International financial management

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Unit 1: THE FINANCE FUNCTION

Finance

- Finance function is the procurement of funds and their effective utilization in business concerns. The concept of finance includes capital, funds, money, and amount.

Types of Finance

- Public finance

Central Govt.

State Govt.

Semi Govt.

- Private finance

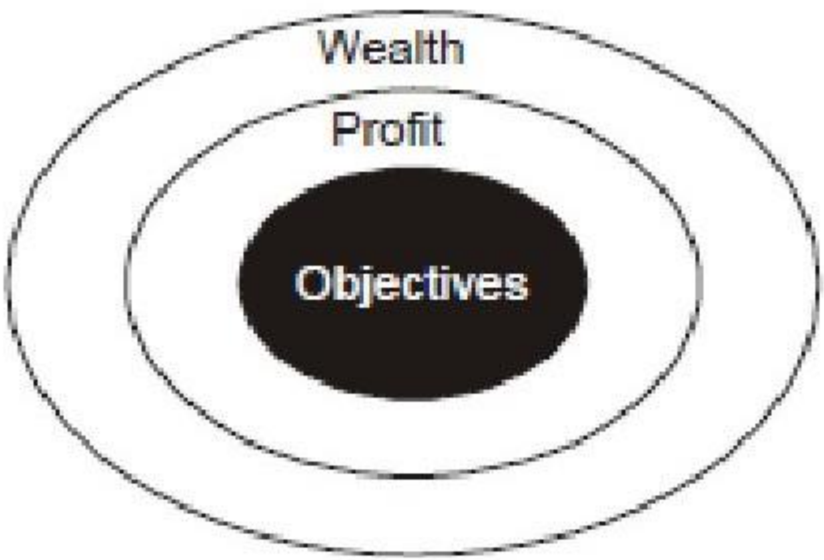
Individual finance

Partnership finance

Business finance

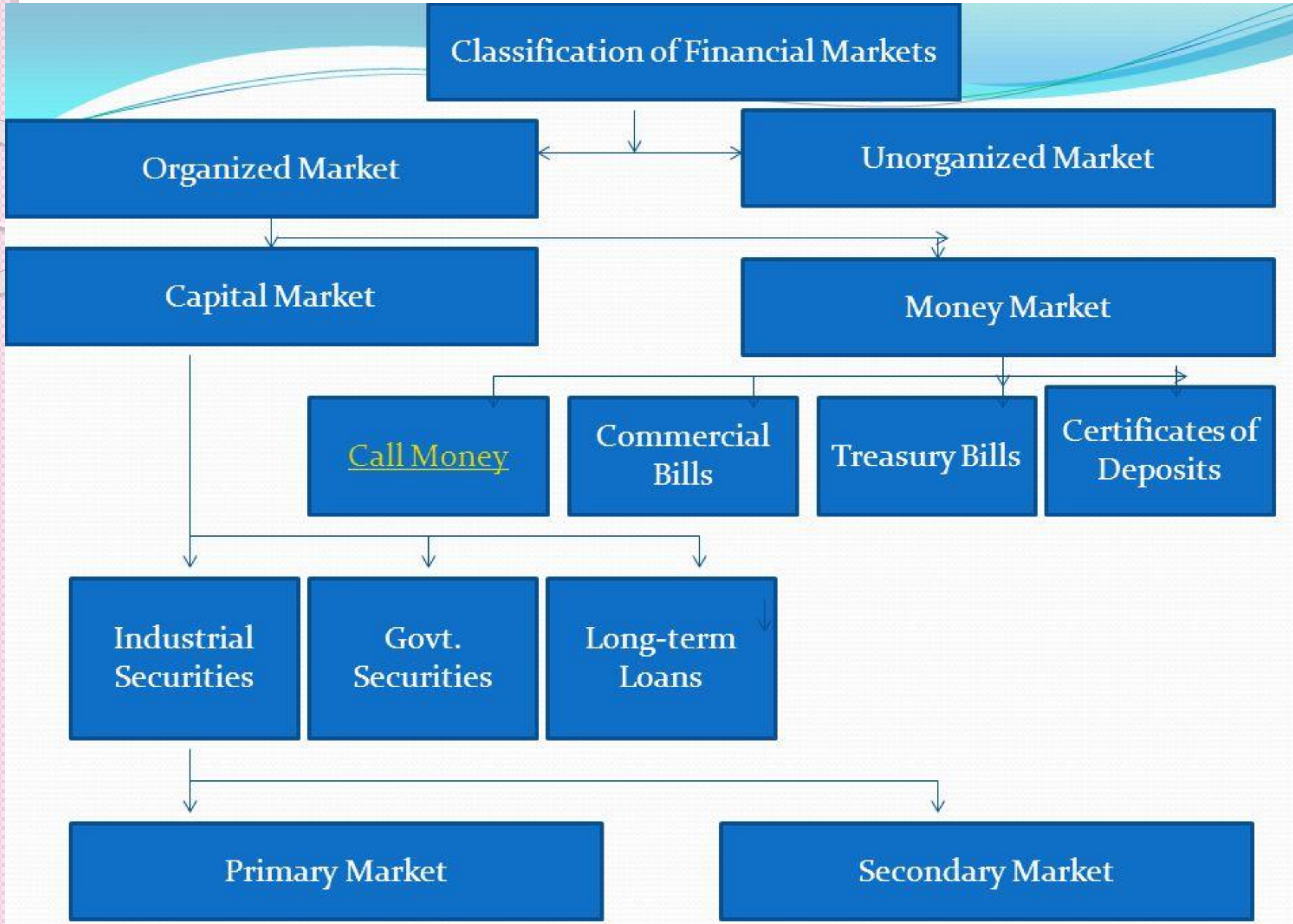
GOALS OF FINANCE FUNCTION

- Profit maximization
- Wealth maximization



Financial markets in India comprise

- The money market
- Government securities market
- Capital market
- Insurance market
- The foreign exchange market

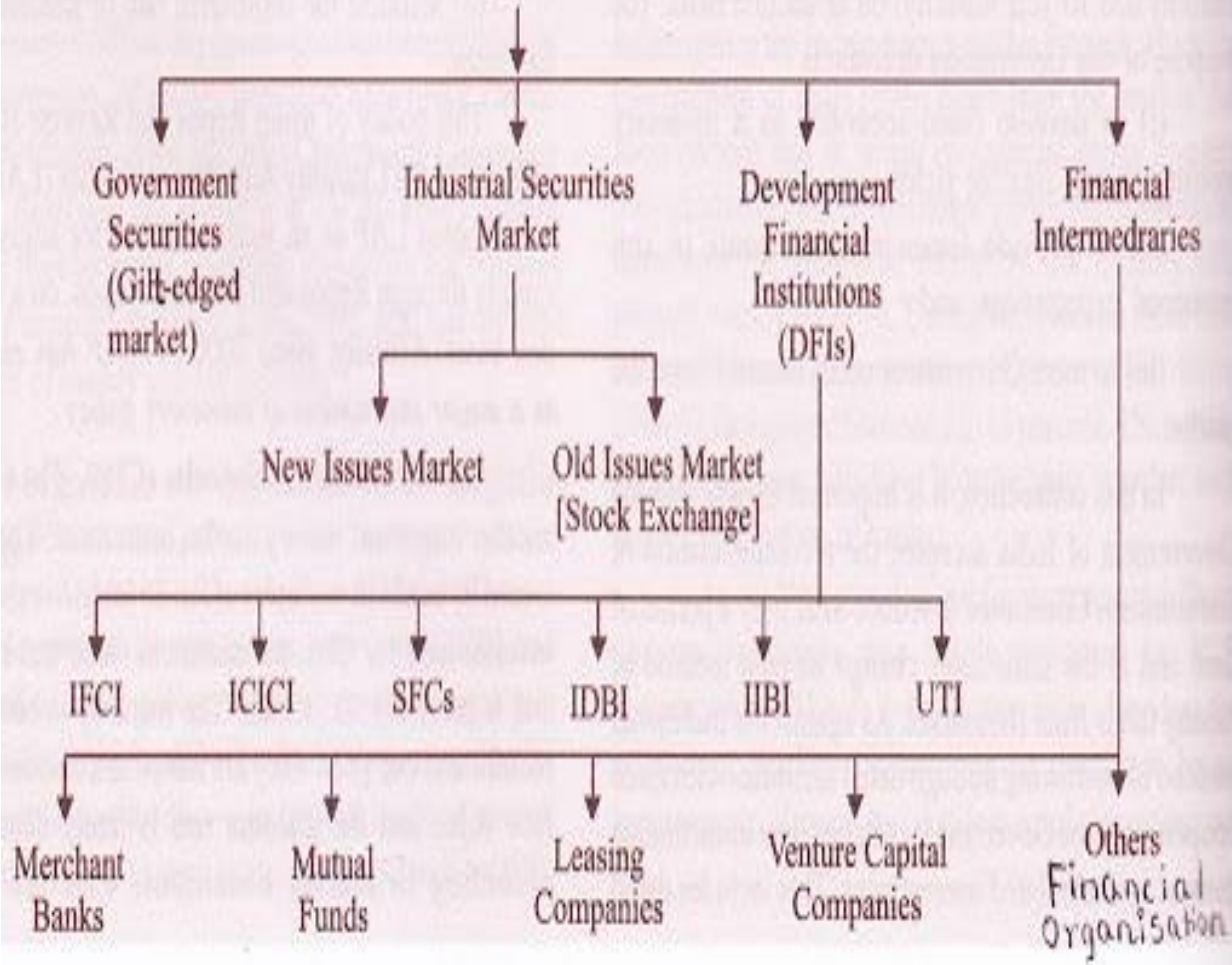

Classification of Financial Markets
Organized Market
Unorganized Market
Capital Market
Money Market
Call Money
Commercial Bills
Treasury Bills
Certificates of Deposits
Industrial Securities
Govt. Securities
Long-term Loans
Primary Market
Secondary Market

Money Market

- Market for short period- 1year or less than 1year
- It includes trade bills, promissory notes and government securities.
- Money market instruments have the characteristics of quick liquidity and minimum transaction cost.
- Relatively risk-free
- Borrowers in the money market are the central government, state governments, local bodies, trader's industrialists, farmers, exporters, importers and the public

participants	borrowing	lending
Scheduled Commercial Banks	borrow a maximum of 125 per cent of their capital funds on any day, during a fortnight.	on a daily average basis in a reporting fortnight, lending outstanding should not exceed 25 per cent of their capital funds.
Co-operative Banks	on a daily basis should not exceed 2.0 per cent of their aggregate deposits as at end March of the previous financial year.	No limit
Primary Dealers (PDs)	on daily average basis in a reporting fortnight, up to 225 per cent of their net owned funds (NOF)	PDs are allowed to lend in call/notice money market, on daily average basis in a reporting fortnight, up to 25 per cent of their NOF

Capital market in India



CALL MONEY MARKET

- The call money market (CMM) the market where overnight (one day) loans can be availed by banks to meet liquidity.
- Banks who seeks to avail liquidity approaches the call market as borrowers and the ones who have excess liquidity participate there as lenders.
- The CMM is functional from Monday to Friday.
- Banks can access CMM to meet their reserve requirements (CRR and SLR) or to cover a sudden shortfall in cash on any particular day

- Loans are availed through auction/negotiation. The auction is made on interest rate. Highest bidder (who is ready to give higher interest rate) can avail the loan
- Since the participants are banks, the call money rate tells about the overall liquidity position in the economy
- Higher call rate indicates liquidity stress in the economy.

Treasury Bill Market

- Treasury bills are issued by the central government for short period loans (91 days).
- These bills are sold by the Reserve Banks on behalf of the government.
- These bills are purchased by Reserve Bank, Commercial Banks, non-banking financial intermediaries, the LIC, UTI and GIC.
- They are zero-risk instruments, and hence returns are not that attractive.

- Treasury bills are highly liquid because Reserve Bank of India is always willing to purchase or discount them.
- Treasury Bills are bought and sold on discounted basis. It means that the amount of interest due on it is paid in the form of discount in the price charged for the bill.
- The price is thus lower than its face value by the amount of interest due on the bill. The interest rate on the Treasury bill is very low

Certificate of Deposit (CD)

- CDs have a specific maturity date (from three months to five years)
- Issued in a dematerialised form against funds deposited in a bank for a specific period.
- Certificate of Deposit is like a promissory note issued by a bank in form of a certificate entitling the bearer to receive interest
- It is similar to bank term deposit account. The certificate bears the maturity date, fixed rate of interest and the value.

- These certificates are available in the tenure of 3 months to 5 years.
- The returns on certificate of deposits are higher than T-Bills because they carry higher level of risk.

Commercial papers

- Commercial paper is usually issued by companies with very high credit ratings
- It matures in a very short period of time, commercial paper tends to be a very low-risk investment.
- The instrument is not backed by collateral
- Commercial Paper is the short term unsecured promissory note issued by corporate and financial institutions at a discounted value on face value

- They come with fixed maturity period ranging from 1 day to 270 days.
- These are issued for the purpose of financing of accounts receivables, inventories and meeting short term liabilities.
- The return on commercial papers is higher as compared to T-Bills so as the risk as they are less secure in comparison to these bills.
- It is easy to find buyers for the firms with high credit ratings. These securities are actively traded in secondary market

There are a number of capital market instruments used for market trade, including –

- Stocks
- Bonds
- Debentures
- Treasury-bills
- Foreign Exchange
- Fixed deposits