring LIQUIDITY by making a market; the latter function entails offering two-way quotes for a stipulated period from the date of LISTING. The dealers are intermediaries between buyers and sellers. They may deal in securities or act as brokers.

The Initial Counter Receipt (ICR) is the document an investor gets upon allotment in an OTCEI issue. The existence of an electronic depository eliminates and cumbersome method of physical movement of securities and so, facilitates quick transfers at the registrar's end. Thus the share certificates remain in the custody of the registrar.

Subject to certain conditions, any company with a PAID-UP CAPITAL from Rs.30 lakh to Rs.25 crore could be listed on the OTCEI. The shares may be originated by a direct public issue or through a BOUGHT-OUT DEAL. In this function, it is necessary to appoint a sponsor from among the OTCEI members. Besides listed securities, certain DEBENTURES, permitted securities and MUTUAL FUND shares are also traded on the OTCIE.

A major advantage of the system is the transparency and speed with which transactions are completed, including payment and delivery of securities. An investor is able to see the price quotes on the OTC scan when placing a buy/ sell order. The COUNTER RECEIPT is the document in OTCEI transactions that evidences the purchase of a share. The 'Sales Confirmation Slip' (SCS) confirms the sale of the shares. Payment is made to an investor against the SCS.

Primary Market The segment of FINANCIAL MARKETS in which securities are originated. Thus, the transactions for fresh offerings fo EUQUITY SHARES, DEBENTURES, PREFERNENCE SHARES, and other securities are collectively referred to as the primary market.

Private Placement The sale, by a company, of its securities to one or a few FINANCIAL INSTITUTIONS through a process of direct negotiations, or to a limited number of individual investors. In contrast, the conventional method of PUBLIC ISSUE invites subscription from investors in general. The advantage of a private placement is the substantial saving in marketing expenses that a public issue entails. A recent trend has been the placement of EQUITY SHARES with foreign financial institutions for sourcing foreign exchange.

Prospectus A document required to be filed with the Registrar of Companies and also, widely distributed by a public company that seeks to mobilize funds from the public at large. A prospectus contains several details about the company including the following :

- Particulars about the issue-number of shares or other securities for which subscription is invited.
- Dates of opening and closing of the issue.
- Names and addresses of the directors of the company.
- Names of the underwriters and brokers to the issue.
- The purpose for which funds are being raised, i.e., the information about the project, prospects, risk factors and other relevant information.
- Auditors' report.
- Excerpts from the company's Memorandum and Articles of Association such as its main objects rules regarding FORFEITURE of shares and so on.

The format and contents of the prospectus must conform to the relevant provisions of the Companies Act, 1956 and rules laid down by SEBI.

Proxy A document that facilitates the transfer of a share-holders right to vote in favour of another person who may represent and vote on his/her behalf at a general meeting of the company. The term proxy also refers to the person authorized to act on behalf of another.

Public Debt The debt obligations of the Government of India comprising external debt, i.e., loans from foreign countries, international FINANCIAL INSTITUTIONS, etc. and internal debt that includes market loans, TREASURY BILLS, special bearer BONDS and special loans and securities outstanding. A very large portion of the internal debt obligations is held by the Reserve Bank of India.

In a broader sense, public debt includes the debt of Central, State and Local governments and also Government-owned entities.

Public Issue An invitation to the public at large to subscribe to shares or other

securities of a company. A public issue entails numerous tasks such as organizing the syndicate of UNDERWRITERS, brokers and others, preparation of the PROSPECTUS and fulfillment of several formalities including, notably, prior approval from SEBI and the Registrar of Companies.

Canvassing for the issue is done mainly by the brokers who approach prospective investors directly or via sub-brokers and supply application forms and informative brochures.

Random Walk Theory A proposition that describes the movement of share prices as being random, i.e., devoid of any definite pattern. This assertion, therefore, challenges the very basis of TECHNICAL ANALYSIS, especially CHARTING which rests on the idea of trends in share prices.

Ratio Analysis The use of financial ratios for assessing the financial ratios for assessing the financial performance and financial position of a company by means of various ratios that relate to the LIQUIDITY, turnover, profitability, etc., of a company.

Reddy Committee A working group on matters relating to money supply which was appointed in December 1997 under the Chairmanship of Y.V. Reddy of the Reserve Bank of India (RBI). Its terms of reference sought, among other things, an assessment of the adequacy of existing money stock measures and suggestions to improve the existing reporting system.

The committee submitted its report in June 1998, which includes the following recommendations :

- The introduction of a new set of monetary and liquidity aggregates as detailed below.
- A comprehensive commercial bank survey to be carried out, which would reflect the changing scope of their activities.
- Compilation of a comprehensive financial sector survey in order "to capture the dynamic interlinkages" between depository corporations (banking sector) and FINANCIAL INSTITUTIONS.

Refinance The system of borrowing by a bank or other financial intermediary from an apex institution or the CENTRAL BANK of a country, on the strength of its loans or financial ASSETS. Thus, for instance, IDBI and NABARD provide refinance to a host of banks and institutions vis-à-vis the loans made by the latter to ultimate borrowers. Refinance may also be increased by the Reserve Bank of India as a short-term measure to douse a sudden flare-up in MONEY MARKET rates, e.g. the CALL MONEY rate.

Reinsurance An arrangement under which an insurer shares the risk of large losses with another insurer. Through reinsurance, an insurance company spreads the risk of excessive loss on big contracts. The arrangement helps to dilute exposure and retain financial flexibility.

Reinvestment Rate The rate of interest at which the cash flows from an investment

(e.g., coupon from a DEBENTURE or in-flows from a project) are periodically reinvested. This depends on the investment choice available during the term of a security or project. However in the case of a ZERO-COUPON BOND, the problem of having to reinvest does not arise since there is no periodic cash flow. The reinvestment rate is unvarying and is the same as its YIELD TO MATURITY,

Rekhi Committee A committee on INDIRECT TAXES, that submitted its report in 1992, containing recommendations for simplification and streamlining of customs and central excise laws and procedures.

Revaluation The meaning of this term depends on the context in which it appear.

With reference to foreign exchange it denotes an upward revision of a currency's official exchange rate vis-à-vis other currencies or in relation to gold. It may be noted that INFLATION in a country has a similar consequence as revaluation, since exportable goods become more expensive to foreign buyers. In finance, the term refers to a fresh valuation of FIXED ASSETS of a company such as land and machinery by an approved valuer. Revaluation helps to establish realistic values of assets in place of historical costs since market prices and realizable values are taken into consideration by the valuer.

SEBI An abbreviation for Securities and Exchange Board of India, which is a regulatory body established under the Securities and Exchange Board of India Act, 1992. Its role is to protect the interests of investors in securities, to promote the development of securities markets and to regulate the same.

Towards the achievement of these goals, SEBI is empowered to adopt various measures which include :

- Regulating the business at stock exchanges at other markets.
- Registration of stock brokers, sub-brokers, transfer agents, registrars to issues, MERCHANT BANKERS, UNDERWIRTERS and others.
- Regulating MUTUAL FUNDS.
- Promoting investor education.
- Undertaking inspection and audit of stock exchanges and various intermediaries.

Secondary Market The segment of FINANCIAL MARKETS in which securities that have already been issued are traded. Thus the secondary market comprises security exchanges and also transactions taking place elsewhere, as e.g., KERB DEALS,

Securitization The transfer of loans (ASSETS) of a homogeneous nature, from a lending institution to investors through an intermediary, by packaging them in the form of securities which are usually termed "PASS-THROUGH SECURITIES". The cash flow by was of PRINCIPAL and interest on the underlying loans is "passed through" to the security holders. The assignment of loans is mostly without recourse to the original lender. Various assets that generate cash flows can be securitized- as e.g., housing loans and car loans. The lending institution benefits by this arrangement since it frees a large amount of funds for reinvestment, long before they become due. The assets are selected from a pool that is carefully sifted- this is known as 'Cherry

Picking'. They are subsequently monitored over a period of time to confirm their financial soundness – this part is termed 'Seasoning'. Considering that there is such a careful appraisal coupled with the backing of the underlying assets, the financial instruments that are created present an attractive investment opportunity. Moreover, their investment quality can be determined from the CREDIT RATING, if available. A trust or an intermediary termed 'Special Purpose Vehicle' (SPV) is involved in the arrangement of securitization. The SPV holds the loans and issues paper against the security of the loans, say MORTGAGES. The proceeds from the issue of securities are given to the housing finance company. The periodic interest and principal are collected by the SPV and passed on after retaining service costs and insurance fees.

Security Analyst An individual who evaluates and identifies stocks and other securities for investment. The technique that is commonly employed to identify mispriced securities, involves an examination of the fundamental aspects – economic outlook, industry prospects and a company's plans, projections, strengths and weaknesses – that will have a bearing on the intrinsic worth of an ASSET. On this basis, a security analyst makes recommendations to buy, sell or hold securities. Alternatively, an analyst may use tools of TECHNICAL ANALYSIS in order to generate short-term forecasts of stock prices. Analysts in the U.S. are employed by brokerage firms and banks, among others. They tend to specialize in a particular industry or a few industries. For instance, an analyst may specialize in airline stocks while another in pharmaceuticals.

Security Market Line A linear relationship between the expected rate of return on a security and its SYSTEMATIC RISK indicated by BETA.

Seed Capital The financial assistance towards a promoter's equity contribution. Seed Capital, alternatively called 'Equity Support', is to enable promising entrepreneurs with inadequate capital to set up their enterprises. The assistance is usually in the form of a loan at very generous terms, as e.g., a long MORATORIUM period, nominal service charge and a lengthy repayment period.

Sensitive Index A statistical measure of the prices of 30 selected stocks traded on the Bombay Stocks traded on the Bombay Stock Exchange. The method of compilation is similar to the one used in Standard & Poor's indices, USA. This base-weighted aggregative method assigns to the price of each component share. A weight corresponding to the number of shares outstanding. Therefore, the index on a particular day is the ratio of the aggregate market capitalization of 30 stocks on that day to the average MARKET CAPITALIZATION of the same stocks during the base period. The base year is the financial year 1978-79. In the event of an increase in the number of shares outstanding owing to a RIGHTS ISSUE, conversion, etc., proportional adjustments are made to the weights and base year average market capitalization. Although the index is more popular, it is a narrow barometer of market movements since it comprises only 30 stocks.

Service Tax A levy on the value of taxable services provided to any person.

Based on the recommendations of the CHELLIAH COMMITTEE on tax reforms, a

beginning was made with the Union Budget for 1994-95 to impose a 5 percent service tax on stock-brokerage, general insurance and telephone connection. Its administration is the responsibility of the Central Excise Department. The onus of collection and payment of tax is on the stockbroker, the telegraph authority or the insurer who is providing taxable services. The Union Budget 1996-97 extended the service tax to advertising, radio paging and courier services.

Shah Committee A working group constituted by the Reserve Bank of India (RBI) in May 1992, under the chairmanship of A.C. Shah to suggest reforms relating to NON-BANKING FINANCIAL COMPANIES (NBFCs). The task of the group was to carry out an in-depth study of these companies and suggest regulatory and control measures to promote their healthy growth and operations. Its report was submitted in September 1992 and subsequently, the RBI acted upon some important recommendations which are mentioned below :

- There should be uniform regulatory norms for all categories of NBFCs.
- Regulation should be made applicable to incorporated deposit-accepting entities having 'Net Owned Funds' (NOF) of at least Rs.50 lakh (NOF is the sum of PAID-UP CAPITAL and free reserves less accumulated loss, deferred revenue expenditure and INTANGIBLE ASSETS. In 1998, the RBI modified the definition to include convertible preference shares, for certain purposes).
- New NBFCs should have a minimum NOF level of Rs.50 lakh.
- Regulation should focus on ASSETS rather than LIABILITIES; this view has resulted in a prescription of norms for CAPITAL ADEQUACY, LIQUIDITY, FINANCIAL LEVERAGE, etc. For instance, the group suggested capital requirement at 8 percent of risk-weighted assets which is comparable to that for banks. Similarly, the minimum LIQUIDITY RATIO suggested was 10 percent of total deposit liabilities. Examples of liquid assets are bank deposits and investments in GOVERNMENT SECURITIES and APPROVED SECURITIES.
- Mandatory CREDIT RATING for all NBFCs by 1998.

The RBI has been implementing these recommendations in a phased manner. For instance, the minimum period of deposits of NBFCs has been reduced to 12 months. Also HIRE-PURCHASE, finance and equipment leasing companies are required to maintain liquid assets as per a specified composition at 10 percent of deposits.

Speculation An approach to investing that relies more on chance and therefore, entails a greater risk. Speculation is driven by an expectation of a high rate of return over a very short holding period.

Spot Market The transactions in which securities and foreign exchange get traded for immediate delivery. Since the exchange of securities and cash is virtually immediate (to be precise, the settlement would take place within two working days), the term cash market has also been used to refer to spot dealings.

Spread The difference between the rate of interest charged to borrowers and the rate paid to lenders by a bank or FINANCIAL INSTITUTION.

Stock Index Future Futures contracts based on broad stock market indices. This vehicle is meant for investors and active traders who have a forecast on the stock market's direction, but are unsure or unwilling to select specific stocks. So, investors who are bullish could buy stock index futures, whereas those expecting a market downturn may sell the contract. In essence, stock index futures enable investors and speculators to take a position based on their opinion about the market without actually selecting individual stocks. The instrument may also be used to offset unrealized or probable losses on a long or short position. In general, a futures contract is an obligation to accept or effect delivery as per the transaction. However, this obligation may be discharged with an offsetting transaction by the last trading day. With stock index futures, since each contract represents a hypothetical PORTFOLIO of stocks, there is no physical delivery of securities, and the difference in market value is settled in each.

Stock Split Adjustments effected in the FACE VALUE of shares and the number of shares outstanding, such that no change occurs in the total PAID-UP CAPITAL. Stock splits are generally associated with shares having a high face value and which correspondingly trade at a higher price. By reducing the face value and increasing the number of shares (for instance, 10 shares of PAR VALUE Rs. 10 each in place of each share of Rs.100), a company hopes to bring down the market price to ensure continued investor interest. In a 'Reverse split', a company increases the face value and accordingly reduces the number of shares. This has been the case with some companies in the U.S. where a very low face value with a low market price had created a negative impression on investors.

Sunk Costs The costs that have already been incurred because of decisions in the past. Consequently, decisions taken today cannot vary nor reverse what has already happened.

Swap The exchange of financial LIABILITIES which may be in the same currency or in different currencies. Swaps may relate to CAPITAL MARKETS or to the foreign exchange market. They are used to manage risks relating to changes in interest rate or foreign exchange rate. An interest rate swap is undertaken to alter the stream of interest payment flows mostly from fixed to floating or vice versa, with no PRINCIPAL obligations changing hands. For instance, a company with a variable-rate liability may opt for a swap with another borrower who has raised a fixed-rate loan. Thus, the difference in the two interest payments would be exchanged. A currency swap involves conversion of principal and interest into another currency for the duration of the flows, after which the principal sums are reconverted to the original currencies.

Sweat Equity Equity shares allotted to certain employees of company either on discount or for consideration other than cash, as a reward for providing know-how or sharing intellectual rights or some other value addition to the company.

Synergy A notion of disproportionately higher financial benefits expected by combining complementary businesses, which would exceed the performances of the entities achieved separately. For example, the MERGER some years ago of the two electrical equipment giants in Europe, namely ASEA and Brown Boveri with

individual strengths in marketing and R&D respectively, was effected to reap the benefit of synergy.

Systematic Risk The portion of risk or variability that is caused by factors, which affect the returns on all securities. Major political, economic and social phenomena, for instance, would affect all stocks, which implies that systematic risk cannot be eliminated by DIVERSIFICATION. Therefore, it is also termed 'Undiversifiable RISK'. However, by diversifying internationally, an investor can reduce the level of systematic risk of a PORTFOLIO; the lack of coincidence between economic cycles of different countries helps to achieve this. Systematic risk of a financial ASSET is indicated by the BETA coefficient. It shows the sensitivity of return on a security or a portfolio to return from the market.

Treasury Bill (T-Bill) A short-term debt instrument of the Government of India. This security bears no DEFAULT RISK and has a high degree of LIQUIDITY and low INTEREST RATE RISK in view of its short term. The instrument is negotiable and is issued at a discount from the FACE VALUE. At MATURITY, the investor receives the face value and hence the increment constitutes the interest earned. Two types of T-Bills were issued in India, by the Reserve Bank of India (RBI), on behalf of the government :

Ad-hoc T-Bills (or Ad-hocs) of 91 days maturity (which were non-marketable) to the RBI to replenish the Central Government's cash balance.

Ordinary T-Bills "on tap" that are taken up mainly by banks, for short-term investment or to comply with statutory requirements.

For several years, T-Bills were issued on tap at a fixed DISCOUNT of 4.60 percent per annum. The purpose behind the low rate was to control the burden of interest charges. However, the system caused large-scale monetization of government debt. Financing government expenditure by issuing Ad-hoc Bills to the RBI caused an increase in the outstanding RESERVE MONEY, i.e., money created by the RBI. This situation was compounded by the REDISCOUNTING of tap T-Bills by banks with the RBI. To control such monetization, the government resorted to auctions of 182-day T-Bills from November 1986, 364-day T-Bills from April 1992, and 91 day T-Bills from January 1993 (in addition to the tap bill). The idea was to improve the YIELD, so as to attract investment from sources other than the RBI.

There have been major changes in recent years with regard to T-Bills :

An agreement was singed between the Finance Ministry and the RBI in September 1994 to limit the net issue of Ad-hoc T-Bills, with the express objective of phasing them out within three years.

Discontinuation of the issuance of Ad-hocs and tap T-Bills from April 1997. The former has been substituted by a system of WAYS and MEANS ADVANCES to the Union Government, with specific limits.

Conversion of outstanding Ad-hocs and tap Bills as on March 31, 1997 into special securities, bearing an interest rate of 4.60 percent per annum and having an indefinite life.

Issue of 14-day Intermediate T-Bills from April 1997 to serve as investment vehicles exclusively for State Governments, foreign CENTRAL BANKS and other specified bodies.

Proposed introduction of 28-day and 182-day (not issued since April 1992) Bills, so as to promote the emergence of a YIELD CURVE for short-term RISK-FREE securities.

Introduction of the practice of notifying amounts in the case of all T-Bill auctions.

The proposed use of uniform price auction method in the case of 91-day T-Bills, to eliminate the problem of "WINNER'S CURSE".

More recently, it has been decided that 14-day and 91-day Bills will be auctioned weekly, whereas 182-day and 364-day Bills will be auctioned fortnightly. Further, the notified amounts are to be pre-announced for the whole year, although the discretion to change the amounts will rest with the RBI

Treasury Stock The equity shares repurchased by the issuing company. Companies in the U.S. undertake treasury stock operations for a variety of reasons-the shares could be used for ACQUISITIONS, stock option plans or other purposes. In India, however, the Companies Act 1956, vide Section 77, has explicitly forbidden treasury stock operations.

By an ordinance promulgated in October 1998, companies have been allowed to buy back their shares up to 25 percent of their PAID-UP CAPITAL and free reserves; the same ordinance also permits companies to issue SWEAT EQUITY. As a sequel, the Securities and Exchange Board of India has announced the related regulations.

Unsystematic Risk A risk that is unique to a firm or industry. The returns on an ASSET can be affected by occurrences such as a labour strike, changes in consumer preferences, or even wrong management decisions. The adverse impact of any such occurrence would be confined to one or a few firms. Therefore, these unsystematic variations occur independently of broad price movements in the market. By having a diversified PORTFOLIO, it is possible to neutralize unsystematic risk, which is also therefore termed, 'Diversifiable Risk'. Generally, firms which are less vulnerable to macroeconomic changes, as e.g., those manufacturing consumer non-durables (e.g., Hindustan Lever and Colgate) would have less SYSTEMATIC RISK and a higher degree of unsystematic risk

Vaghul Committee A working group on the MONEY MARKET in India, appointed by the Reserve Bank of India (RBI) in 1986. It was headed by N. Vaghul, Chairman, ICICI. Some of its recommendations for developing the money market were :

- Deregulation of administered interest rates.
- Introduction of COMMERCIAL PAPER (CP) and later, CERTIFICATE OF DEPOSIT (CD).
- Activating the SECONDARY MARKET by establishing an institutional intermediary to deal in money market instruments.

As a sequel to the report, some very significant changes were ushered in by the RBI. These include the introduction of money market instruments such as CDs and CPs at market-determined rates and establishment of the DISCOUNT AND FINANCE HOUSE OF INDIA LIMITED (DFHI).

Zero-coupon Bond A BOND that bears a zero COUPON RATE and hence is issued at a price substantially below its FACE VALUE.

At MATURITY, an investor receives the face value. So, the return consists of the DISCOUNT, i.e., the excess of face value over the issue price. Thus, zero-coupon bonds are a sub-set of the group of DEEP DISCOUNT BONDS. The advantage with this security to an investor is that, he does not have to worry about reinvestment, since there are no periodic inflows. Similarly, a company need not bother about meeting interest obligations at regular intervals, and yet would obtain tax deduction.

A few companies in India have issued such securities especially zero-coupon CONVERTIBLES. IDBI and SIDBI too have issued the zero-coupon variety of deep discount bonds. An interesting development was the issue of five year zero-coupon bonds by the Government of India by auction, in January 1994

Capital market: Capital market is the market it deals with the long term investment funds. It consists of two markets 1. primary market 2. secondary market.

Primary market: Those companies which are issuing new shares in this market. It is also called new issue market.

Secondary market: Secondary market is the market where shares buying and selling. In India secondary market is called stock exchange.

Arbitrage: It means purchase and sale of securities in different markets in order to profit from price discrepancies. In other words arbitrage is a way of reducing risk of loss caused by price fluctuations of securities held in a portfolio.

Mutual funds: A mutual fund is a pool of money, collected from investors, and is invested according to certain investment objectives.

Characteristics of mutual fund: Ownership of the MF is in the hands of the investors MF managed by investment professionals. The value of portfolio is updated every day.

Advantage of MF to investors: Portfolio diversification professional management reduction in risk reduction of transaction casts liquidity conveniene and flexibility.

Net asset value: The value of one unit of investment is called as the net asset value.

Open ended fund: Open ended funds means investors canbuy and sell units of fund, at NAV related prices at any time, directly from the fund this is called open ended fund. For ex: Unit 64

Close ended funds: Close end funds means it is open for sale to investors for a specific period, after which further sales are closed. Any further transaction for buying the units or repurchasing them, happen, in the secondary markets.

Dividend option: Investors who choose a dividend on their investments, will receive dividends from the MF, as when such dividends are declared.

Growth option: Investors who do not require periodic income distributions can be choose the growth option.

Equity funds: Equity funds are those that invest pre-dominantly in equity shares of company.

Sectoral funds: Sectoral funds choose to invest in one or more chosen sectors of the equity markets.

Index funds: The fund manager takes a view on companies that are expected to perform well and invests in these companies.

Debt funds: The debt funds are those that are pre-dominantly invest in debt securities.

Liquid funds: The debt funds invest only in instruments with maturities less than one year.

Gilt funds: Gilt funds invests only in securities that are issued by one GOVT. and therefore does not carry any credit risk.

Balanced funds: Funds that invest both in debt and equity markets are called balanced funds.

Sponsor: Sponsor is the promoter of the MF and appoints trustees, custodians and the AMC with prior approval or SEBI

Trustee: Trustee is responsible to the investors in the MF and appoint the AMC for managing the investment portfolio.

AMC: The AMC described asset management company, it is the business face of the MF, as it manages all the affairs of the MF.

R&T Agents: the R&T agents are responsible for the securities held in the mutual funds portfolio.

Custodians: Custodians are responsible for the securities held in the mutual funds portfolio.

Scheme take over: If an existing MF scheme is taken over by the another AMC, it is called as scheme take over.

Meaning of load: Load is the factor that is applied to the NAV of a scheme to arrive at the price.

Market capitalization: Market capitalization means number of shares issued multiplied with market price per share.

Price earning ratio: The ratio between the share price and the post tax earnings of company is called as price per share.

Dividend yield: The dividend paid out by the company, is usually a percentage of the face value of a share.

Market risk: It refers to the risk which the investor is exposed to as a result of adverse movements in the interest rates. It also referred to as the interest rate risk.

Re-investment risk. It is the risk which an investor has to face as a result of a fall in the interest rates at the time of reinvesting the interest income flows from the fixed income security.

Call risk: Call risk is associated with bonds have an embedded call option in them. This option hives the issuer the right to call back the bonds prior to maturity.

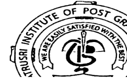
Credit risk: credit risk refers to the probability that a borrower could default on a commitment to repay debt or band loans.

Inflation risk: Inflation risk reflects the changes in the purchasing power of the cash flows resulting from the fixed income security.

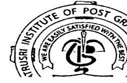
Liquid risk: It is also called market risk, it refers to the ease with which bonds could be traded in the market.

Some useful links

www.sebi.gov.in
www.rbi.org.in
www.moneycontrol.com
www.indiainfoline.com
www.nseindia.com
www.bseindia.com
www.amfi.org.in



BANKING TERMS



BANKING TERMS

Acceptance The drawee's acknowledgement of the LIABILITY on a BILL OF EXCHANGE, in writing on the instrument itself. A bill may also bear the co-acceptance by a bank, which is a guarantee to honour the instrument in the event of default by the drawee.

Accommodation Bill A BILL OF EXCHANGE without any consideration, or quid pro quo. In this case, a person signs a bill and makes himself liable, without receiving any value in return, such as, an advantage or a benefit. The purpose of accepting such a bill is to accommodate the drawer who is temporarily in need of funds. The acceptance enhances the LIQUIDITY of the instrument, which can be discounted by the drawer with a bank.

Bank Guarantee The financial guarantees and performance guarantees issued by banks on behalf of their clients. A financial guarantee assures repayment of money. (e.g. an advance received on an electrification contract), in the event of non-completion of the contract by the client. A performance guarantee provides an assurance of compensation in the event of inadequate or delayed performance on a contract. A deferred payment guarantee promises payment of installments due to a supplier of machinery or equipment.

Bank Rate The rate of interest charged by the Reserve Bank of India (RBI) on financial accommodation extended to banks and FINANCIAL INSTITUTIONS. The support is provided in the form of a bills rediscounting facility and advances or REFINANCE against specified ASSETS (e.g. TREASURY BILLS and DATED SECURITIES) or PROMISSORY NOTES.

The intent behind changing the Bank Rate at certain junctures is to raise or lower the cost of funds that banks obtain from the RBI. This, in turn, would alter the structure of banks' interest rates and thereby serve to curb or encourage the use of credit. However, the Bank Rate is a relatively passive instrument of credit control. In the wake of the East Asian currency crisis, the RBI used the Bank Rate in conjunction with the CASH RESERVE RATIO and other measures to stabilize the exchange rate of the Rupee.

In recent times, it has been RBI's endeavor to make the Bank Rae and effective signaling device as well as a reference rate. However, since frequent changes in the Bank Rate may be undesirable, the short-term REPOS interest rate seems to be a useful supplement in influencing the flow and cost of funds in the short term.

Call Money A term used for funds borrowed and lent mainly by banks for overnight use. This is a market, which banks access in order to meet their reserve requirements or to cover a sudden shortfall in funds and the interest rate is determined by supply

and demand conditions. The situation arises when banks face an unforeseen shortfall in funds, perhaps because they have invested a large amount in other ASSETS, e.g., GOVERNMENT SECURITIES and loans or due to heavy withdrawals by depositors for different reasons. High call money rates are an indication of such a mismatch or of a deliberate policy to substantially borrow short-term and lend long-term. The more stringent requirements relating to the Cash Reserve Ratio from January 1995, particularly the severe penalty for default, has also forced banks to borrow short-term; this explains the sudden but short-lived jumps in the call money rate.

An alternative source for banks would be to do REPOS deals with the Discount and Finance House of India (DFHI) or Securities Trading Corporation of India (STCI), using the excess security holdings. Incidentally, DFHI is also an active intermediary in the call money market. Besides, certain FINANCIAL INSTITUTIONS and corporate entities (through PRIMARY DEALERS) have also been permitted to participate as lenders. The announcement by the Reserve Bank of India (RBI) in April, 1995 to permit private sector MUTUAL FUNDS to lend in the call money/NOTICE MONEY/BILL REDISCOUNTING market may alleviate the situation considerably. Incidentally, this measure also provides these entities a facility for parking short-term funds. Ultimately, though, the RBI intends to make the call money/notice money/term money market into a purely inter-bank market, with the additional involvement of Primary Dealers. Accordingly, the REPOS market is being widened and developed for the benefit of non-bank participants, who may be permitted to do repos deals (i.e., borrowing funds) as well. Further, the underlying eligible securities will include PSU BONDS, corporate BONDS, and others in dematerialized form. Moreover, the participation of non-banks in the call/notice money market is to cease by the end of 1999.

Capital Adequacy Ratio: A requirement imposed on banks to have a certain amount of capital in relation to their ASSETS, i.e., loans and investments as a cushion against probable losses in investments and loans. Capital is classified into Tier I or Tier II. Tier I comprises share capital and disclosed reserves, whereas Tier II includes revaluation reserves, hybrid capital and subordinated debt. Further, Tier II capital should not exceed Tier I capital. The risk weightage depends upon the type of assets. The capital adequacy ratio is percentage of total capital funds to the total risk-weighted assets.

The capital risk-weighted assets ratio system introduced by the Reserve Bank of India (RBI) in 1992, in accordance with the standards of the Bank for International Settlements (BIS), and currently the norm is 9%.

The impact of this system on Indian banks was reflected in the increased demand for capital and changes in the composition of assets. The trend of fund-raising by banks through equity and other issues, as well as the accumulation of GOVERNMENT SECURITIES should be seen in this perspective.

To shore up the capital position of public sector banks, the Government of India has injected several thousand crore rupees in the last few years. This infusion is reflected in the banks' investment in Government BONDS known as 'Recapitalization Bonds'.

Incidentally, capital adequacy norms have also been announced for term-lending institutions and NON-BANKING FINANCIAL COMPANIES.

Capital Reserves The reserves created in certain ways, that include the sale of FIXED ASSETS at a profit. These amounts are regarded as not available for distribution as DIVIDENDS.

Cash Reserve Ratio (CRR) A legal obligation on all SCHEDULED COMMERCIAL banks excluding REGIONAL RURAL BANKS to maintain certain reserves in the form of cash with the Reserve Bank of India (RBI). The reserves, to be maintained over a fortnight, are computed as a percentage of a bank's net demand and time LIABILITIES. Banks earn interest on eligible cash balances thus maintained and it contributes to their profitability. However, such interest payment tends to attenuate monetary control, and hence these outflows need to be moderated if the situation so demands. An alternative that has been suggested is to fix a lower level of reserves and pay a modest interest.

Central Bank The premier bank in a country that discharges the responsibilities of issuing currency, managing MONEY SUPPLY by appropriate measures in order to maintain price stability and economic growth, maintaining the exchange value of the domestic currency, superintendence and regulation of the commercial banks, etc. In India, the Reserve Bank of India (RBI) is the Central Bank. RBI, therefore, carries out the duties mentioned above, and also acts as a banker to the Central and State Governments. Besides this, it also manages the public debt, i.e., fund-raising programmes of the government.

Chakravarty Committee A committee set up by the Reserve Bank of India (RBI), under the chairmanship of S. Chakravarty to appraise the working of the monetary system and suggest measure for improving the effectiveness fo monetary policy in promoting economic development. In its report submitted in April 1985, the committee made several recommendations to reform the financial system including :

1. MONETARY TARGETING as a policy tool, that is, controlled increase in money supply to maintain price stability while facilitating increase in real output.
2. Removal of ceilings on interest rates on bank loans to the non-priority sectors and on call loans.
3. Upward revision on interest rates on TREASURY BILLS and GOVERNMENT SECURITIES. Selling marketable securities to the public (instead of the RBI) at attractive YIELDS would avoid the excessive creation of money.

Chelliah Committee A committee on tax reforms constituted by the Government of India in 1991, under the chairmanship of Raja Chelliah. Its recommendations encompass the areas of corporate taxes, customs and excise duties, and personal income taxes. Among its numerous suggestions aimed at improving revenue buoyancy and simplicity are the following :

1. Reduction of the corporate tax rate on domestic companies progressively to 40 percent.
2. Introducing of the system of 'Presumptive Taxation' for groups such as small traders, contractors, transport operators and others.

3. Simplification of the excise duty structure and a move towards a Value Added Tax (VAT) system covering commodities and services.
4. Substantial reductions in import tariffs and excise duties in a phased manner.
5. Levying taxes on the service sector to cover stock-brokers, telephone services and insurance contracts among others.

Chore Committee A working group appointed by the Reserve Bank of India (RBI), in 1979, to review the operation of the CASH CREDIT SYSTEM, to suggest improvements in the same, as well as to propose alternative types of credit facilities in order to ensure greater discipline and a more productive use of credit. The group headed by K. B. Chore of the RBI made several recommendations including :

1. To administer lending under method II of the TANDON COMMITTEE norms.
2. In assessing credit requirements, banks should appraise and fix separate limits for the normal level and for peak level needs.
3. Simplification of the Quarterly Information System (QIS) and penalty for delay in submitting the reports.
4. Establishment of a discount house in India.

Chit Fund This is a non-banking financial intermediary. A chit fund scheme typically involves the collection of periodic subscriptions from enrolled members, which is then disbursed as a loan to a member. The member is selected either by lot or through an auction. The promoter is also called the ‘Foreman’ and the capital given out is called ‘Prize Money’.

Hypothecation This refers to the pledging of assets as security for funds borrowed. Bank lending for working capital involves a hypothecation of INVENTORIES and book debts. Under this arrangement, the CURRENT ASSETS remain with the borrower, but in case of default, the bank may seek recovery of the loan by instituting a lawsuit to seize the hypothecated assets, which can later be sold.

ICICI An acronym for Industrial Credit and Investment Corporation of India Limited, which is a private sector term lending institution set up in 1955. Its sponsors include foreign institutions, notably the World Bank. Besides granting term loans, particularly foreign currency loans, it assists businesses by DISCOUNTING bills, providing LEASE finance, managing PUBLIC ISSUES and providing VENTURE CAPITAL. The corporation has also been instrumental in setting up other important institutions such as Credit Rating and Information Services of India Limited (CRISIL) for credit rating. Technology Development and Information Company of India (TDICI) for the promotion of indigenous technology and SCICI for financing the shipping industry. In its drive towards becoming a global financial supermarket, ICICI’s new thrust areas are banking, financial advisory services and MUTUAL FUNDS.

ICRA An acronym for the credit rating institution. Investment Information and Credit Rating Agency of India Limited, which has subsequently been rechristened as ICRA Limited. The agency has been promoted by various financial institutions including Industrial Finance Corporation of India, State Bank of India and Unit Trust of India. The role of this agency like Credit Rating and Information Services of India Limited (CRISIL), is to assist investors in assessing the credit risk of various securities such as BONDS and COMMERCIAL PAPER, by assigning letter ratings.

IDBI An acronym for the Industrial Development Bank of India, which is the apex term lending institution in the field of industrial finance. From 1976, IDBI has been functioning as a separate entity, wholly owned by the Government of India. In 1995, IDBI issued equity shares through public subscription. It is active in providing finance through term loans, DISCOUNTING and REDISCOUNTING of bills, REFINANCING loans granted by State Financial Corporations and banks. It has also subscribed to securities of FINANCIAL INSTITUTIONS. Besides these activities, IDBI also performs the important task of coordinating the functions and operations of other term lending institutions in the country. IDBI has played a key role in setting up Small Industries Development Bank of India (SIDBI) and more recently, the National Stock Exchange and Credit Analysis and Research (CARE). Like other financial institutions venturing into newer areas. IDBI has turned to leasing, asset credit and merchant banking.

IFCI The oldest of the term lending institutions, Industrial Finance Corporation of India was set up by the Government of India in 1948 to provide medium and long-term finance to businesses in the private sector. Over the years, IFCI has diversified its activities to leasing and merchant banking. IFCI is also responsible for establishing among others, the Tourism Finance Corporation of India Limited, the Management Development Institute in Gurgaon, and Technical Consultancy Organizations in different states. In late 1993, it floated a PUBLIC ISSUE of equity shares after its conversion into a company. Earlier, IFCI was forbidden from raising funds through debt or equity.

IL&FS An abbreviation for the finance company, Infrastructure Leasing and Financial Services Limited. As the name suggests, its area of focus is financing major infrastructure projects such as highways, bridges and power plants, IL&FS is also active in leasing, advisory services for infrastructure projects and stock broking. Its promoters include Central Bank of India and Unit Trust of India.

Kannan Committee A committee constituted by the Indian Banks' Association to examine the relevance of the concept of Maximum Permissible Bank Finance (MPBF) as a method of assessing the requirements of bank credit for WORKING CAPITAL, and to suggest alternative methods. The committee was headed by K. Kannan, Chairman, Bank of Baroda and its report submitted in 1997, includes the following recommendations :

- The MPBF prescription is not to be enforced and banks may use their discretion to determine the credit limits of corporates.

The CREDIT MONITORING ARRANGEMENT and QIS may cease to be regulatory requirements.

The financing bank may use its discretion to determine the level of stocks and receivables as security for working capital assistance.

The mechanism for verifying the end-use of bank credit should be strengthened.

A credit Information Bureau may be floated independently by banks.

Since April 1997, banks have been given the freedom to assess working capital requirement within prudential guidelines and exposure norms. Banks may evolve their

methods to assess the working capital needs of borrowers – the Turnover Method or the Cash Budget Method or the MPBF System with necessary modifications or any other system.

Khan Committee A working group that was appointed by the Reserve Bank of India (RBI) in December 1997 to harmonize the role and operations of development finance institutions (DFIs) and banks. Headed by S.H. Khan, then Chairman of the Industrial Development Bank of India, the terms of reference of the committee included the following :

- To review the role, structure and operations of DFIS and commercial banks in the emerging environment and to suggest changes.
- To suggest measures for achieving harmonization in the activities of DFIS and banks.

The developments that prompted the decision to appoint the Committee were the gradual entry by DFIs and banks into each other's territory, viz., term finance and WORKING CAPITAL, the dwindling supply of funds to DFIs owing to a reduction in the STATUTORY LIQUIDITY RATIO, and the absence of reserve requirements of DFIs, an advantage vis-à-vis banks. Some of the recommendations of the committee are :

- A gradual move towards UNIVERSAL BANKING with an appropriate enabling regulatory framework for that purpose.
- Exploring the possibility of gainful mergers between banks, and among banks and financial institutions.
- Speedy implementation of legal reforms to hasten debt recovery.
- Reducing CASH RESERVE RATIO to international standards and phasing out the STATUTORY LIQUIDITY RATIO.

Khusro Committee A Committee headed by an economist, A.M. Khusro, that conducted an appraisal of the agricultural credit system in India. Several observations and recommendations were made in its report in 1989, including the following :

- Setting up of an apex institution for the co-operative banks.
- Merger of Regional Rural Banks (RRBs) with the respective sponsoring banks.
- Establishment of Agricultural and Rural Development Corporations for some eastern and north-eastern states of India, in order to increase the tempo of agricultural lending.

Malhotra Committee A committee set up to recommend reforms in the insurance sector; headed by the former Reserve Bank of India Governor, R. N. Malhotra, the INSURANCE REFORMS COMMITTEE has made several suggestions in its report submitted in January 1994, that includes the following :

- To permit the entry of private as well as foreign firms in the insurance business.
- To reduce government stake in Life Insurance Corporation (LIC) and General Insurance Corporation (GIC) to 50 percent and restructure the two.
- The delink GIC and its four subsidiaries namely:

(a) Oriental Fire and Insurance Co. Ltd.
(b) National Insurance Co. Ltd.
(c) New India Assurance Co. Ltd., and
(d) United India Insurance Co. Ltd.

- To discard the system of licensing of surveyors by the Controller of Insurance.
- To restructure the Tariff Advisory Committee.
- To set up a regulatory authority for the insurance industry.

Marathe Committee (on Urban Co-operative Banks) A committee set up to review the licensing policy for new urban co-operative banks. Headed by S. S. Marathe of the Reserve Bank of India (RBI) Board, the committee's prescriptions submitted in May 1992, favour a liberal entry policy and include :

- Establishment of new urban co-operative banks on the basis of need and potential, and achievement of revised viability norms. The one-bank-per-district approach is to be discarded.
- Achieving prescribed viability norms in terms of share capital, initial membership and other parameters within a specified time.
- Introduction of a monitoring system to generate early warning signals and for the timely detection of sickness.

The committee's recommendations have been accepted by the RBI with certain modifications.

NABARD An acronym for the National Bank for Agricultural and Rural Development. Set up in 1982, it is the apex institution for agricultural and rural credit, though primarily, a REFINANCE extension institution. Accordingly, NABARD interacts with commercial banks, state co-operative banks, REGIONAL RURAL BANKS and others, for the development of agriculture, small-scale industries, village industries, handicrafts and other sectors in rural areas, all over India. Besides refinance assistance, NABARD gives loans to banks and state governments which are channeled to the rural sector.
According to the proposals of the Union Budget 1996-97, NABARD's share capital will quadruple to Rs.2000 crore in the coming five years. This is one of the measures aimed at doubling the flow of credit to agriculture and agro-industries. Accordingly, NABARD's share capital has been progressively enhanced to Rs.1500 crore, as announced in the SLACK SEASON credit policy of 1997-98 by the Reserve Bank of India.
Narasimham Committee (1991) A committee appointed by the Government of India in August 1991, to examine all aspects of the financial system, in terms of its structure, organization functions and procedures. The committee was headed by M. Narasimham, former Governor, Reserve Bank of India (RBI). Some of the recommendations offered by the committee, in its report submitted in November 1991, are :

- A reduction, phased over five years in the STATUTORY LIQUIDITY RATIO (SLR) to 25 percent, synchronized with the planned contraction in FISCAL DEFICIT.

- A progressive reduction in the CASH RESERVE RATIO (CRR).
- Gradual deregulation of interest rates.
- All banks to attain CAPITAL ADEQUACY OF 8 percent in a phased manner.
- Banks to make substantial provisions for bad and doubtful debts.
- Profitable and reputed banks be permitted to raise capital from the public.
- Instituting an ASSETS RECONSTRUCTION FUND to which the bad and doubtful debts of banks and FINANCIAL INSTITUTIONS could be transferred at a DISCOUNT.
- Facilitating the establishment of new private banks, subject to RBI norms.
- Banks and financial institutions to classify their ASSETS into four broad groups, viz, Standard, Sub-standard, Doubtful and Loss.
- RBI to be primarily responsible for the regulation of the banking system.
- Larger role for SEBI, particularly as a market regulator rather than as a controlling authority.

As a sequel to the report, the government has acted upon many of the suggestions. These actions include reductions in CRR and SLR, stipulation of capital adequacy norms for banks and announcement of guidelines for new private banks.

Non-Banking Financial Company (NBFC) A financial intermediary that is engaged in certain financing activities other than banking. These activities are specified in the Non-Banking Financial Companies (Reserve Bank) Directions, 1977 and amendments thereto. They include equipment leasing, HIRE-PURCHASE, housing finance and investments in financial securities; however, insurance companies and stock broking enterprises and excluded. Many of these intermediaries offer other FUND-BASED products too, as for instance bill DISCOUNTING and FACTORING; also offered are fee-based services such as security issues management and advice on MERGERS and ACQUISITIONS, capital restructuring etc. The activities of NBFCs are both complementary and competitive to banks. Incidentally, in view of the new areas of financial services that NBFCs have charted, the SHAH COMMITTEE has suggested redefining NBFCs by amending the relevant law.

There have been other developments of import concerning NBFCs. An expert group was constituted by the Reserve Bank of India (RBI), to develop an appropriate supervisory framework for those NBFCs that purvey credit. It is headed by P.R. Khanna, a member of the Advisory Council to the BOARD FOR FINANCIAL SUPERVISION. Among other recommendations, it has prescribed a system of off-site surveillance, a supervisory rating system as well as legislation that would enable the RBI to effectively regulate NBFCs and deal with their financial health and viability. Further, as per RBI's new regulatory framework introduced in January 1998, the focus of regulatory and supervisory attention is on those NBFCs that accept public deposits. Further, for new NBFCs incorporated in April 1999 or later, the eligibility norm for registration has been made more stringent.

Non-performing Asset (NPA) A credit facility which ceases to generate income for a bank. Generally, it is one on which interest or any amount to be received has remained 'past due' for a period of two quarters as on March 31, 1995. An amount under a credit facility is past due when it has not been paid within 30 days from the due date. For CASH CREDIT and OVERDRAFT facilities, there are some specified

criteria for identifying NPAs. Income from NPAs cannot be taken to the profit and loss accounts of banks, as per Reserve Bank of India's directive.

Open-Market Operations (OMO) The purchase or sale of securities, by the CENTRAL BANK of a country to expand or contract the reserves with the banking system. Open Market Opertions serve as an instrument of PUBLIC DEBT management and also of monetary control, besides the CASH RESERVE RATIO and STATUTORY LIQUIDITY RATIO. Through OMO, the Reserve Bank of India (RBI) is able to absorb liquidity from, or inject the same into, the banking system. Since it is envisaged that OMO will become the dominant tool of monetary control in India, the government and RBI have initiated a series of measures to deepen and widen the market for GOVERNMENT SECURITIES. These actions, which will enhance the effectiveness of OMO, are as follows :

- A shift to market rates of interest on Government Securities.
- The promotion of new institutions viz., DISCOUNT AND FINANCE HOUSE OF INDIA and SECURITIES TRADING CORPORATION OF INDIA.
- The appointment of 'PRIMARY DEALERS' to intensify the participation of intermediaries.
- The introduction of the
- Delivery versus Payment' system.
- Promotion of the MARKING-TO-MARKET basis for the valuation of APPROVED SECURITIES held by banks.
- Permitting banks to trade in Government Securities, in order to promote the retail market segment.

Primary Reserve The sum of (a) cash reserves, legally required to be held by a bank and (b) working reserves maintained to facilitate operations such as payments to depositors and credit disbursement. The level of working reserves depends on several factors that include the scale of operations, profile of depositors, business conditions, and size of the SECONDARY RESERVE.

Prime Lending Rate (PLR) The rate of interest charged by banks on WORKING CAPITAL and short term loans to their most credit-worthy borrowers. The prime rate serves as a benchmark for deciding on the interest rate to be charged to other borrowers. Accordingly, major banks and also FINANCIAL INSTITUTIONS in India periodically announce their PLRs depending on their cost of funds and competitive lending rates. From October 1997, the Reserve Bank of India has decided to permit banks to announce separate Prime Term Lending Rates on term loans of three years and beyond. More recently, banks have been given the freedom to have different PLRs for different maturities.

Scheduled Bank A bank that is registered in the Second Schedule to the Reserve Bank of India (RBI) Act, 1934. To be included in the schedule, a bank must fulfill certain conditions that include :

1. The PAID-UP CAPITAL and reserves must be at least Rs.5 lakh.
2. Its conduct must not be to the detriment of its depositors.

Scheduled banks are required to maintain cash reserves with the RBI as prescribed. In return, they enjoy certain privileges from RBI such as borrowing facilities and remittances at concessional rates

Shetty Committee A committee appointed by the Reserve Bank of India (RBI) to review CONSORTIUM based lending. The committee which was headed by J.V. Shetty, Chairman, Canara Bank, submitted its report in 1993. As a sequel to the report, the RBI effected certain changes in the system of bank finance for WORKING CAPITAL, thereby imparting greater flexibility to the system. For example, the limit for obligatory consortium arrangement was raised to Rs.50 crore. Thus companies whose requirements are below Rs.50 crore need not have a consortium; they may deal with just one bank. Also, as an alternative to the obligatory consortium arrangement, banks may arrange LOAN SYNDICATION. This could result in a more competitive pricing and infuse greater discipline owing to a fixed repayment period.

In April 1997, it was decided that it would no longer be obligatory for banks to form a consortium, even if they credit limit of the borrower exceeded Rs.50 crore.

Statutory Liquidity Ratio (SLR) The portion of net demand and time LIABILITIES that SCHEDULED commercial banks (excluding REGIONAL RURAL BANKS) must invest in specified financial ASSETS such as TREASURY BILLS and GOVERNMENT SECURITIES. The SLR indirectly serves as an instrument of credit control, by reducing the monetization of the DEFICIT that would have taken place if funds from the banking system were not statutorily pre-empted by the government sector.

Tandon Committee A study group set up by the Reserve Bank of India (RBI) in 1974, to examine the then prevailing system of WORKING CAPITAL financing by banks and to make suitable recommendations on the same.

The contribution of the committee, headed by Prakash Tandon, that stands out relates to :

- The framing of norms for INVENTORY and receivables for 15 major industries.
- Determining the amount of permissible bank finance.

The committee suggested norms, i.e., ceilings for inventory and receivables, which could be considered for bank finance. The 15 industries included cotton and synthetic textiles, paper, cement, pharmaceuticals and engineering. Thus, for instance, the norms proposed for the pharmaceutical industry were :
Raw materials : 2.75 months' consumption
Stocks in process : ½ month's cost of production
Finished goods : 2 months' cost of sales
Receivables : 1.25 months' sales

For determining the maximum permissible bank finance (MPBF), the methods suggested were :
Method I : 0.75 (CA – CL)

Method II : 0.75 CA – CL
Method III : 0.75 (CA – CCA) – CL

Here CA stands for CURRENT ASSETS corresponding to the suggested norms or past levels if lower, CL represents CURRENT LIABILITIES excluding bank lending and CCA stands for the 'Core Current Assets', i.e., permanent current assets. Method I and, following the CHORE COMMITTEE recommendations, Method II have been used by banks in assessing working capital needs of businesses, for the last several years. In October 1993, the RBI infused operational autonomy by permitting banks to determine appropriate levels of inventory and receivables, based on production, processing cycle, etc. These lending norms were made applicable to all borrowers enjoying an aggregate (FUND-BASED) working capital limit of Rs.1 crore and above from the banking system. However, the requirement of the CURRENT RATIO at 1.33 was retained.

Other recommendations of the Tandon Committee related to the mode of lending and an information and reporting system concerning the operation of the lending system.

Tarapore Committee A committee on Capital Account CONVERTIBILITY (CAC), which was headed by S. S. Tarapore of the Reserve Bank of India. Among other things, the committee was asked to recommend measures for achieving CAC and to specify the sequence and time-table for such measures. Some of the recommendations in the report submitted in 1997 are :

A phased implementation of CAC over a three-year period, i.e. 1997-2000.

The implementation of measures in each phase to be based on certain preconditions or signposts.

The preconditions include a specified reduction in the GROSS FISCAL DEFICIT of the Union Government, a nominal INFLATION rate, full deregulation in the interest rates, reduction in the CASH RESERVE RATIO and the level of NON-PERFORMING ASSETS and monitoring of various macroeconomic indicators such as the exchange rate, adequacy of reserves, etc.

Progressively allowing individual residents, corporates and others to invest overseas in financial ASSETS and industrial ventures.

Measures to develop and integrate the forex, MONEY and CAPITAL MARKETS, such as permitting all participants in the SPOT MARKET to operate in the forward market.

Derivative: Derivative is product whose value is derived from the value of one or more basic variables of underlying asset.

Forwards: A forward contract is customized contracts between two entities were settlement takes place on a specific date in the future at today's pre agreed price.

Futures: A future contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Future contracts are standardized exchange traded contracts.

Options: An option gives the holder of the option the right to do some thing. The option holder option may exercise or not.

Call option: A call option gives the holder the right but not the obligation to sell an asset by a certain date for a certain price.

Put option: A put option gives the holder the right but not obligation to sell an asset by a certain date for a certain price

Option price: Option price is the price which the option buyer pays to the option seller. It is also referred to as the option premium

Expiration date: The date which is specified in the option contract is called expiration date.

European option: It is the option at exercised only on expiration date it self.
Basis: Basis means future price minus spot price.

Cost of carry: The relation between future prices and spot prices can be summarized in terms of what is known as cost of carry.

Initial margin: The amount that must be deposited in the margin a/c at the time of first entered into future contract is known as initial margin.

Maintenance margin: This is some what lower than initial margin.

Mark to market: In future market, at the end of the each trading day, the margin a/c is adjusted to reflect the investor's gains or loss depending upon the future selling price. This is called mark to market.

Baskets: Basket options are options on portfolio of underlying asset.

Swaps: Swaps are private agreements between two parties to exchange cash flows in the future according to a pre agreed formula.

Impact cost: Impact cost is cost it is measure of liquidity of the market. It reflects the costs faced when actually trading in index.

Hedging: Hedging mans minimize the risk.