

INTRODUCTION
OF
FINANCIAL SYSTEM
AND
MARKETS

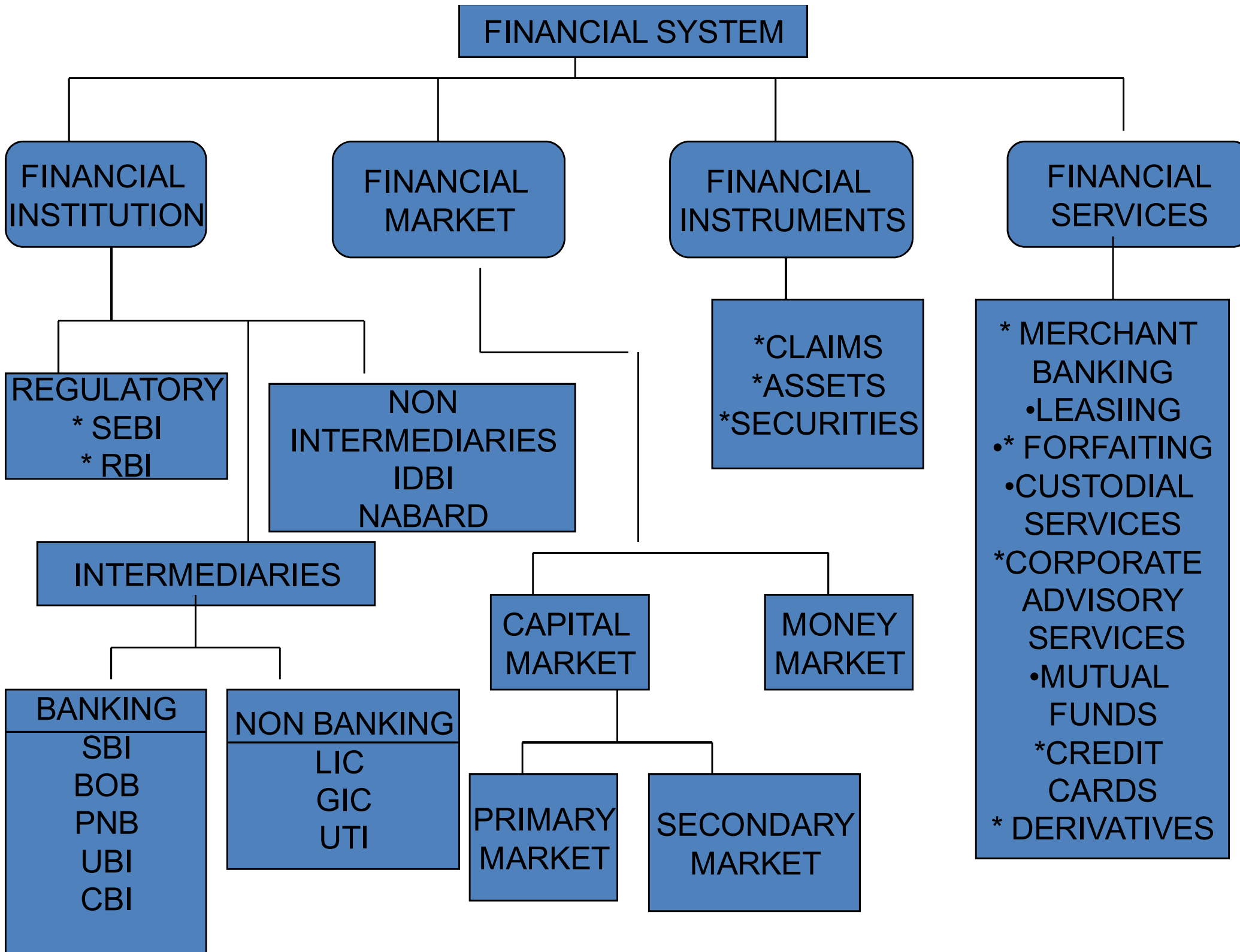
CONTENTS

- Meaning of financial system
- Structure of financial system (classification)
- Role of financial Institutions
- Relationship between Financial system and Economic development (meaning of ED, theories, indicators of ED)
- Financial market (meaning,classification,importance)
- Indian financial system –an overview
- Conclusion

Financial system

“The financial system is the system that allows the transfer of money between savers and borrowers.”

In other words, a financial system is defined as a set of institutions, instruments and markets which foster savings and channel them to their most efficient use. The system comprises of individuals (savers), intermediaries, markets and users of savings.



Components of Financial System in India

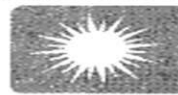
- Financial Institution: - Financial Institution can be classified as banking and non banking institutions. Banking Institutions are creators and purveyors of credit while non banking financial institutions are purveyors of credit.
- Financial Markets: - Financial Markets can be classified as primary and secondary markets. A Primary Market deals with new issues and secondary markets is meant for trading in existing securities.
- Financial Instruments: - A financial instrument is a claim against an institution or a person for payment at a future date of a sum of money in the form of dividend.
- Financial Services: - Financial services are those , which help with borrowing and funding, buying and selling securities, lending and investing, making and enabling payments and settlements and managing risk exposures in financial markets.

Financial Institutions

- Regulatory
 - (i) RBI
 - (ii) SEBI
- Intermediaries
 - (a) Banking
 - (b) Non Banking
- Non-intermediaries

Financial markets

- Money market
- Capital market
 - (a) Primary market
 - (b) Secondary market

**आर ई सी
REC**असीमित ऊर्जा, अनन्त संभावनाएँ
Endless energy. Infinite possibilities.

RURAL ELECTRIFICATION CORPORATION LIMITED

Our Company was incorporated under the Companies Act, 1956, as amended, on July 25, 1969, at New Delhi as "Rural Electrification Corporation Private Limited". Presently, the name of our Company is "Rural Electrification Corporation Limited", upon conversion into a public limited company pursuant to a special resolution passed by our shareholders dated September 27, 2002. Our Company received a fresh certificate of incorporation consequent to change of its name from the Registrar of Companies, National Capital Territory of Delhi and Haryana, at New Delhi, on July 18, 2003. For further details in relation to the corporate history of our Company, see the section titled "History and Certain Corporate Matters" on page 92 of the Red Herring Prospectus. Registered Office and Corporate Office: Core 4, SCOPE Complex, 7, Lodhi Road, New Delhi 110 003, India. Telephone: +91 11 2436 5161; Facsimile: +91 11 2436 0644; E-mail: FPO@rec.ltd.in. Website: www.recindia.ltd.in For further details in relation to the changes in our registered office, see the section titled "History and Certain Corporate Matters" on page 92 of the Red Herring Prospectus. Company Secretary and Compliance Officer: Mr. B. R. Raghunandan, Telephone: +91 11 2436 7305; Facsimile: +91 11 2436 2039; E-mail: complianceofficer@rec.ltd.in

PUBLIC ISSUE OF 171,732,000 EQUITY SHARES OF FACE VALUE OF RS. 10 EACH ("EQUITY SHARES") OF RURAL ELECTRIFICATION CORPORATION LIMITED (THE "COMPANY" OR THE "ISSUER") FOR CASH AT PRICES DETERMINED THROUGH THE ALTERNATE BOOK BUILDING METHOD UNDER PART D OF SCHEDULE XI OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009, AS AMENDED (THE "SEBI REGULATIONS") AGGREGATING UP TO RS. [-] MILLION (THE "ISSUE") CONSISTING OF A FRESH ISSUE OF 128,799,000 EQUITY SHARES BY THE COMPANY ("FRESH ISSUE") AND AN OFFER FOR SALE OF 42,933,000 EQUITY SHARES ("OFFER FOR SALE") BY THE PRESIDENT OF INDIA, ACTING THROUGH THE MINISTRY OF POWER, GOVERNMENT OF INDIA (THE "SELLING SHAREHOLDER"). THE ISSUE COMPRISES A NET ISSUE OF 171,382,000 EQUITY SHARES TO THE PUBLIC ("NET ISSUE") AND A RESERVATION OF 350,000 EQUITY SHARES FOR SUBSCRIPTION BY ELIGIBLE EMPLOYEES (THE "EMPLOYEE RESERVATION PORTION"). THE ISSUE SHALL CONSTITUTE 17.39% OF THE FULLY DILUTED POST-ISSUE CAPITAL OF THE COMPANY AND THE NET ISSUE SHALL CONSTITUTE 17.36% OF THE FULLY DILUTED POST-ISSUE CAPITAL OF THE COMPANY.

THE FACE VALUE OF THE EQUITY SHARES IS RS. 10 EACH**FLOOR PRICE : Rs. 203 PER EQUITY SHARE OF FACE VALUE OF Rs. 10 EACH****THE FLOOR PRICE IS 20.3 TIMES OF THE FACE VALUE.**

BIDS CAN BE MADE FOR A MINIMUM OF 30 EQUITY SHARES AND IN MULTIPLES OF 30 EQUITY SHARES THEREAFTER EACH ELIGIBLE EMPLOYEE BIDDING UNDER THE EMPLOYEE RESERVATION PORTION WILL BE OFFERED EQUITY SHARES AT THE EMPLOYEE PRICE, i.e. RS. 193 PER EQUITY SHARE. EACH ELIGIBLE EMPLOYEE CAN APPLY ONLY UP TO 510 EQUITY SHARES

Our Company and the Selling Shareholder, in consultation with the Book Running Lead Managers, reserve the right to revise the Bidding Period, subject to the Bidding Period not exceeding a total of 10 Working Days. Any revision in the Bidding Period, if applicable, will be widely disseminated by notification to the Bombay Stock Exchange Limited ("BSE") and the National Stock Exchange of India Limited ("NSE") and together with BSE, the "Stock Exchanges", by issuing a press release, and also by indicating the change on the website of the Book Running Lead Managers and at the terminals of the Syndicate.

This issue is being made through the Alternate Book Building Process wherein up to 50% of the Net Issue shall be allocated on a "price priority" basis to Qualified Institutional Buyers ("QIBs" and such portion, the "QIB Portion"). 5% of the QIB Portion shall be available for allocation on a "price priority" basis to Mutual Funds only. The remainder of the QIB Portion shall be available for allocation on a "price priority" basis to QIBs (including Mutual Funds), subject to valid Bids being received from them above the Floor Price. However, if the aggregate demand from Mutual Funds is less than 4,264,550 Equity Shares, the balance Equity Shares available for allocation in the Mutual Fund Portion will be added to the QIB Portion and allocated on a "price priority" basis to the QIBs. Not less than 15% of the Net Issue shall be available for allocation on a proportionate basis to Non Institutional Bidders and not less than 35% of the Net Issue shall be available for allocation on a proportionate basis to Retail Individual Bidders, subject to valid Bids being received from them at the Floor Price. Further, 350,000 Equity Shares shall be available for allocation on a proportionate basis to the Eligible Employees, subject to valid Bids being received from them at the Employee Price. Investors, except QIBs, may participate in this issue through the ASBA process by providing the details of their respective bank accounts in which the corresponding Bid Amounts will be blocked by the Self Certified Syndicate Banks ("SCSBs"). Specific attention of investors is invited to the section titled "Issue Procedure" on page 244 of the Red Herring Prospectus.

PROMOTER OF THE COMPANY: THE PRESIDENT OF INDIA, ACTING THROUGH THE MINISTRY OF POWER, GOVERNMENT OF INDIA**ASBA*****Simple, Safe, Smart way of making an Application - Make use of it!!!**

*Applications supported by blocked amount (ASBA) is a better way of applying to issues by simply blocking the fund in the bank account, investors can avail the same. For details, check section on ASBA below

**BID/
ISSUE****OPEN****CLOSES ON TUESDAY, FEBRUARY 23, 2010**

Bidders should note that on the basis of name of the Bidders, Depository Participant's name, Depository Participant Identification number and Beneficiary Account Number provided by them in the Bid cum Application Form, the Registrar to the Issue will obtain from the Depository the demographic details including address, Bidders' bank account details, MICR code and occupation (hereinafter referred to as "Demographic Details"). These bank account details would be used for giving refunds (including through physical refund warrants, direct credit, ECS, NEFT and RTGS) to the Bidders. Hence, Bidders are advised to immediately update their bank account details as appearing on the records of the Depository Participant. Please note that failure to do so could result in delays in disbursement of refunds to Bidders at the Bidders' sole risk and neither the Book Running Lead Managers nor the Registrar to the Issue nor the Escrow Collection Banks nor our Company nor the Selling Shareholder shall have any responsibility and undertake any liability for the same. Hence, Bidders should carefully fill in their Depository Account details in the Bid cum Application Form.

Listing: The Equity Shares offered through the Red Herring Prospectus are proposed to be listed on the NSE and the BSE. Our Company has received in-principle approvals from the NSE and the BSE for listing of the Equity Shares pursuant to their letters dated December 11, 2009. For the purposes of this issue, NSE shall be the Designated Stock Exchange.

Disclaimer Clause of SEBI: "SEBI only gives its observations on the offer documents and this does not constitute approval of either the issue of the specified securities or the offer document."

Disclaimer Clause of NSE - (THE DESIGNATED STOCK EXCHANGE): "It is to be distinctly understood that the permission given by NSE should not in any way be deemed or construed that the offer document has been cleared or approved by NSE nor does it certify the correctness or completeness of any of the contents of the offer document. The investors are advised to refer to the Red Herring Prospectus for the full text of the Disclaimer clause of NSE."

Disclaimer Clause of BSE: "It is to be distinctly understood that the permission given by Bombay Stock Exchange Limited should not in any way be deemed or construed that the Red Herring Prospectus has been cleared or approved by Bombay Stock Exchange Limited nor does it certify the correctness or completeness of any of the contents of the Red Herring Prospectus. The investors are advised to refer to the Red Herring Prospectus for the full text of the Disclaimer clause of the Bombay Stock Exchange Limited."

BOOK RUNNING LEAD MANAGERS

BOOK RUNNING LEAD MANAGERS				REGISTRAR TO THE ISSUE	
Kotak Investment Banking	BofA Merrill Lynch	ICICI Securities	JM FINANCIAL	RBS The Royal Bank of Scotland	KARVY Karvy ComputerShare Private Limited
Kotak Mahindra Capital Company Limited 1st Floor, Bakti Tower 225, Nariman Point Mumbai 400 021, India Telephone: +91 22 6834 1100 Facsimile: +91 22 2284 0492 Email: rec.fpo@kotak.com Website: www.kmcc.co.in Investor Grievance ID: kmccredres@kotak.com Contact Person: Mr. Chandrakant Bhole SEBI registration number: INM000008704	DSP Merrill Lynch Limited* Mafatlal Centre 10th Floor Nariman Point Mumbai 400 021, India Telephone: +91 22 6632 8761 Facsimile: +91 22 2204 8518 Email: rec.fpo@baml.com Website: www.dspml.com Investor Grievance ID: India_merchantbanking@ml.com Contact Person: Mr. N.S. Shekhar SEBI Registration No.: INM000011625	ICICI Securities Limited* ICICI Centre, H.T. Parekh Marg Churchgate, Mumbai 400 020, India Telephone: +91 22 2288 2460 Facsimile: +91 22 2282 6580 Email: rec.fpo@icicisecurities.com Website: www.icicisecurities.com Investor Grievance ID: customercare@icicisecurities.com Contact Person: Mr. Rajiv Poddar SEBI registration number: INM0000511179	JM Financial Consultants Private Limited* 141, Maker Chambers III Nariman Point Mumbai 400 021, India Telephone: +91 22 6830 3030 Facsimile: +91 22 2204 7185 Email: rec.fpo@jmfincan.in Website: www.jmfincan.in Investor Grievance ID: grievance.jbd@jmfincan.in Investor Grievance ID: Ms. Naazneen Yazdani SEBI registration number: INM000010351	RBS Equities (India) Limited* (formerly known as ABN AMRO Asia Equities (India) Limited) B3/B4, Sakhar Bhawan, Bandra, Mumbai, India 230 Nariman Point Mumbai 400 021, India Telephone: +91 22 6632 5535 Facsimile: +91 22 6632 5541 Email: rec.fpo@rbs.com Website: www.abnamro.co.in Investor Grievance ID: customercare.ecm@in.abnamro.com Contact Person: Mr. Amit Prasad SEBI registration number: INM000010551	Karvy ComputerShare Private Limited Plot no 17 to 24 Vijaya rao Nagar, Madhapur Hyderabad 500 056, India Telephone: +91 40 2342 0815 Toll Free Number: 1-800-345 4001 Facsimile: +91 40 2342 0814 Email: rec.fpo@karvy.com Website: www.karvy.com Investor Grievance ID: efnward.res@karvy.com Contact Person: Mr. M Murali Krishna SEBI registration number: INR000000221

* Sequenced in alphabetical order of logos

COMPANY SECRETARY AND COMPLIANCE OFFICER:

Mr. B.R. Raghunandan, Rural Electrification Corporation Limited, Core-4, SCOPE Complex, 7, Lodhi Road, New Delhi 110 003, India. Telephone: +91 11 2436 7305; Facsimile: +91 11 2436 2039; E-mail: complianceofficer@rec.ltd.in
Investors can contact the Compliance Officer or the Registrar to the Issue in case of any pre-Issue or post-Issue related problems such as non-receipt of letters of Allotment, credit of Allotted Equity Shares in the respective beneficiary account or refund orders

Availability of Red Herring Prospectus: Investors are advised to refer to the Red Herring Prospectus and the Risk Factors contained therein before applying in the Issue. The Red Herring Prospectus is available at the websites of SEBI, NSE, BSE and the BRLMs at www.sebi.gov.in, www.nseindia.com, www.bseindia.com, www.kmcc.co.in, www.dspml.com, www.icicisecurities.com, www.jmfincan.in and www.abnamro.co.in.

Financial Instruments

- Claims
- Assets
- Securities

FINANCIAL SERVICES

Financial services cover a wide range of activities which are divided into two categories:-

- Traditional activities
 - (i) FUND BASED ACTIVITIES
 - (ii) FEE BASED ACTIVITIES
- Modern activities

TYPES OF FINANCIAL SERVICES

- Merchant banking
- Leasing
- Forfaiting
- Custodial services
- Corporate advisory service
- Mutual funds
- Venture capital
- Credit cards
- Derivatives

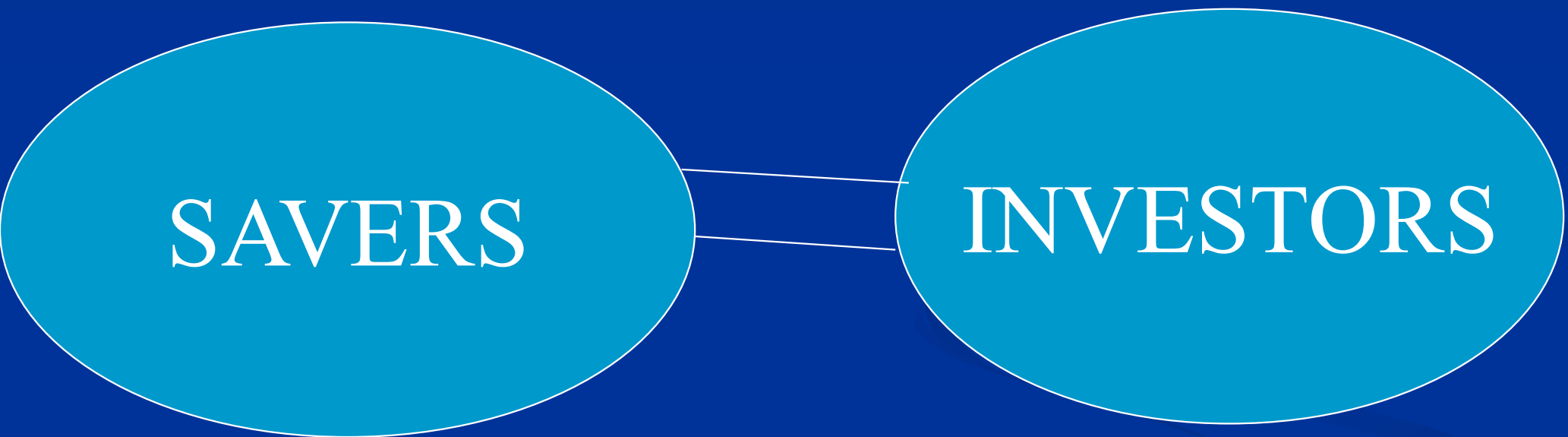
ROLE OF FINANCIAL INSTITUTIONS

- ✓ Role as a financial intermediary
- ✓ Role as a catalytic agent
- ✓ Role as a creator of money
- ✓ Role as a promoter
- ✓ Role as a counselor

**FINANCIAL SYSTEM
AND
ECONOMIC DEVELOPMENT**

Economic development of any country cannot be thought of without the involvement of finance. The role of finance in any country depends on its financial structure. A strong financial system can bring about an all round planned economic development.

- Financial system is bridge between savers and investors.



Theories of Economic development on savings and investment

- ✓ Prior savings theory
- ✓ Credit creation theory
- ✓ Theory of forced savings
- ✓ Financial regulation theory
- ✓ Financial liberalisation theory

Prior Savings Theory

The PST regards saving as a prerequisite of investment and it holds that all saving in the economy can find investment outlets. It stresses the need for appropriate monetary policy and fiscal policy for promoting and mobilising saving voluntarily for investment and growth.

“It is believed that Investment is an alternative to consumption.”

Credit Creation Theory

According to CCT, the contribution of a financial system to growth goes beyond increasing prior saving based investment. Financial system plays a positive role by providing finance or credit through creation of credit in anticipation of savings.

“Credit creation refers to expansion of bank deposits by giving loans and advances.”

- Let us assume the Bank A has deposits of Rs. 5,000. Let us also assume that the bank carries a reserve of 10 %. The bank will, therefore, the balance of Rs. 4,500 in profitable manner.

Theory of Forced Saving

Forced saving refers to an involuntary reduction in consumption which arises when an economy is in full employment and when it has an excess supply of loans.

According to Tobin and Keynes, “Investment is determined by savings, it is savings which are determined by investment”.

Financial Liberalisation Theory

Financial liberalization implies greater access to international capital, facilitated in part through an expanded role for foreign banks and non-bank financial institutions. This definition of financial liberalization goes beyond mere domestic financial reform.

Financial Regulation Theory

Regulation may be defined as action that 'command and control' the individual decisions of firms, in an effort to prevent private decision-making that would take inadequate account of the 'public interest'. Regulation may be self-imposed, or as is usual, by a third party.

Indicators of Economic Development

➤ Financial Ratio

Total financial claims (primary + secondary)

= -----

National Income

➤ Financial Interrelation Ratio

➤ New Issue Ratio

➤ Intermediation Ratio

Cont...

- The well developed secondary markets in all financial securities are essential for calling a financial system a developed system.
- The lower the transaction cost and information cost, the higher the economic development.

FINANCIAL MARKET

Financial Markets

Money Market

Capital Market

Primary
Market

Secondary
Market(DFHI)

Primary
Market

Secondary
Market

Public and
Rights Issues
(Domestic
including
OTCEI
issues)

Euro
Issues
and
Overseas
Offerings

Private
Placements

STCI

Security
Exchanges

Over-the-
counter
Tran-
sactions

FINANCIAL MARKET

Financial market facilitates transfer of funds from surplus sectors lenders or investors to deficit sector borrowers or users of fund. Households are the main investors, they have excess of funds i.e. savings which they lend or give for investments to industrialists or government.

FUNCTIONS OF FINANCIAL MARKET

The term `financial market' refers to the means through which buyers and sellers are brought together to transact the financial products. The Major Functions Performed by the Financial Markets : -

- o Price Discovery
- o Liquidity
- o Lower Transaction Costs

Price Discovery

- Financial markets provide a centralized place for trading in financial products. This 'place' need not be physical. It may be virtual such as the online trading system of the National Stock Exchange.
- This feature enables the prospective buyers and sellers to discover the going price and take appropriate decisions

Liquidity

- Financial markets also provide a mechanism for the investors to sell their financial assets.

For example, if an investor wishes to sell his shares, the equity markets offer an easy exit

Lower Transaction Costs

- Financial markets save a market player the cost of locating counterparty to his transactions. The counterparty can be readily found by going to the appropriate market.

Types of market

➤ Money market

➤ Capital market

Money market

- The **money market** is a component of the financial markets for assets involved in short-term borrowing and lending with original maturities of one year or shorter time frames. Trading in the money markets involves Treasury bills, commercial paper, bankers' acceptances, certificates of deposit, federal funds, and short-lived mortgage-backed and asset-backed securities.
- It provides liquidity funding for the global financial system.

Types of capital market

- Capital markets may be classified as primary markets and secondary markets
- In primary markets, new stock or bond issues are sold to investors via a mechanism known as underwriting.
- In the secondary markets, existing securities are sold and bought among investors or traders, usually on a securities exchange, over-the-counter, or elsewhere.

INDIAN FINANCIAL SYSTEM

(An overview)

An institutional framework existing in a country to enable financial transaction.

There are three main parts of this-

***Financial assets (Loans, deposits, bonds, equities etc.)**

***Financial institutions (banks, mutual funds, insurance companies etc)**

***Financial markets (money market, capital market, forex market)**

***Regulatory environment of financial system (RBI, SEBI)**

FINANCIAL ASSETS AND INSTRUMENTS

- ***Enable channelising funds from surplus unit to deficit unit**
- ***There are instruments for savers such as deposits equity mutual fund units etc.**
- ***Instruments for borrowers such as loans overdrafts etc.**
- ***Like business, government too raise funds through issuing of bonds treasury bills etc.**
- ***Instruments like PPF,KVP are available to savers who wish to lend money to the government.**

FINANCIAL INSTITUTIONS

Includes institutions and mechanism which

***Affect the generation of savings by the community**

***Mobilisation of saving.**

***Institution are banks insurance companies, mutual funds-promote/ mobilise the savings.**

***Individual investors industrial and trading companies borrowers.**

FINANCIAL MARKETS

- **A market is a place where buyers and sellers come together to exchange something.**
- **Financial markets are where financial instruments/products are exchanged.**
- **A financial market is known by type of product traded in it.**

DIFFERENT FINANCIAL MARKETS

- **Money market**
- **Debt market**
- **Forex market**
- **Capital market**

Money Market

- **Money market for short term**
- **Borrowing**
- **Lending**
- **Instruments**
- **Call money market**
- **Bill market**
- **Treasury bills**
- **Commercial papers**
- **Certificate of deposit (CD)**
- **Market Repo**

Call Money Market

- Part of National money market
- Day to day surplus funds mainly of banks are traded
- Short term in nature
- Maturity varies from 1 to 15 days
- Lent for 1 day: call money
- Lent for more than 1 day and less than 15 days; Notice money
- Lent for more than 15 days: Term money
- Highly liquid loan repayable on demand

Bill Market

- **Treasury Bill Market-Its also called T-Bill market.**
- **Bills are short term liabilities(91-364 days)**
- **Issued by RBI on behalf of government of India.**
- **Issued at discount to the face value and at the end of maturity the face value is paid.**
- **Bills are freely transferable.**
- **Consider as safest investment.**

Commercial Papers

- **First introduced in India in 1990**
- **Unsecured promissary note.**
- **Issued by well known companies with strong and high credit rating.**
- **Sold directly by issuers to investors or through agents like merchant banks and security houses.**
- **Less interest rates with compared to banks.**
- **Maturity 7 days to 1 year and high flexible maturity.**
- **Issued subject to minimum of Rs. 5 lac and in multiple of Rs. 5 lac after that**

Certificate of Deposits

Defined as short term deposit by way of promissary notes.

Greater flexibility to investors in the deployment of surplus funds.

Permitted by RBI to banks.

Maturity of not less than 3 months and up to 1 year.

Transferable in nature.

Market Repo

- **Repo (repurchase agreement) instruments enable collateralised short term borrowing through the selling of debt instruments.**
- **A security is sold with an agreement to repurchase it at a predetermined date and rate.**
- **Average daily turn over of repo transaction increased from Rs. 11311 crore during April 2001 to Rs. 42252 crore in June 2006**

Debt Market

- Debt
- Contract
- One party lends to another party.
- Predetermined interest rate and term.
- Participant
- Banks
- Financial institutions
- Mutual funds
- Insurance companies
- Instruments
- Government security
- Public sectors/units bond
- Corporate security

Foreign exchange Markets

- **Foreign goods**
- **Payment in foreign currency forex market**
- **Participants**
- **Government payment for imports repayment of loans.**
- **Importers**
- **Exchange rates-1 currency in terms of other**
- **Eg, \$1=Rs.45**

Capital Market

- Long term funds raised by
- Government
- Corporate
- Trading instruments used
- Shares
- Derivatives
- Units of mutual funds

Primary Market

- **Instruments issued for first time**
- **Used by government/ corporate/ PSU's**
- **IPO (initial public offer)**
- **Secondary market**
- **Trading of already used**
- **Stocks**
- **Bonds**
- **Stock exchange**

Indian banking system

- **Central bank (Reserve Bank of India)**
- **Commercial bank**
- **Co-operative bank**
- **Banks can be classified as**
- **Scheduled (second scheduled of RBI act 1934)**
- **Non-scheduled**
- **Scheduled banks can be classified as**
- **Public sector banks (28)**
- **Private sector banks**
- **Foreign banks**
- **Regional rural banks**

Development oriented banking

- **Close association between banks and some traditional industries.**
- **Banking has not been mere acceptance of deposit and lending money included development banking.**
- **Lead bank scheme-opening bank office in all important locality**

Progress of banking in India

- **Nationalisation of bank in 1969- 14 banks were nationalised**
- **Population served per branch has come down from 64000 to 16000**
- **At present only 32180 villages out of 500000 covered**
- **Expansion of bank credit**
- **Growing at 20% to 30% thanks to rapid growth in industry.**

Stock and Shares

- Stock-capital raised by corporation
- Through issue and distribution of shares
- Shares-signifies ownership in company
- Which company issued shares for the first time in the world?
- *The Dutch East India Company 1602*

Stock Exchange

- **Place where share traded**
- **BSE**
- **NSE**
- **BSE-Bombay Stock Exchange**
- **Oldest in India**
- **Sensex-sensitive index**
- **NSE-National Stock Exchange**
- **Incorporative in 1992**
- **NIFTY**

THANK YOU