

Money Market and Capital Market in India

EXERCISE [PAGES 91 - 92]

Exercise | Q 1.1 | Page 91

Complete the following statement:

Development financial institutions were established to _____.

1. provide short term funds.
2. **develop industry, agriculture and other key sectors.**
3. regulate the money market.
4. regulate the capital market.

Solution: Development financial institutions were established to **develop industry, agriculture and other key sectors.**

Exercise | Q 1.2 | Page 91

Complete the following statement:

Money market faces shortage of funds due to _____.

1. **inadequate savings**
2. growing demand for cash
3. presence of unorganized sector
4. financial mismanagement

Solution: Money market faces shortage of funds due to **inadequate savings.**

Exercise | Q 1.3 | Page 91

Complete the following statement:

Individual investors have lost confidence in the capital market due to _____.

1. lack of financial instruments
2. high transaction costs
3. low returns
4. **financial scams**

Solution: Individual investors have lost confidence in the capital market due to **financial scams.**

Exercise | Q 1.4 | Page 91

Complete the following statement:

Commercial banks act as intermediaries in the financial system to _____.

1. make profits
2. accelerate the country's economic growth
3. **mobilize the savings and allocating them to various sectors of the economy**
4. control the credit

Solution: Commercial banks act as intermediaries in the financial system to **mobilize the savings and allocating them to various sectors of the economy**.

Exercise | Q 2.1 | Page 91

Complete the correlation:

Money market : Short term funds :: _____ : Long term funds

Solution: Money market : Short term funds :: **Capital market** : Long term funds

Exercise | Q 2.2 | Page 91

Complete the correlation:

_____ : Central bank :: SBI : Commercial Bank

Solution: **RBI** : Central Bank :: SBI : Commercial Bank

Exercise | Q 2.3 | Page 91

Complete the correlation:

Co-operative banks : Organized sector :: Indigenous bankers : _____

Solution: Co-operative banks : Organized sector :: Indigenous bankers : **Unorganized sector**

Exercise | Q 2.4 | Page 91

Complete the correlation:

Primary market : _____ :: Secondary market : Old issues

Solution: Primary market : **New issues** :: Secondary market : Old issues

Exercise | Q 3.1 | Page 91

Find the odd word:

Types of Bank Accounts: Saving a/c, D-mat a/c, Recurring a/c, Current a/c

Solution: D-mat a/c

Exercise | Q 3.2 | Page 91

Find the odd word:

Unregulated Financial intermediates: Mutual fund, Nidhi, Chit fund, Loan Companies

Solution: Mutual fund

Exercise | Q 3.3 | Page 91

Find the odd word:

Financial Assets: Bonds, Land, Govt. Securities, Derivatives

Solution: Govt. Securities

Exercise | Q 3.4 | Page 91

Find the odd word:

Quantitative Tools: Bank rate, Open market operations, Foreign Exchange rate,
Variable reserve ratios

Solution: Foreign Exchange rate

Exercise | Q 4.1 | Page 92

Assertion and Reasoning:

Assertion (A): Money market economizes use of cash

Reasoning (R): Money market deals with financial instruments that are close substitutes of money

1. (A) is True, but (R) is False
2. (A) is False, but (R) is True
3. **Both (A) and (R) are True and (R) is the correct explanation of (A)**
4. Both (A) and (R) are True and (R) is not the correct explanation of (A)

Solution: Both (A) and (R) are True and (R) is the correct explanation of (A)

Exercise | Q 4.2 | Page 92

Assertion and Reasoning:

Assertion (A): Regional stock exchanges have witnessed a sharp decline in the volume of trade.

Reasoning (R): Investors prefer to trade in securities listed in premier stock exchanges like BSE, NSE, etc.

1. (A) is True, but (R) is False
2. (A) is False, but (R) is True
3. **Both (A) and (R) are True and (R) is the correct explanation of (A)**
4. Both (A) and (R) are True and (R) is not the correct explanation of (A)

Solution: Both (A) and (R) are True and (R) is the correct explanation of (A)

Exercise | Q 4.3 | Page 92

Assertion and Reasoning:

Assertion (A): The unorganized sector of the money market lacks transparency.

Reasoning (R): Activities of the unorganized sector are largely confined to rural areas.

1. (A) is True, but (R) is False
2. **(A) is False, but (R) is True**
3. Both (A) and (R) are True and (R) is the correct explanation of (A)
4. Both (A) and (R) are True and (R) is not the correct explanation of (A)

Solution: (A) is False, but (R) is True

Exercise | Q 4.4 | Page 92

Assertion and Reasoning:

Assertion (A): Foreign exchange management and control is undertaken by commercial banks.

Reasoning (R): RBI has to maintain the official rate of exchange of rupee and ensure its stability.

1. (A) is True, but (R) is False
2. **(A) is False, but (R) is True**
3. Both (A) and (R) are True and (R) is the correct explanation of (A)
4. Both (A) and (R) are True and (R) is not the correct explanation of (A)

Solution: (A) is False, but (R) is True

Exercise | Q 6.1 | Page 92

Distinguish between:

Money market and Capital market.

Solution:

Basic for comparison	Money market	capital market
Meaning	A segment of the financial market where lending and borrowing of short term securities are done.	A section of the financial market where long term securities are issued and traded.
Nature of Market	Money markets are informal in nature	Capital markets are formal in nature
Financial instruments	Treasury Bills, Commercial Papers, Certificate of Deposit, Trade Credit, etc.	Shares, Debentures, Bonds, Retained Earnings, Asset Securitization, Euro Issues, etc.
Risk Factor	Money markets have a low risk	Capital markets have more risk as compared to money markets
Return on Investment	ROI is usually low in money market	ROI is comparatively high in the capital market
Liquidity	Money markets are highly liquid	Capital markets are comparatively less liquid

Exercise | Q 6.2 | Page 92

Distinguish between:

Demand deposit and Time deposit

Solution:

Basic for comparison	Demand deposit	Time deposit
Time Period	There is no fixed time period involved in the case of a demand deposit.	Time deposits are deposited in the bank for a fixed period of time (usually 1 year to 5 years)

Example	Saving accounts and current accounts are examples of demand deposits.	Fixed or term deposit is an example of time deposits
Rate of Interest	In the case of saving and current accounts it is lower (which is around 4 to 6 percent).	The rate of interest offered by the banks on time deposit is higher around 7 to 9 percent
Facilities	In case of demand deposits, one needs all facilities like ATM, credit card, the online banking as these accounts are meant for withdrawal of funds as and when required by the account holder.	In case of time deposit, one does not need facilities like ATM, credit card, online banking as funds are tied for a specific period

Exercise | Q 6.3 | Page 92

Distinguish between:

Organized sector and Unorganized sector of the money market.

Solution:

Organized sector	Unorganized sector
In the organized market, the employment terms are fixed and regular.	In the unorganized market, the workers are paid on a daily bases.
The workers in the organized market get assured work and some basic facilities.	The workers in the unorganized market do not get assured work and no basic facilities such as medical policies are not provided to them.
The organized market is the one that is combined with the relevant administration or government and comprehends its rules and regulation.	The unorganized market is not associated with the government and therefore, no rules are expected to be followed.

Exercise | Q 7.1 | Page 92

Answer the following:

Explain the problems faced by the money market in India.

Solution:

Compared to advanced countries, the Indian money market is less developed in terms of volume and liquidity.

Following points explain the problems of the Indian Money Market:

1. **Dual Structure of the Money Market:** Presence of both, the organized and unorganized sectors in the money market leads to disintegration, lack of transparency, and increased volatility. The unorganized markets lack co-ordination and do not come under the direct control and supervision of the RBI.
2. **Lack of uniformity in the rates of interest:** The money market comprises of various entities such as commercial banks, co-operative banks, non-bank finance companies, development finance institutions, investment companies, etc. The category of borrowers is also different.
3. **Shortage of funds:** Money market faces a shortage of funds due to inadequate savings. Low per capita income, poor banking habits among the people, indulgence in wasteful consumption, inadequate banking facilities in the rural areas, etc. have also been responsible for the paucity of funds in the money market.
4. **Seasonal fluctuations:** Demand for funds varies as per the seasons. During the peak season, from October to June, finance is required on a large scale for various purposes such as trading in agricultural produce, investment in business activities, etc. This results in wide fluctuations in the money market.
5. **Lack of financial inclusion:** Banking facilities in the country are still inadequate and inaccessible to the vulnerable groups such as the weaker sections and the low-income groups. This shows a lack of financial inclusion.
6. **Delays in technological up-gradation:** Use of advanced technology is a pre-requisite for the development and smooth functioning of financial markets. Delays in the up-gradation of technology hamper the working of the money market.

Exercise | Q 7.2 | Page 92

Answer the following:

Explain the functions of commercial banks.

Solution:

The functions of commercial banks are classified into two main divisions.

(a) Primary functions:

- **Accepts deposit** – The bank takes deposits in the form of saving, current, and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary required of commercial transactions.
- **Provides Loan and Advances** – Another critical function of this bank is to offer loans and advances to the entrepreneurs and business people and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit, and short-run loans, etc.
- **Credit Cash** – When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer, and then the money is transferred to the account. This process allows a bank to create money.

(b) Secondary functions:

- **Discounting bills of exchange** – It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.
- **Overdraft Facility** – It is an advance given to a customer by keeping the current account to overdraw up to the given limit.
- **Purchasing and Selling of the Securities** – The bank offers you the facility of selling and buying the securities.
- **Locker Facilities** – Bank provides lockers facility to the customers to keep their valuable belonging or documents safely. Banks charge a minimum of an annual fee for this service.
- **Paying and Gather the Credit** – It uses different instruments like a promissory note, cheques, and bill of exchange.

Exercise | Q 7.3 | Page 92

Answer the following:

Explain the role of capital market in India.

Solution: Role of Capital Market in India:

1. **Mobilizes long term savings:** There is an increasing demand for investment funds by industrial organizations and the government. But the availability of financial resources is insufficient to meet this growing demand. The capital market helps to mobilize long term savings from various sections of the population through the sale of securities.
2. **Provides equity capital:** Capital market provides equity capital or share capital to entrepreneurs which could be used to purchase assets as well as fund business operations.
3. **Operational efficiency:** Capital market helps to achieve operational efficiency by lowering the transaction costs, simplifying transaction procedures, lowering settlement timings in the purchase and sale of stocks.
4. **Quick valuation:** Capital market helps to determine a fair and quick value of both equity (shares) and debt (bonds, debentures) instruments.
5. **Integration:** Capital market leads to integration among real and financial sectors, equity and debt instruments, government and private sector, domestic and external funds, etc.

Exercise | Q 7.4 | Page 92

Answer the following:

Explain the problems of the capital market in India.

Solution:

Following points explain the problems faced by the Indian Capital Market :

1. **Financial Scams:** Increasing number of financial frauds have resulted in an irreparable loss for the capital market. Besides this, it has also lead to public distrust and loss of confidence among the individual investors.

2. **Insider trading and price manipulation:** Insider trading means buying or selling of a security by someone who has access to non-public information or 'unpublished information' for personal benefit. Price manipulation or price rigging on the other hand means to simply raise the prices of shares through buying and selling of shares within certain individuals themselves for personal gains. Such illegal practices have also affected the smooth functioning of the capital market.
3. **Inadequate debt instruments:** Debt instruments include bonds, debentures, etc. There is not much trading in the debt securities due to narrow investor base, high cost of issuance, lack of accessibility to small and medium enterprises.
4. **Decline in the volume of trade:** Regional stock exchanges have witnessed a sharp decline in the volume of trade because investors prefer to trade in securities listed in premier stock exchanges like BSE, NSE, etc.
5. **Lack of informational efficiency:** A market is said to be informationally efficient if a company's stock prices incorporate all the available information into the current prices. However, the stock market in India lacks informational efficiency compared to advanced countries.

Exercise | Q 8.1 | Page 92

Answer in detail:

Explain the role of the money market in India.

Solution:

The following points outline the role of the money market in India :

1. **Short-term requirements of borrowers:** Money market provides reasonable access for meeting the short-term financial needs of the borrowers at realistic prices.
2. **Liquidity Management:** Money market is a dynamic market. It facilitates better management of liquidity and money in the economy by the monetary authorities. This, in turn, leads to economic stability and development of the country.
3. **Portfolio Management:** Money market deals with different types of financial instruments that are designed to suit the risk and return preferences of the investors. This enables the investors to hold a portfolio of different financial assets which in turn, helps in minimizing risk and maximizing returns.
4. **Equilibrating mechanism:** Through the rational allocation of resources and mobilization of savings into investment channels, the money market helps to establish equilibrium between the demand for and supply of short-term funds.
5. **Economizes the use of cash:** Money market deals with various financial instruments that are close substitutes of money and not actual money. Thus, it economizes the use of cash.

Exercise | Q 8.2 | Page 92

Answer in detail:

Explain the functions of RBI.

Solution:

1. **Issue of Notes:** The Reserve Bank has a monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations except one rupee note (which is issued by the Ministry of Finance). The Reserve Bank has adopted the Minimum Reserve System for issuing/printing the currency notes. Since 1957, it maintains gold and foreign exchange reserves of Rs. 200 Cr. of which at least Rs. 115 cr. should be in gold and remaining in the foreign currencies.
2. **Banker to the Government:** The second important function of the Reserve Bank is to act as the Banker, Agent, and Adviser to the Government of India and states. It performs all the banking functions of the State and Central Government and it also tenders useful advice to the government on matters related to economic and monetary policy. It also manages the public debt of the government.
3. **Banker's Bank:** The Reserve Bank performs the same functions for the other commercial banks as the other banks ordinarily perform for their customers. RBI lends money to all the commercial banks of the country.
4. **Controller of the Credit:** The RBI undertakes the responsibility of controlling credit created by commercial banks. RBI uses two methods to control the extra flow of money in the economy. These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country. When RBI observes that the economy has sufficient money supply and it may cause an inflationary situation in the country then it squeezes the money supply through its tight monetary policy and vice versa.
5. **Custodian of Foreign Reserves:** For the purpose of keeping the foreign exchange rates stable, the Reserve Bank buys and sells foreign currencies and also protects the country's foreign exchange funds. RBI sells the foreign currency in the foreign exchange market when its supply decreases in the economy and vice-versa. Currently, India has a Foreign Exchange Reserve of around US\$ 360bn.
6. **Other Functions:** The Reserve Bank performs a number of other developmental works. These works include the function of clearinghouse arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities (gilt edge, treasury bills, etc) and trade bills, giving loans to the Government buying and selling of valuable commodities, etc. It also acts as the representative of the Government in the International Monetary Fund (I.M.F.) and represents the membership of India.