- Financial Restructuring: When a company cannot pay its cash obligations - it goes bankrupt. In this situation, a company can, of course, choose to simply shut down operations and walk away or, it can also restructure and remain in business.

6. Leading and Lagging

Solution :

Leading means advancing a payment i.e. making a payment before it is due.
Lagging involves postponing a payment i.e. delaying payment beyond its due date.
In forex market Leading and lagging are used for two purposes:-

(1) Hedging foreign exchange risk: A company can lead payments required to be made in a currency that is likely to appreciate. For example, a company has to pay $100000 after one month from today. The company apprehends the USD to appreciate. It can make the payment now. Leading involves a finance cost i.e. one month's interest cost of money used for purchasing $100000.

A company may lag the payment that it needs to make in a currency that it is likely to depreciate, provided the receiving party agrees for this proposition. The receiving party may demand interest for this delay and that would be the cost of lagging. Decision regarding leading and lagging should be made after considering (i) likely movement in exchange rate (ii) interest cost and (iii) discount (if any).

(2) Shifting the liquidity by modifying the credit terms between inter-group entities: For example, A Holding Company sells goods to its 100% Subsidiary. Normal credit term is 90 days. Suppose cost of funds is 12% for Holding and 15% for Subsidiary. In this case the Holding may grant credit for longer period to Subsidiary to get the best advantage for the group as a whole. If cost of funds is 15% for Holding and 12% for Subsidiary, the Subsidiary may lead the payment for the best advantage of the group as a whole. The decision regarding leading and lagging should be taken on the basis of cost of funds to both paying entity and receiving entity. If paying and receiving entities have different home currencies, likely movements in exchange rate should also be considered.

7. Inter-Bank Participation Certificate

Solution :

The IBPCs are short-term instruments to even-out the short-term liquidity within the banking system. The primary objective is to provide some degree of flexibility in the credit portfolio of banks and to smoothen the consortium arrangements. The IBPC can be issued by scheduled commercial bank and can be subscribed to by any commercial bank. The IBPC is issued against an underlying advance, classified standard and the aggregate amount of participation in any account time issue. During the currency of the participation, the aggregate amount of participation should be covered by the outstanding balance in account.

The participation can be issued in two types, viz. with and without risk to the lender. While the participation without it can be issued for a period not exceeding 90 days. Participation is now with risk for a period between 91 days and 180 days.
The interest rate on IBPC is freely determined in the market. The certificates are neither transferable nor prematurely redeemable by the issuing bank. In the case of the bank issuing IBPC with risk, the aggregate amount of participation would be reduced from the aggregate advance outstanding.
The scheme is beneficial both to the issuing and participating banks. The issuing bank can secure funds against advances without actually diluting its asset-mix. A bank having the highest loans to total asset ratio and liquidity bind can square the situation by issuing IBPCs. To the lender, it provides an opportunity to deploy the short-term surplus funds in a secured and profitable manner.

8. Asset Securitization

Solution :
Asset Securitisation: It is a method of recycling of funds. It is especially beneficial to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this assets pool market securities can be issued. The process can be classified in the following three functions.

1. The origination function: A borrower seeks a loan from finance company, bank or housing company. On the basis of credit worthiness repayment schedule is structured over the life of the loan.
2. The pooling function: Similar loans or receivables are clubbed together to create an underlying pool of assets. This pool is transferred in favour of a SPV (Special Purpose Vehicle), which acts as a trustee for the investor. Once, the assets are transferred they are held in the organizers portfolios.
3. The securitisation function: It is the SPV's job to structure and issue the securities on the basis of asset pool. The securities carry coupon and an expected maturity, which can be asset based or mortgage based. These are generally sold to investors through merchant bankers. The investors interested in this type of securities are generally institutional investors like mutual fund, insurance companies etc. The originator usually keeps the spread.

Generally, the process of securitisation is without recourse i.e. the investor bears the credit risk of default and the issuer is under an obligation to pay to investors only if the cash flows are received by issuer from the collateral.

MONEY MARKET

1. Distinguish between Money market and Capital market.

Solution :

The capital market deals in financial assets. Financial assets comprises of shares, debentures, mutual funds etc. The capital market is also known as stock market.

Stock market and money market are two basic components of Indian financial system. Capital market deals with long and medium term instruments of financing while money market deals with short term instruments.

Some of the points of distinction between capital market and money market are as follows:

	Money Market	Capital Market
(i)	There is no classification between primary market and secondary market	There is a classification between primary market and secondary market.
(ii)	It deals for funds of short-term requirement (less than a year).	It deals with funds of long-term requirement (more than 1 year).
(iii)	Money market instruments include interbank call money, notice money upto 14 days, short-term deposits upto three months, commercial paper, 91 days treasury bills.	Capital Market instruments are shares and debt instruments.
(iv)	Money market participants are banks, financial institution, RBI and Government.	Capital Market participants include retail investors, institutional investors like Mutual Funds, Financial Institutions, corporate and banks.
(v)	Supplies funds for working capital requirement.	Supplies funds for fixed capital requirements.
(vi)	Each single instrument is of a large amount.	Each single instrument is of a small amount.
(vii)	Risk involved in money market is less due to smaller term of maturity. In short term the risk of default is less.	Risk is higher

(viii)	Transactions take place over phone calls. Hence there is no formal place for transactions.	Transactions are at a formal place viz. the stock exchange.
(ix)	The basic role of money market is liquidity adjustment.	The basic role of capital market includes putting capital to work, preferably to long term, secure and productive employment.
(x)	Closely and directly linked with the Central Bank of India	The Capital market feels the influence of the Central Bank but only indirectly and through the money market

2. What are the rigidities in the Indian money market?

Solution:

Notwithstanding the deregulation process initiated by the Reserve Bank of India and several innovations, the money market is not free from certain rigidities which are hampering the growth of the market. The most important rigidities in the Indian money market are:

(i) Markets not integrated,
(ii) High volatility,
(iii) Interest rates not properly aligned,
(iv) Players restricted,
(v) Supply based-sources influence uses,
(vi) Not many instruments,
(vii) Players do not alternate between borrowing and lending,
(viii) Reserve requirements,
(ix) Lack of transparency,
(x) Inefficient Payment Systems,
(xi) Seasonal shortage of funds,
(xii) Commercial transactions are mainly in cash, and
(xiii) Heavy Stamp duty limiting use of exchange bills

3. Call Money in Context of Money Market

Solution:

The Call Money is a part of the money market where, day to day surplus funds, mostly of banks, are traded. Moreover, the call money market is most liquid of all short-term money market segments.

The maturity period of call loans vary from 1 to 14 days. The money that is lent for one day in call money market is also known as 'overnight money'. The interest paid on call loans are known as the call rates. The call rate is expected to freely reflect the day-to-day lack of funds. These rates vary from day-to-day and within the day, often from hour-to-hour. High rates indicate the tightness of liquidity in the financial system while low rates indicate an easy liquidity position in the market.

In India, call money is lent mainly to even out the short-term mismatches of assets and liabilities and to meet CRR requirement of banks. The short-term mismatches arise due to variation in maturities i.e. the deposits mobilized are deployed by the bank at a longer maturity to earn more returns and duration of withdrawal of deposits by customers vary. Thus, the banks borrow from call money markets to meet short-term maturity mismatches.

Moreover, the banks borrow from call money market to meet the cash Reserve Ratio (CRR) requirements that they should maintain with RBI every fortnight and is computed as a percentage of Net Demand and Time Liabilities (NDTL).

4. What is money market? What are its features? What kind of inefficiencies it is suffering from?

Solution:

In a wider spectrum, a money market can be defined as a market for short-term money and financial assets that are near substitutes for money with minimum transaction cost.

Features:

- The term short-term means generally a period upto one year and near substitutes to money is used to denote any financial asset which can be quickly converted into money.
- Low cost.
- It provides an avenue for equilibrating the short-term surplus funds of lenders and the requirements of borrowers.
- It, thus, provides a reasonable access to the users of short term money to meet their requirements at realistic prices.
- The money market can also be defined as a centre in which financial institutions congregate for the purpose of dealing impersonally in monetary assets.

Inefficiencies:

(i) Markets not integrated,
(ii) High volatility,
(iii) Interest rates not properly aligned,
(iv) Players restricted,
(v) Supply based-sources influence uses,
(vi) Not many instruments,
(vii) Players do not alternate between borrowing and lending,
(viii) Reserve requirements,
(ix) Lack of transparency,

(x) Inefficient Payment Systems,
(xi) Seasonal shortage of funds,
(xii) Commercial transactions are mainly in cash, and
(xiii) Heavy Stamp duty limiting use of exchange bills

5. Commercial Paper

Solution:

A commercial paper is an unsecured money market instrument issued in the form of a promissory note. Since the CP represents an unsecured borrowing in the money market, the regulation of CP comes under the purview of the Reserve Bank of India which issued guidelines in 1990 on the basis of the recommendations of the Vaghul Working Group. These guidelines were aimed at:

(i) Enabling the highly rated corporate borrowers to diversify their sources of short term borrowings, and
(ii) To provide an additional instrument to the short term investors.

It can be issued for maturities between 7 days and a maximum upto one year from the date of issue. These can be issued in denominations of Rs. 5 lakh or multiples therefore. All eligible issuers are required to get the credit rating from credit rating agencies.

Eligibility criteria for issuer of commercial paper

The companies satisfying the following conditions are eligible to issue commercial paper.

- The tangible net worth of the company is Rs. 5 crores or more as per audited balance sheet of the company.
- The fund base working capital limit is not less than Rs. 5 crores.
- The company is required to obtain the necessary credit rating from the rating agencies such as CRISIL, ICRA etc.
- The issuers should ensure that the credit rating at the time of applying to RBI should not be more than two months old.
- The minimum current ratio should be 1.33:1 based on classification of current assets and liabilities.
- For public sector companies there are no listing requirement but for companies other than public sector, the same should be listed on one or more stock exchanges.
- All issue expenses shall be borne by the company issuing commercial paper.

6. Limitations of Credit Rating

Solution:

Credit rating is a very important indicator for prudence but it suffers from certain limitations. Some of the limitations are:

mutual fund tracking agencies may serve as a benchmark. The ratio is lower of annual purchase plus annual sale to average value of the portfolio.

2. Distinction between Open ended schemes and Closed ended schemes

Solution:

Open Ended Scheme do not have maturity period. These schemes are available for subscription and repurchase on a continuous basis. Investor can conveniently bu y and sell unit. The price is calculated and declared on daily basis. The calculated price is termed as NAV. The buying price and selling price is calculated with certain adjustment to NAV. The key future of the scheme is liquidity.

Close Ended Scheme has a stipulated maturity period normally 5 to 10 years. The Scheme is open for subscription only during the specified period at the time of launch of the scheme. Investor can invest at the time of initial issue and thereafter they can buy or sell from stock exchange where the scheme is listed. To provide an exit rout some close -ended schemes give an option of selling bank (repurchase) on the basis of NAV. The NAV is generally declared on weekly basis.

3. Money Market Mutual Funds

Solution:

An important part of financial market is Money market. It is a market for short-term money. It plays a crucial role in maintaining the equilibrium between the short-term demand and supply of money. Such schemes invest in safe highly liquid instruments included in commercial papers certificates of deposits and government securities.

Accordingly, the Money Market Mutual Fund (MMMF) schemes generally provide high returns and highest safety to the ordinary investors. MMMF schemes are active players of the money market. They channelize the idle short funds, particularly of corporate world, to those who require such funds. This process helps those who have idle funds to earn some income without taking any risk and with surety that whenever they will need their funds, they will get (generally in maximum three hours of time) the same. Short- term/emergency requirements of various firms are met by such Mutual Funds. Participation of such Mutual Funds provides a boost to money market and help in controlling the volatility.

4. What are the signals that indicate that is time for an investor to exit a mutual fund scheme?

Solution:

(1) When the mutual fund consistently under performs the broad based index, it is high time that it should get out of the scheme.