UNIT-1

1. Explain the nature and scope of financial services?

Introduction

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.

NATURE OF FINANCIAL SERVICES INDUSTRY

1. **Customer-Specific:** Financial services are usually customer focused. The firms providing these services, study the needs of their customers in detail before deciding their financial strategy, giving due regard to costs, liquidity and maturity considerations.
2. **Intangibility:** In a highly competitive global environment brand image is very crucial. Unless the financial institutions providing financial products and services have good image, enjoying the confidence of their clients, they may not be successful.
3. **Concomitant:** Production of financial services and supply of these services have to be concomitant.
4. **Tendency to Perish:** Unlike any other service, financial services do tend to perish and hence cannot be stored. They have to be supplied as required by the customers.
5. **People Based Services:** Marketing of financial services has to be people intensive and hence it‟s subjected to variability of performance or quality of service.
6. **Market Dynamics:** The market dynamics depends to a great extent, on socioeconomic changes such as disposable income, standard of living and educational changes related to the various classes of customers.

SCOPE OF FINANCIAL SERVICES

Financial services cover a wide range of activities. They can be broadly classified into two, namely:
1. Traditional Activities

Traditionally, the financial intermediaries have been rendering a wide range of services encompassing both capital and money market activities. They can be grouped under two heads, viz.

1. Fund based activities and
2. Non-fund based activities.

Fund based activities: The traditional services which come under fund based activities are the following:

- Underwriting or investment in shares, debentures, bonds, etc. of new issues (primary market activities).
- Dealing in secondary market activities.
- Participating in money market instruments like commercial papers, certificate of deposits, treasury bills, discounting of bills etc.
- Involving in equipment leasing, hire purchase, venture capital, seed capital etc.
- Dealing in foreign exchange market activities. Non fund based activities

Non fund based activities: Financial intermediaries provide services on the basis of non-fund activities also. This can be called „fee based‟ activity. Today customers, whether individual or corporate, are not satisfied with mere provisions of finance. They expect more from financial services companies. Hence a wide variety of services, are being provided under this head. They include:

- Managing the capital issue i.e. management of pre-issue and post-issue activities relating to the capital issue in accordance with the SEBI guidelines and thus enabling the promoters to market their issue.
- Making arrangements for the placement of capital and debt instruments with investment institutions.
- Arrangement of funds from financial institutions for the clients project cost or his working capital requirements.
- Assisting in the process of getting all Government and other clearances.

2. What are the roles of financial services in the economic development?

The development of any country depends on the economic growth the country achieves over a period of time. Economic growth deals about investment and production and also the extent of Gross Domestic Product in a country. Only when this grows, the people will experience growth in the form of improved standard of living, namely economic development.

Role of financial system in economic development of a country

- **Savings-investment relationship**

To attain economic development, a country needs more investment and production. This can happen only when there is a facility for savings. As, such savings are channelized to productive resources in the form of investment.

- **Financial systems help in growth of capital market**

Any business requires two types of capital namely, fixed capital and working capital. Fixed capital is used for investment in fixed assets, like plant and machinery. While working capital is used for the day-to-day running of business. It is also used for purchase of raw materials and converting them into finished products.

- **Government Securities market**

Financial system enables the state and central governments to raise both short-term and long-term funds through the issue of bills and bonds which carry attractive rates of interest along with tax concessions.

- **Financial system helps in Infrastructure and Growth**

Economic development of any country depends on the infrastructure facility available in the country. In the absence of key industries like coal, power and oil, development of other industries will be hampered. It is here that the financial services play a crucial role by providing funds for the growth of infrastructure industries.

- **Financial system helps in development of Trade**

The financial system helps in the promotion of both domestic and foreign trade. The financial institutions finance traders and the financial market helps in discounting financial instruments such as bills. Foreign trade is promoted due to per-shipment and post-shipment finance by commercial banks.

- **Employment Growth is boosted by financial system**

The presence of financial system will generate more employment opportunities in the country. The money market which is a part of financial system, provides working capital to the businessmen and manufacturers due to which production increases, resulting in generating more employment opportunities.

- **Venture Capital**

There are various reasons for lack of growth of venture capital companies in India. The economic development of a country will be rapid when more ventures are promoted which require modern technology and venture capital.

- **Financial system ensures Balanced growth**

Economic development requires a balanced growth which means growth in all the sectors simultaneously. Primary sector, secondary sector and tertiary sector require adequate funds for their growth.

- **Financial system helps in fiscal discipline and control of economy**

It is through the financial system, that the government can create a congenial business atmosphere so that neither too much of inflation nor depression is experienced. The industries should be given suitable protection through the financial system so that their credit requirements will be met even during the difficult period.

- **Role of financial system in attracting foreign capital**

Financial system promotes capital market. A dynamic capital market is capable of attracting funds both from domestic and abroad. With more capital, investment will expand and this will speed up the economic development of a country.

UNIT-2

1. **What is meant by leasing? Explain the types of leasing?**

   A "lease" is defined as a contract between a lessor and a lessee for the hire of a specific asset for a specific period on payment of specified rentals. The maximum period of lease according to law is for 99 years. Previously land or real estate, mines and quarries were taken on lease.

But now a day‟s plant and equipment, modem civil aircraft and ships are taken.

Definition:

(i) Lessor:

The party who is the owner of the equipment permitting the use of the same by the other party on payment of a periodical amount.

(ii) Lessee:

The party who acquires the right to use equipment for which he pays periodically.

Types of Leases:

The different types of leases are discussed below:

1. Financial Lease:

This type of lease which is for a long period provides for the use of asset during the primary lease period which devotes almost the entire life of the asset. The lessor assumes the role of a financier and hence services of repairs, maintenance etc., are not provided by him. The legal title is retained by the lessor who has no option to terminate the lease agreement.

The principal and interest of the lessor is recouped by him during the desired playback period in the form of lease rentals. The finance lease is also called capital lease is a loan in disguise. The lessor thus is typically a financial institution and does not render specialized service in connection with the asset.

2. Operating Lease:

It is where the asset is not wholly amortized during the non-cancellable period, if any, of the lease and where the lessor does not rely for is profit on the rentals in the non- cancellable period. In this type of lease, the lessor who bears the cost of insurance, machinery, maintenance, repair costs, etc. is unable to realize the full cost of equipment and other incidental charges during the initial period of lease. The lessee uses the asset for a specified time. The lessor bears the risk of obsolescence and incidental risks. Either party to the lease may termite the lease after giving due notice of the same since the asset may be leased out to other willing leases.

3. Sale and Lease Back Leasing:

To raise funds a company may-sell an asset which belongs to the lessor with whom the ownership vests from there on. Subsequently, the lessor leases the same asset to the company (the lessee) who uses it. The asset thus remains with the lessee with the change in title to the lessor thus enabling the company to procure the much needed finance.

4. Sales Aid Lease:

Under this arrangement the lessor agrees with the manufacturer to market his product through his leasing operations, in return for which the manufacturer agrees to pay him a commission.

5. Specialized Service Lease:

In this type of agreement, the lessor provides specialized personal services in addition to providing its use.

6. Small Ticket and Big Ticket Leases:

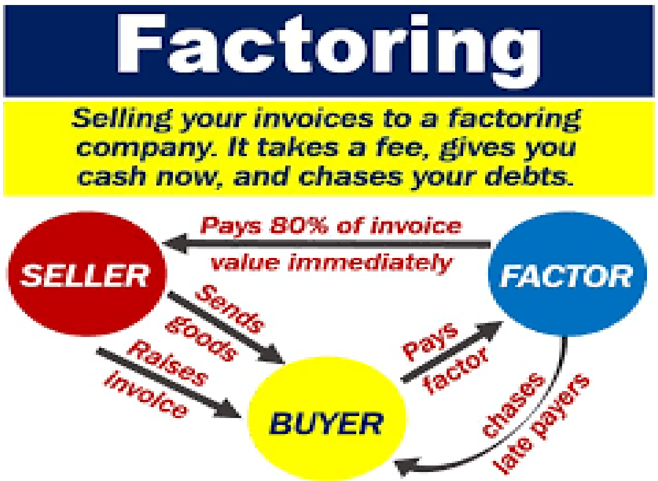
The lease of assets in smaller value is generally called as small ticket leases and larger value assets are called big ticket leases.

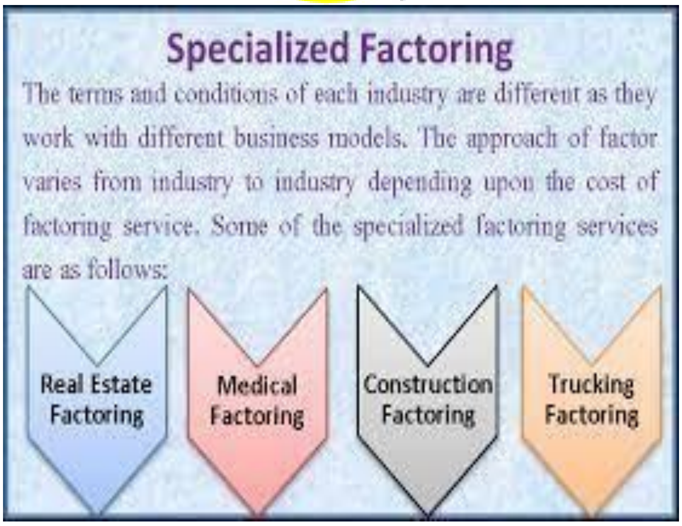
7. Cross Border Lease:

Lease across the national frontiers is called cross broker leasing. The recent development in economic liberalisation, the cross border leasing is gaining greater importance in areas like aviation, shipping and other costly assets which base likely to become absolute due to technological changes.

2. What is meant by factoring and forfeiting?

Factoring is defined as "an outright purchase of credit approved accounts receivables, with the factor assuming bad debt losses."





- **Salient Features of Factoring:**

(i) Credit Cover:

The factor takes over the risk burden of the client and thereby the client‟s credit is covered through advances.

(ii) Case advances:

The factor makes cash advances to the client within 24 hours of receiving the documents.

(iii) Sales ledgering:

As many documents are exchanged, all details pertaining to the transaction are automatically computerized and stored.

(iv) Collection Service:

The factor, buys the receivables from the client, they become the factor‟s debts and the collection of cheques and other follow-up procedures are done by the factor in its own interest.

(v) Provide Valuable advice:

- **Types of Factoring: Recourse Factoring:**

In Recourse factoring the credit risk remains with the client though the debt is assigned to the factor, i.e., the factor can have recourse to the client in the event of non-payment by the customer.

Non-Recourse Factoring:

The Non-Recourse Factoring also called as „Old-line factoring‟. It is an arrangement whereby he factor has no recourse to the client when the bill remains unpaid by the customer. Thus, the risk of bad debt is absorbed by the factor.

Advance Factoring:

Where the payment is made by the factor immediately is called Advance Factoring Under this type of factoring, the factor provides financial accommodation apart from non-financial services rendered by him.

Confidential and Undisclosed Factoring:

In confidential and undisclosed factoring the arrangement between the factor and the client are left un-notified to the customers and the client collects the bills from the customers without intimating them to the factoring arrangements.

Maturity Factoring:

In maturity factoring method, the factor may agree to pay an amount to the client for the bills purchased by him either immediately or on maturity. The later refers to a date agreed upon on which the factor pays the client.

- **<u>Forfaiting</u>**

Forfaiting in French means to give up one‟s right. Thus, in forfaiting the exporter hands over the entire export bill with the forfaiter and obtains payments. The exporter has given up his right on the importer which is now taken by the forfaiter. By doing so, the exporter is benefited as he gets immediate finance for his exports. The risk of his exports is now borne by the forfaiter. In case if the importer fails to pay, recourse cannot be made on the exporter

Forfaiting in India

For a long time, Forfaiting was unknown to India. Export Credit Guarantee Corporation was guaranteeing commercial banks against their export finance. However, with the setting up of export-import banks, since 1994 forfaiting is available on liberalized basis.

The **exim bank** undertakes forfaiting for a minimum value of Rs. 5 lakhs. For this purpose, the exporter has to execute a special Pronote in favor of the exim bank. The exporter will first enter into an agreement with the importer as per the quotation given to him by the exim bank. The exim bank on its part, gets quotation from the forfaiting agency abroad. Thus, the entire forfaiting process is completed by exporter agreeing to the terms of the exim bank and signing the Pronote.

Forfaiting business in India will pick up only when there is trading of foreign bills in international currencies in India for which the value of domestic currency has to be strengthened. This would be possible only with increasing exports. At present, India‟s share stands at 1.7 percent in the world exports. Perhaps, this will bring a push to the forfaiting market.

<u>UNIT-3</u>

1. What is merchant banking services? Explain the issue management in merchant banking services?

The word merchant bank does not have a fixed definition as this term is used differently in different countries. In United States these are called as "Investment Banks" and in UK they are called as "accepting and issuing houses". The notification of Ministry Of Finance in India defines Merchant Banker as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, or subscribing to the securities as manager, consultant, adviser in relation to such an issue management".

Services Provided by Merchant Banks

Below mentioned are the major services offered by Merchant Bankers;

- Project Counseling
- Management of debt and equity offerings
- Issue Management
- Managers, Consultants or Advisers to the Issue
- Underwriting of Public Issue
- Portfolio Management
- Restructuring strategies
- Off Shore Finance
- Non-resident Investment
- Loan Syndication
- Corporate Counseling and advisory services
- Placement and distribution

- **ISSUE MANAGEMENT IN MERCHANT BANKING**

- In issue management, the main role of merchant bankers is to help the company issuing securities in raising funds for the purpose of financing new projects, expansion/ modernization/diversification of existing units and augmenting long term resources for working capital requirements. The most important aspect of merchant banking business is to function as lead managers to the issue management. The role of the merchant banker as an issue manager can be studied from the following points:
- **1. Easy fund raising:** An issue manager acts as an indispensable pilot facilitating a public/ rights issue. This is made possible with the help of special skills possessed by him to execute the management of issues.
- **2. Financial consultant:** An issue manager essentially acts as a financial architect, by providing advice relating to capital structuring, capital gearing and financial planning for the company.
- **3. Underwriting:** An issue manager allows for underwriting the issues of securities made by corporate enterprises. This ensures due subscription of the issue.
- **4. Due diligence:** The issue manager has to comply with SEBI guidelines. The merchant banker will carry out activities with due diligence and furnish a Due Diligence Certificate to SEBI. The detailed diligence guidelines that are prescribed by the Association of Merchant Bankers of India (AMBI) have to be strictly observed. SEBI has also prescribed a code of conduct for merchant bankers.
- **5. Co-ordination:** The issue manger is required to co-ordinate with a large number of institutions and agencies while managing an issue in order to make it successful.
- **6. Liaison with SEBI:** The issue manager, as a part of merchant banking activities, should Register with SEBI. While managing issues, constant interaction with the SEBI is required by Way of filing of offer documents, etc. In addition, they should file a number of reports relating to the issues being managed.

2. **Describe the intermediaries in merchant banking? Explain the role & responsibility of lead manager?**

Deposit-type institutions

Depository-type institutions are the most commonly used types of financial intermediaries because people use their services on a daily basis.

- **Commercial Bank**

Commercial Banks are the largest among all financial intermediaries and are also the most diversified due to the large range of assets and liabilities they hold.

- **Thrift Institutions**

Savings and loans associations and mutual savings banks are often called thrift institutions.

- **Credit Unions**

Credit Unions are small non-profit depository institutions that are owned by their members who are also their customers.

Contractual Savings Institutions

These are savings institutions that obtain their funds through long-term contractual arrangements and invest these funds on the capital markets.

- **Life Insurance Companies**

Life insurance companies issues securities which are claims meant to protect individuals and families from events such as premature death or early retirement.

- **Casualty Insurance Companies**

These types of insurance companies sell policies that protect individuals or businesses against loss of property from fire, theft, accidents or other causes that can be predicted through statistical models.

- **Pension Funds**

Pension funds generally acquire funds from employer and employee contributions while the employee is still working and provide the employee with payments during retirement. Pension funds usually invest funds in corporate bonds and equities.

Investment Funds

- **Mutual Funds**

Mutual funds pool together funds from investors and then build a portfolio consisting of equities and bonds. The investors own shares which represent a portion of the mutual fund pie.

- **Money Market Mutual Funds**

A money market mutual fund (MMMF) is simply a mutual fund that strictly invests its pool of funds in money market securities which are short-term securities with low default-risk.

Other Types of Financial Intermediaries

- **Finance Companies**

Finance companies obtain most of their money by issuing commercial paper (short-terms) to investors, and the rest is obtained from the sale of equity capital and long-term debt obligations.

- **Federal Agencies**

The U.S. government acts as a financial intermediary through its agencies which take part in financial intermediary type transactions.

Responsibility of Lead Manager:

Every lead managers has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosures, allotment and refund. A statement specifying these is furnished to the SEBI at least one month before the opening of the issue for subscription. In case of more than one lead manager, the statement has to provide details about their respective responsibilities. A lead merchant banker cannot manage an issue if the issuing company is his associate. He can also not associate with a merchant banker who does not hold a certificate of registration with the SEBI.

Due Diligence Certificate: The lead manager is responsible for the verification of the contents of a prospectus/letter of offer in respect of an issue and the reasonableness of the views expressed in them.

Submission of Documents: The lead managers to an issue have to submit to the SEBI, at least two weeks before the date of filing with the registrar of companies/regional stock exchanges or both, particulars of the issue, draft prospectus/letter of offer, other literature to be circulated to the investors/ share holders and so on to the SEBI.

Acquisition of Shares: A merchant banker is prohibited from acquiring securities of any company on the basis of unpublished price sensitive information obtained during the course of any professional assignment either from the client or otherwise.

Procedure for Inspection: The SEBI can undertake inspection of the books of accounts, records, and the provision of the SEBI Act, rules, regulations are being complied with, and to investigate complaints from investors/other merchant bankers/any other person or any matter having a bearing on his activities as a merchant banker and to investigate in the interest of securities business/investors into the affairs of the merchant banker.

UNIT-4

1. What is meant by credit rating? Explain the importance of credit rating?

INTRODUCTION

A credit rating is an assessment of the creditworthiness of a borrower in general terms or with respect to a particular debt or financial obligation. A credit rating can be assigned to any entity that seeks to borrow money – an individual, corporation, state or provincial authority, or sovereign government.

Credit assessment and evaluation for companies and governments is generally done by a credit rating agency such as Standard & Poor‟s (S&P), Moody‟s, or Fitch. These rating agencies are paid by the entity that is seeking a credit rating for itself or for one of its debt issues.

Definition:

Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity. It is a rating given to a particular entity based on the credentials and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

RATING SERVICES

CARE is promoted by IDBI jointly with investment institutions, banks and finance companies. The company commenced its operations in October 1993 and announced its first rating in 1993. Services offered by CARE are:

(1) Credit rating:

CARE undertakes credit rating of all types of debt instruments, both short-term and long-term. Credit rating is an opinion on the relative ability and willingness of an issuer to make timely payments on specific debt or relative obligations over the life of the instrument.

(2) Information services:

The broad objective of the Information Service will be to make available information on any company, local body, industry or sector required by a business enterprise.

(3) Equity research:

Another major activity of CARE will be Equity Research. This will involve extensive study of the shares listed in the major stock exchanges and identification of the potential winners and losers among them on the basis of the fundamentals affecting the industry

(4) Rating of parallel marketers of LPG and kerosene:

CARE undertakes „performance rating" of parallel marketers of Liquefied Petroleum Gas (LPG) and Superior Kerosene Oil (SKO) as notified by Government of India

PROCEDURE OF CREDIT RATING

Application

At this stage client"s authorized representatives need to register the application officially and to sign an agreement on implementation of rating procedure. At this time company and client"s representatives discuss all the questions concerning rating assignment and main aspects of future cooperation.

Analytic group

After all the questions are discussed, Credit-Rating agency begins preparation procedure and forms analytic group. Analytic group consists of two or three analysts and group manager (leading analyst) who controls the whole work.

Information requirements

To get all the information necessary for analysis, „Credit-Rating" agency sends a client the letter with information requirements: a list of all the information and documents necessary for credit rating analysis. „Credit-Rating" guarantees that your confidential information will be kept safe.

Meetings with client company managers

Meetings and consultations with client company managers and officials are very important in the process of credit rating assignment. As a rule, we need two or three meetings. In the first meeting analysts would ask questions about financial plans and further development prospects. This information helps us to remain objective in assessment of client"s financial position for the long-term period.

Analysis

All the information obtained from a client or other reliable sources is processed with a help of special methodologies, worked out by the agency.

Importance of credit rating:

1. Improves Corporate Image
2. Lowers Cost of Borrowing
3. Wider Audience for Borrowing
4. Good for Non-Popular Companies
5. Act as a Marketing Tool
6. Helps in Growth and Expansion

2. What is meant by venture capital? Explain the advantages of venture capital?

It is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. Venture Capital is money invested in businesses that are small; or exist only as an initiative, but have huge potential to grow. The people who invest this money are called venture capitalists (VCs). The venture capital investment is made when a venture capitalist buys shares of such a company and becomes a financial partner in the business.

Features of Venture Capital investments

- High Risk
- Lack of Liquidity
- Long term horizon
- Equity participation and capital gains
- Venture capital investments are made in innovative projects
- Suppliers of venture capital participate in the management of the company

Methods of Venture capital financing

- Equity
- participating debentures

- conditional loan

The venture capital funding process typically involves four phases in the company‟s development:

- Idea generation
- Start-up
- Ramp up
- Exit

Step 1: Idea generation and submission of the Business Plan

The initial step in approaching a Venture Capital is to submit a business plan.

Step 2: Introductory Meeting

Once the preliminary study is done by the VC and they find the project as per their preferences, there is a one-to-one meeting that is called for discussing the project in detail.

Step 3: Due Diligence

The due diligence phase varies depending upon the nature of the business proposal. This process involves solving of queries related to customer references, product and business strategy evaluations, management interviews, and other such exchanges of information during this time period.

Step 4: Term Sheets and Funding

If the due diligence phase is satisfactory, the VC offers a term sheet, which is a non-binding document explaining the basic terms and conditions of the investment agreement. The term sheet is generally negotiable and must be agreed upon by all parties, after which on completion of legal documents and legal due diligence, funds are made available.

Advantages of Venture Capital

- They bring wealth and expertise to the company
- Large sum of equity finance can be provided
- The business does not stand the obligation to repay the money
- In addition to capital, it provides valuable information, resources, technical assistance to make a business successful

Disadvantages of Venture Capital

- As the investors become part owners, the autonomy and control of the founder is lost
- It is a lengthy and complex process
- It is an uncertain form of financing
- Benefit from such financing can be realized in long run only

UNIT-5

1. Discribe the insurance services in detail?

IMPORTANCE OF INSURANCE

Human beings, his family and properties are always exposed to different kinds of risks. Risk involve the losses. Insurance is a tool which reduces the cost of loss or effect of loss caused by variety of risk. It accumulates funds to meet individual losses. It is not device to prevent unwanted event of happening or cause of loss but protects them against that loss by compensating which as lost. The role and importance of insurance are discussed as follows:

1. Insurance provides security

Insurance provides safety and security against the loss on a particular event. Life insurance provides security against death and old age sufferings. Fire insurance protects against loss due to fire while Marine insurance provides protection and safety against loss of ship and cargo. For personal accident and sickness insurance financial protection is given when the individual is unable to earn. In other insurance too, this security is provided against the loss at a given contingency.

2. Insurance reduces business risk or losses

In Business, commerce and industry, huge properties are employed. Because of slight negligence, the property may be turned in to ashes. A person may not be sure of his life, health and cannot continue the business up to the longer period to support his dependents. By the help of insurance, he can be sure of his earning, because the insurance company will pay a fixed amount at the time of death, damage by fire, theft, accident and other perils.

3. Insurance provides peace of mind

Insurance removes the tensions, fears, anxiety, frustrate or weaken of the human mind associated with the future uncertainty. By providing financial position and promise to compensate losses arise out from various risk, it provides peace of mind and stimulates more and better work performance of an individual.

4. Life insurance encourages saving

The insured has an obligation to pay premium regularly and cannot be withdrawn easily before the expiry of the term of policy. Life insurance encourages the habit of regular and systematic saving through premium and after a certain period, it would be a part of necessary saving of the insured person.

5. Insurance accelerates the economic growth of the country

To develop the economic growth of the country, insurance provides strong hand and mind, with protection against loss of property and capital to produce more wealth. It provides protection against different kinds of loss caused by risk. It accumulates the capital from the insured and utilizes for the development of country. Thus, the insurance meets all the requirements for the economic growth of a country.

6. Insurance provides credit facilities

The insured person can get loan by pledging insurance policy and the interest will not exceed the cash value of policy charged by insurer. In case of death of insured person, the policy can be utilized for setting of the loan with interest. Business person can take loan on the basis of insurance documents from the bank also.

7. Insurance helps to reduce inflation

Inflation created from over supply of money and on less production entities. Insurance can help to reduce the inflationary pressure in two ways. Firstly, it collects money as an amount of premium which controls over supply of money and secondly, it provides sufficient funds for increase production entities. Thus, it reduces the impact of inflation.

8. Insurance makes security and welfare of employees

The security and welfare of employees is the responsibility of employer. These security and welfare are easily met by life insurance, accident and sickness benefit and pension which are generally provided by group insurance. The premium for group insurance is normally paid by the employer. Insurance is the simple method for employer to fulfill their responsibility. Due to these benefits, employee will devote their maximum capacities to complete their job.

9. Other Importances of Insurance

a) Insurance helps to promote foreign trade providing protection again trade risk.
b) Insurance increases business efficiency eliminating the loss of damage, destruction, or disappearance of property of goods.
c) Insurance protects the social wealth providing protection against social evil.
d) Development of insurance business helps to solve the evil of unemployment, generating employment opportunity in the country.

2. What is meant by microfinance? Explain its features in detail?

Access to credit can play a pivotal role in economic growth. Banks and lending institutions provide the services that allow people to save and invest available assets and resources, which further supports and strengthens economic activity. Within underdeveloped communities, the role of microfinance institutions provides the credit access and financial services needed to develop income-earning businesses.

Microfinance Institutions

Microfinance institutions fill a needed gap within the financial services industry by offering small loans, or micro-loans, to people unable to access conventional loan services.

Access to Financial Services

Within any society, financial services provide a means for people and businesses to obtain credit and manage available assets on a continuous basis. Access to financial services enables existing businesses to grow and provides the starting capital for starter businesses.

Microfinance Approaches

On average, loan repayment rates for microfinace institutions range around 97 to 98 percent, according to the Developing World Markets news and reference site.

Reliable Supports

Microfinance institutions provide a reliable source of financial support and assistance compared to other sources for financing. Sources operating outside the microfinance industry typically form informal relationships with borrowers and have no real legal or substantial ties with their customers.

Features of micro finance:

According to (Murray, U and Boros, R, 2002), there are many activities and functions are included in microfinance. Some are:

- Small amounts of loans and savings.
- Short- terms loan (usually up to the term of one year).
- Payment schedules attribute frequent installments (or frequent deposits).
- Installments made up of both principal and interest, which is amortized over the course of time.
- Higher interest rates on credit (higher than commercial bank rates but lower than loan-shark rates), which reflect the labor-intensive work associated with making small loans and allowing the microfinance intermediary to become sustainable over time.
- Easy entrance to the microfinance intermediary saves the time and money of the client and permits the intermediary to have a better idea about the clients' financial and social status.
- Application procedures are simple.
- Short processing periods (between the completion of the application and the disbursements of the loan).
- The clients who pay on time become eligible for repeat loans with higher amounts.
- The use of tapered interest rates (decreasing interest rates over several loan cycles) as an incentive to repay on time. Larger loans are less costly to the MFI, so some lenders provide large size loans on relatively lower rates.
- No collateral is required contrary to formal banking practices. Instead of collateral, microfinance intermediaries use alternative methods, such as the assessments of clients' repayment potential by running cash flow analyses, which is based on the stream of cash flows, generated by the activities for which loans are taken.