INDIAN SCHOOL MUSCAT
Senior Section
Department of Commerce and Humanities

Class : 12

SOLVED SUPPORT MATERIAL
CHAPTER :10 : FINANCIAL MARKETS

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BUSINESS STUDIES (054)

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1 What is Financial Market?
Financial Market is a market for creation and exchange of financial assets.

2 'Financial market plays an important role in the allocation of scarce resources in an economy by performing many important functions.' Explain the functions of Financial Markets.
A. The important functions of Financial markets are:
1. Mobilisation of Savings & channeling them into the most productive uses:- savings of house hold sector is used by the industrial sector through Financial markets only. Thus Financial markets act as intermediaries.
2. Facilitate Price Discovery: You all know that the forces of demand and supply help to establish a price for a commodity or service in the market. In the financial market, the households are suppliers of funds and business firms represent the demand. The interaction between them helps to establish a price for the financial asset which is being traded in that particular market.
3.Provide Liquidity to Financial assets:- Any person can easily sell Financial instruments through financial markets. Thus these markets provide liquidity to such instruments.
Reduce the cost of Transactions:- Person does not have to move from one place to another for selling the financial instruments. Thus the cost for searching a buyer is reduced**.**
4. Reduce the Cost of Transactions: Financial markets provide valuable information about securities being traded in the market. It helps to save time, effort and money that both buyers and sellers of a financial asset would have to otherwise spend to try and find each other.

3 What is Money Market?
The money market is a market for short term funds which deals in monetary assets whose period of maturity is up to one year.

4 Explain the Money Market Instruments.
1. Treasury Bill: A Treasury bill is basically an instrument of short-term borrowing by the Government of India maturing in less than one year. They are also known as Zero Coupon

Bonds issued by the Reserve Bank of India on behalf of the Central Government to meet its short-term requirement of funds. Treasury bills are issued in the form of a promissory note. Treasury bills are available for a minimum amount of Rs 25,000 and in multiples thereof.
2. Commercial Paper: Commercial paper is a short-term unsecured promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period. It is issued by large and creditworthy companies to raise short-term funds at lower rates of interest than market rates. It usually has a maturity period of 15 days to one year.
3. Call Money: Call money is short term finance repayable on demand, with a maturity period of one day to fifteen days, used for inter-bank transactions. Commercial banks have to maintain a minimum cash balance known as cash reserve ratio. Call money is a method by which banks borrow from each other to be able to maintain the cash reserve ratio.
4. Certificate of Deposit: Certificates of deposit (CD) are unsecured, negotiable, short-term instruments in bearer form, issued by commercial banks and development financial institutions. They can be issued to individuals, corporations and companies during periods of tight liquidity when the deposit growth of banks is slow but the demand for credit is high.
5. Commercial Bill: A commercial bill is a bill of exchange used to finance the working capital requirements of business firms. It is a short-term, negotiable, self-liquidating instrument which is used to finance the credit sales of firms. When goods are sold on credit, the buyer becomes liable to make payment on a specific date in future.

5 What is Capital Market?
The term capital market refers to facilities and institutional arrangements through which long-term funds, both debt and equity are raised and invested.
The Capital Market can be divided into two parts: a. Primary Market b. Secondary Market.

6 State the differences between Capital Market and Money Market.

	Basis	Capital Market	Money Market
1	Participants	development banks, commercial banks and stock exchanges.	Reserve Bank of India (RBI), Commercial Banks, Non Banking Finance Companies, State Governments, Large Corporate Houses and Mutual Funds.
2	Instruments traded	Equity shares, preference shares, debentures, bonds	Treasury Bill, Commercial Paper, Call Money, Certificate of Deposit, Commercial Bill.
3	Investment outlay	Does not necessarily require a huge financial outlay	Entails huge sums of money
4	Duration	Deals in medium and long-term securities having maturity period of over one year	Deals in short term funds having maturity period up to one year
5	Liquidity	Less liquid	Highly liquid
6	Expected return	High return	Low return

7	Safety	Riskier	Much safer.

7 What is Primary Market?
The primary market is also known as the new issues market. It deals with new securities being issued for the first time.

8 What are the methods of floatation in Primary Market?
Methods of Floatation:
1. Offer through Prospectus: Offer through prospectus is the most popular method of raising funds by public companies in the primary market. This involves inviting subscription from the public through issue of prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines.
2. Offer for Sale: Under this method securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers. In this case, a company sells securities enbloc at an agreed price to brokers who, in turn, resell them to the investing public.
3. Private Placement: Private placement is the allotment of securities by a company to institutional investors and some selected individuals. It helps to raise capital more quickly than a public issue. Access to the primary market can be expensive on account of various mandatory and non-mandatory expenses. Some companies, therefore, cannot afford a public issue and choose to use private placement.
4. Rights Issue: This is a privilege given to existing shareholders to subscribe to a new issue of shares according to the terms and conditions of the company. The shareholders are offered the 'right' to buy new shares in proportion to the number of shares they already possess.
5. e-IPOs: A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the stock exchange. This is called an Initial Public Offer (IPO).

9 What is Secondary Market?
The secondary market is also known as the stock market or stock exchange. It is a market for the purchase and sale of existing securities. Securities are traded, cleared and settled within the regulatory framework prescribed by SEBI.

10 Distinguish between Primary Market and Secondary Market?

	Basis	Primary Market	Secondary Market
1	Securities	Only new securities are traded	Existing securities are traded
2	Price	Prices are determined by the management	Prices are determined by the forces of demand and supply of securities
3	Purchase and sale	Securities are sold directly by the company/through intermediary	Investor exchange ownership of securities
4	Place of market	No fixed geographical location	Located at specified places
5	Medium	Only buying of securities takes	Both buying and selling of

		place	securities takes place.

11 Define Stock Exchange.
A stock exchange is an institution which provides a platform for buying and selling of existing securities. As a market, the stock exchange facilitates the exchange of a security (share, debenture etc.) into money and vice versa.

12 Discuss the functions of Stock Exchange.
1. Providing Liquidity and Marketability to Existing Securities: The basic function of a stock exchange is the creation of a continuous market where securities are bought and sold. It gives investors the chance to disinvest and reinvest. This provides both liquidity and easy marketability to already existing securities in the market.
2. Pricing of Securities: Share prices on a stock exchange are determined by the forces of demand and supply. A stock exchange is a mechanism of constant valuation through which the prices of securities are determined. Such a valuation provides important instant information to both buyers and sellers in the market.
3. Safety of Transaction: The membership of a stock exchange is well regulated and its dealings are well defined according to the existing legal framework. This ensures that the investing public gets a safe and fair deal on the market.
4. Contributes to Economic Growth: A stock exchange is a market in which existing securities are resold or traded. Through this process of disinvestment and reinvestment savings get channelised into their most productive investment avenues. This leads to capital formation and economic growth.
5. Spreading of Equity Cult: The stock exchange can play a vital role in ensuring wider share ownership by regulating new issues, better trading practices and taking effective steps in educating the public about investments.

13 What is SEBI? State its objectives.
The Securities and Exchange Board of India was established by the Government of India on 12 April 1988 as an interim administrative body to promote orderly and healthy growth of securities market and for investor protection.
Objectives of SEBI
The overall objective of SEBI is to protect the interests of investors and to promote the development of, and regulate the securities market. This may be elaborated as follows:
1. To regulate stock exchanges and the securities industry to promote their orderly functioning.
2. To protect the rights and interests of investors, particularly individual investors and to guide and educate them.
3. To prevent trading malpractices and achieve a balance between self regulation by the securities industry and its statutory regulation.
4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc., with a view to making them competitive and professional.

14 Discuss the functions of SEBI.
Regulatory Functions:
1. Registration of brokers and sub brokers and other players in the market.

2. Registration of collective investment schemes and Mutual Funds.
3. Regulation of Stock Bankers and portfolio exchanges, and merchant bankers.
4. Regulation of takeover bids by companies
5. Calling for information by undertaking inspection, conducting enquiries and audits of stock exchanges and intermediaries.
6. Levying fee or other charges for carrying out the purposes of the Act.
7. Performing and exercising such power under Securities Contracts (Regulation) Act 1956, as may be delegated by the Government of India.

Development Functions:

1. Training of intermediaries of the securities market
2. Conducting research and publishing information useful to all market participants
3. Undertaking measures to develop the capital markets by adapting a flexible approach.

Protective functions:

1. Promotion of fair practices and code of conduct of all SRO's.
2. Prohibition of fraudulent and unfair trade practices.
3. Controlling insider trading and imposing penalties for such practices.
4. Undertaking steps for investor protection.

*****************************CHAPTER 10*********************