TYPES OF FINANCIAL SERVICES

Learning Objectives:

- To understand the classification of financial services on the basis of movement of funds during the activities or otherwise.

TYPES OF FINANCIAL SERVICES

- 3.1 Introduction
- Financial services cover a wide range of activities. They assume a significant place in the socio-economic environment of any country. Banking services are believed to be the oldest financial services existing in our country. The traditional financial services provided by the banks were in the form of opening deposits accounts and offering loans and advances.
- The liberalization, globalization and sophisticated technology waves, along with innovation and creativity gave birth to various flavors of financial services involving movement of funds or otherwise.

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- **3.2 Classification of financial services on the basis of movement of funds**
- **Banks no longer limit their services to traditional services, but provide a wide range of financial services.**
- **These financial services can be classified into two groups on the basis of movement of funds namely:**
- **(1) Fund-based activities**
- **(2) Non Fund-based activities**

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- **Fund-based activities:**
- In Fund based activities funds are arranged for the customers and the financial intermediary charges interest for the amount of funds utilized. The funds outlay happens in the form of sanction of credit facility to the borrower. Fund based activities can be of the following types.
- E.g. of Fund-based activities →

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- 1.Working capital requirements by way of cash credit, overdraft, demand loan, bill discount/bill purchase
- 2.Portfolio Management
- 3.Capital expenditure or project requirements by way of term loans, project finance, venture capital etc.
- 4. Angel Financing & Seed capital
- 5. Private equity
- 6. Leasing and Hire purchase and factoring services
- 7. Dealing in Foreign Exchange
- 8. Investment in shares, debentures, bonds etc.
- 9. Packing credit as well as post shipment finance
- 10. Mortgages and reverse mortgages
- 11. Micro-credit
- 12. Retail Loans including priority sector lending and agri - finance

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- **Non Fund-based activities:**
- **These services are basically advisory/ancillary services for which the Bank charges a fee or a commission for rendering the services. They do not involve outlay of funds. Non-fund credit facilities involve only the issuing bank's commitment to honour certain promises as per the letter of credit or guarantee or similar document favoring a third party. However, outlay of funds may take place in the event of development of the commitment on the issuing bank. Non Fund based activities can be of the following types.**
- **E.g. of Fund-based activities ➔**

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- 1. Merchant Banking: managing capital issues
- 2. Project advisory services
- 3. Custodian services
- 4. Credit card services
- 5. Mergers and Acquisitions services
- 6. Credit rating services
- 7. Bills collection services
- 8. Capital restructuring services
- 9. Trusteeship services
- 10. Structuring collaborations and joint ventures
- 11. Hedging of risks by using swaps and other derivative products
- 12. Safe custody of securities

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- 3.3 Classification of financial services on the basis of service offerings to a particular group
- Financial services can also be classified into two groups on the basis of service offerings to a particular group as follows:
- (1) Retail Financial Services : These services are provided to individuals and small /medium business entities.
- (2) Wholesale Financial Services : These services are provided to large corporates.

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- **Retail Financial Services :**
- Retail Financial Services can be further categorized into three sub-categories:
- (a)Acceptance of deposits as well as providing ancillary services like lockers, remittances etc.
- (b)Lending to the borrowers
- (c)Investment of funds in the Stock market, Mutual Funds, Insurance etc

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- **(a)Acceptance of deposits:**
- **A bank accepts money from its customers and keeps the funds in interest bearing accounts like savings accounts, fixed deposits, recurring deposits, flexi deposit accounts or non-interest bearing accounts like current accounts as per the request of the customer. Deposits are payable on demand in case of savings account and current accounts or on specific maturity dates in case of fixed deposits. Flexi deposits enables you to withdraw your money on demand as well as earn the fixed deposit interest on the funds which are not withdrawn.**
- **NRE/NRO/FCNR services, Child plans, Salary accounts, Retirement services, Demat accounts, Stock trading accounts through Banks brokers are also offered to retail investors.**

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- **(b)Lending :**
- The major use of bank funds are loans and advances. Credit facilities extended by the banks to the borrowers are fund based and non fund based.
- Retail lending ie. Lending to individuals and small business entities is done in the form of personal loans, vehicle loans, educational loans, housing loans, gold loans, loan against property, credit card loans etc. and business loans in the form of working capital finance which includes a proper mix of cash credit, overdrafts, demand loan, bills purchase/discounting and term loans.

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- **(c) Investment advice :**
- **With the growth in consumerism, availability of more money in the pockets of the working class and growth of the capital markets, banks have introduced various advisory services on their own or with the help of specialists which includes financial advisors, stock brokers, fund managers, investment banks, mutual funds and insurance companies.**
- **Customers are willing to pay fees to the Bank for providing advisory services to manage their wealth.**

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- Banks are massively cross selling the Mutual Funds and Insurance products to their retail customers, as they earn huge fees as an income to the bank without any outlay of funds.
- This approach involves delivering integrated financial services that are not limited to traditional retail banking services such as lending and deposits.

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- **Mutual Fund Services:**
- Mutual funds are marketed as products exposing investors to lower risks and giving options to invest in small chunks like in the Systematic Investment Plans(SIPs) or in larger chunks as well. Mutual funds give both large and small investors the benefit of trained, experienced and specialized management together with continuous supervision.
- Mutual funds in India offer over 500 products / services / options plans across various types of investors. They consist of both open ended and closed ended schemes.

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- The mutual fund products can be categorized into equity funds, bond funds, hybrid funds, money market funds etc.
- Banks are offering mutual fund products to their clients either through their own subsidiaries or sell mutual fund products of other Mutual Fund companies.
- Banks provide advisory services, funds management services as well as portfolio management services to their clients inclined towards buying Mutual fund products.

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- **Insurance services and products:**
- The selling of life assurance and other insurance products and services by banking institutions is called Bancassurance. Bank staff and tellers, rather than an insurance salesperson, become the point of sale and point of contact for the customer. Bank staff are advised and supported by the insurance company through product information, marketing campaigns and sales training.
- The bank and the insurance company share the commission. Insurance policies are processed and administered by the insurance company. This partnership arrangement can be profitable for both companies.

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- Banks can earn additional revenue by selling the insurance products, while insurance companies are able to expand their customer base without having to expand their sales forces or pay commissions to insurance agents or brokers.
- Insurance products are distributed by branch staff, which is sometimes supported by specialized insurance advisers for more sophisticated products or for certain types of clients.
- Life insurance products are fully integrated in the bank's range of savings and investment products and the trend is for the branch staff to sell a growing number of insurance products that are becoming farther removed from its core business, e.g., protection, health, or non-life products.

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- **Wholesale Financial Services :**
- The wholesale financial services are provided to large corporates including the Governments. The funds outlay is huge in comparison to individual customers. Large amounts are invested in deposits and the borrowings are in crores. The range of service overlaps to some extent with those provided to retail customers.
- Services which are generally restricted to the wholesale market include: ➔

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- **(1)Merchant Bankers/Lead Managers :**
- **Banks are engaged in the business of issue management either by making arrangements regarding buying, selling or subscribing to securities or acting as managers/consultants/advisors or rendering corporate advisory services in relation to issue management.**
- **(2)Bankers to an issue:**
- **Banks are engaged in activities such as acceptance of application forms along with application money from the investors in respect of issues of capital and refund of application money.**

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- **(3)Underwriting new securities: debt and equity:**
- **In underwriting, financial intermediaries arrange to sell securities for a company to the public or to other institutions for a fee. Underwriters agree to take up securities which are not fully subscribed. Underwriters assure the company that the full amount of money sought will be obtained.**
- **Underwriting an issue also creates confidence in the securities being issued. Underwriters are appointed by the issuing companies in consultation with the Lead Managers / Merchant Bankers.**

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- **(4)Debenture Trustee :**
- **A debenture trustee is a trustee for a trust deed needed for securing any issue of debentures by a company. Banks fulfilling the capital adequacy requirements as per the current BASEL III norms are eligible to act as debenture trustee. Banks are also governed by SEBI regulations for acting as a debenture trustee.**
- **(5)Portfolio Managers:**
- **Banks advise/direct/undertake on behalf of the clients the management/ administration of portfolio of securities / funds of clients.**

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- **(6)Corporate Restructuring:**
- Banks provide advisory services for profitable business growth internally through the process of introducing / developing new products for cash management, funds management, expanding/enlarging capacity of existing products or externally through the process of acquisitions of existing business firms.
- The acquisitions may be in the form of mergers, acquisitions, amalgamations, takeovers, absorption, consolidations etc.

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- **(7)Factoring and Forfaiting:**
- Factoring is a fund based financial service which provides resources to finance receivables as well as facilitates the collection of receivables. A bank can act as a factor to maintain and administer the sales ledger as well as provide collection facility of accounts receivables.
- Forfaiting is a form of financing of receivables pertaining to international trade. Forfaiting involves purchase of trade bills/ promissory notes by a Bank without recourse to the seller.

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- **(8)Hire Purchase Finance:**
- **Banks arrange finance for the goods to be sold at a future date. In a hire purchase transaction, the goods are let on hire. The purchase price is to be paid in installments and the hirer is allowed the option to purchase the goods by paying all the installments.**
- **(9)Leasing:**
- **Leasing is a process in which the company can obtain the use of certain fixed assets for which it must make periodical payments of lease rentals. At the end of the payment period the asset revert back to the lessor. Banks can arrange finance for payment of lease rentals after appraising its clients.**

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- **(10) Venture Capital Financing:**
- Venture Capital Financing is a new technique of financing to inject long-term capital into the small and medium business sectors. Banks are very active in arranging venture capital for its clients which can be in the form of equity related investment in a growth oriented small/medium business to enable an investee to accomplish corporate objectives, in return for minority shareholding in the business or the irrevocable right to acquire it.

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- **Export Finance:**
- **Banks handle a variety of financing programmes for Export Oriented Units (EOUs), Importers, and overseas investments by Indian companies. The entire range of export credit services such as supplier's credit, pre-shipment & post shipment finance, export transactions in agriculture sector are provided by the banks at competitive interest rates.**
- **Credit proposals from SMEs under various lending programmes of the bank are also encouraged. Banks also offer variety of advisory and value-added information services aimed at investment promotion & assistance to Indian companies to enable them establish their products in overseas markets.**

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- **3.4 Non-Banking Finance Companies (NBFC's)**
- The Non-Banking Finance Companies (NBFC) constitute a significant element of the organization of the Indian Financial system. They broaden the range of financial services.
- **The important fund based activities of the NBFCs are :**
- (a) Equipment leasing
- (b) Hire-purchase
- (c) Bills discounting
- (d) Loans/investments
- (e) Venture capital
- (f) Housing finance
- (g) Factoring

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- NBFC’s fee based activities includes :
- (a) Issue management
- (b) Portfolio management
- (c) Corporate counseling
- (d) Lease syndication
- (e) Arranging foreign collaboration
- (f) Merger & acquisition
- (g) Capital restructuring

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- The working and operations of asset finance, loan and investment category of NBFCs are regulated by RBI. Housing Finance companies are regulated by the National Housing Bank and the Capital Market financial intermediaries are regulated by SEBI.
- NBFCs have played a crucial role in enhancing competition in the financial ecosystem and diversification of financial sector.
- NBFCs are doing functions akin to that of banks, however there are a few differences. NBFC cannot accept demand deposits. NBFCs are not a part of the payment and settlement system and as such cannot issue cheques to its customers. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation of India (DICGC) is not available for NBFC depositors unlike in case of banks.

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With this, we complete our session on Chapter 3 'TYPES OF FINANCIAL SERVICES'

Next we move to Chapter 4 'Marketing of Financial Services',