CBSE Class 12 Business Studies
NCERT Solutions
Chapter 10
Financial Market

Multiple Choice Type:

1. Primary and secondary markets

(a) Compete with each other

(b) Complement each other

(c) Function independently

(d) Control each other

Ans: (b) Primary and secondary markets complement each other. Primary market deals with the issue of new securities. That is, through the primary market a company raises capital directly from the borrowers. On the other hand, secondary market deals in the purchase and sale of the existing securities. That is, once the securities are issued in primary market, they are then traded in the secondary market. It is in this sense that both the markets complement each other.

2. The total number of Stock Exchange in India is

(a) 20

(b) 21

(c) 22

(d) 23

Ans: (d) The total number of Stock Exchange in India is 23. However, as per the latest updates by SEBI, there are 25 Stock Exchanges in India.

3. The settlement cycle in NSE is

(a) T+5

(b) T+3

(c) T+2

(d) T+1

Ans: (c) Settlement cycle refers to the time period within which the actual settlement between the buyers and sellers of shares takes place. In other words, it refers to the time period within which the seller of the shares would receive the money and the buyers of the share would get the ownership of the share. NSE follows a T+2 settlement cycle. Here, T refers to the transaction date. Thus, T+2 implies that transactions in NSE are settled within 2 days of the transaction date.

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4. The National Stock Exchange of India was recognized as stock exchange in the year

(a) 1992

(b) 1993

(c) 1994

(d) 1995

Ans: (b) National Stock Exchange of India was promoted by financial institutions and established as a public limited company in 1992. However, it was '*recognized as a stock exchange*' in April,'*1993*' under Securities Contracts (Regulation) Act,1956. It commenced its operations in capital market in 1994 and operations in derivatives market were started in 2000.

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5. NSE commenced futures trading in the year

(a) 1999

(b) 2000

(c) 2001

(d) 2002

Ans: (b) National Stock Exchange started its operations in the year 1994. It commenced '*trading in future*' and options market on 12 June, '*2000'*.

6. Clearing and settlement operations of NSE are carried out by

(a) NSDL

(b) NSCCL

(c) SBI

(d) CDSL

Ans: (b) The clearing and settlement operations of NSE are carried out by NSCCL. NSCCL (National Securities Clearing Corporation Ltd.) was incorporated in august, 1995 and it commenced its clearing operations for NSE in April 1996.

7. OTCEI was started on the lines of

(a) NASDAQ

(b) NYSE

(c) NASAQ

(d) NSE

Ans: (a) OTCEI (Over the Counter Exchange of India) was incorporated in the year 1990 on the lines of NASDAQ which is the OTC in USA. OTCEI is a fully computerised and transparent stock exchange. It was established with the objective of addressing the needs of small companies and helps in maintaining the liquidity of their securities.

8. To be listed on OTCEI, the minimum capital requirement for a company is

(a) Rs. 5 crores

(b) Rs. 3 crores

(c) Rs. 6 crores

(d) Rs. 1 crore

Ans: (b) To be listed on OTCEI, the minimum capital requirement for a company is Rs 3 crores and the maximum is Rs 50 crores.

9. A Treasury Bill is basically:

(a) An instrument to borrow short-term funds

(b) An instrument to borrow long-term funds

(c) An instrument of capital market

(d) None of the above

Ans: (a) A Treasury Bill is an instrument to borrow short term funds by the Government of India. They have a maturity period of less than a year. They are also called Zero-Coupon Bonds. They are issued by the RBI on behalf of the Central Government.

Short Answer Type:

1. What are the functions of a financial market?

Ans: A financial market refers to the market where the creation and exchange of financial assets such as shares and debentures takes place. The following are the functions of a financial market-

Financial markets create an open and regulated system for companies to obtain large amounts of financial capital to grow their businesses. This is done through the stock and bond markets. Markets also allow these businesses to offset risk with commodities and foreign exchange futures contracts, as well as other derivatives.

Since the markets are public, they provide an open and transparent way to set prices on everything traded. These prices assume that all available knowledge about everything traded is taken into consideration. This reduces the cost of getting information, because it's already incorporated into the price.

The sheer size of the financial markets provide liquidity. In other words, sellers can easily unload assets whenever they need to raise cash. The size also reduces the cost of doing business, since companies don't have to go far to find a buyer, or someone willing to sell.

2. ''Money Market is essentially a Market for short term funds''. Discuss.

Ans: Money market refers to the market for trading of short term securities and funds. Securities traded in the money market have a very short maturity period ranging from one day to one year. Such assets act as a close substitute for cash or money. Due to their short maturity period they are also known as 'Near Money instruments'. Money market instruments act as an important source of finance for working capital requirements. They enjoy a high degree of liquidity. DFHI discounts money market securities and offers a ready market for them. In addition, securities traded in the money market are safe and secure as the transactions are made in those instruments that are issued by financial institutions and those companies that are financially strong. Common instruments traded in the money market are treasury bills, commercial paper, call money, certificate of deposit, etc.

3. What is a Treasury Bill?

Ans: Treasury bills are issued by Reserve Bank of India on behalf of the government to get short term borrowing as these bills are sold to banks and general public. These bills are negotiable instruments and are freely transferable. These are issued at a discount. These are considered safest investment as these are issued by R.B.I. The maturity period of Treasury Bills varies from 14 to 364 days. They are also called Zero Coupon Bonds. They are issued at a price lower than their face value and repaid at par. These are available for minimum amount of 25000 and in multiples thereof.

4. Distinguish between Capital Market and Money Market.

Ans: The following points highlight the difference between Capital Market and Money

Market.

BASIS 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 financial market where long term securities are issued and traded.
Nature of Market	Informal	Formal
Financial instruments	Treasury Bills, Commercial Papers, Certificate of Deposit, Trade Credit etc.	Shares, Debentures, Bonds, Retained Earnings, Asset Securitization, Euro Issues etc.
Institutions	Central bank, Commercial bank, non-financial institutions, bill brokers, acceptance houses, and so on.	Commercial banks, Stock exchange, non-banking institutions like insurance companies etc.
Risk Factor	Low	Comparatively High
Liquidity	High	Low
Purpose	To fulfill short term credit needs of the business.	To fulfill long term credit needs of the business.
Time Horizon	Within a year	More than a year
Merit	Increases liquidity of funds in the economy.	Mobilization of Savings in the economy.
Return on Investment	Less	Comparatively High

5. What are the functions of a Stock Exchange?

Ans: Stock Exchange refers to a market where buying and selling of the existing securities take place. The following are the main functions of a stock exchange.

(1) Providing Liquidity and Marketability to Existing Securities:

Stock exchange is a market place where previously issued securities are traded. Various types of securities are traded here on regular basis. Whenever required, an investor can invest his money through this market into securities and can reconvert this investment into cash. Availability of ready market for sale and purchase of securities increases their marketability and enhances liquidity.

(2) Pricing of Securities:

A stock exchange provides platform to deal in securities. The forces of demand and supply work freely in the stock exchange. In this way, prices of securities are determined.

(3) Safety of Transactions:

Stock exchanges are organised markets. They fully protect the interest of investors. Each stock exchange has its own laws and bye-laws. Each member of stock exchange has to follow them and if any member is found violating them, his membership is cancelled.

For instance, if any broker working in stock exchange charges more commission than stipulated from any investor or misleads him in any other way, then the management committee of the stock exchange can fine the broker and even his membership can be cancelled.

(4) Contributes to Economic Growth:

A stock exchange provides liquidity to securities. This gives the investor a double benefit-first, the benefit of the change in the market price of securities can be taken advantage of, and secondly, in case of need for money they can be sold at the existing market price at any time.

These advantages provided by the share market encourage the people to invest their money in securities. In this way, people’s money gets invested in industries and economic development becomes possible.

(5) Spreading Equity Cult:

Share market collects every type of information (more particularly about their economic condition) in respect of the listed companies. Generally, this information is published or in case of need anybody can get it from the stock exchange free of any cost.

In this way, the stock exchange guides the investors by providing various types of information. Consequently, the number of shareholders in companies is increasing continuously. Thus, the stock exchanges are playing a vital role in ensuring wider share ownership.

(6) Providing Scope for Speculation:

When securities are purchased with a view to getting profit as a result of change in their market price, it is called speculation. It is allowed or permitted under the provisions of the relevant Act. It is accepted that in order to provide liquidity to securities, some scope for speculation must be allowed. The share market provides this facility.

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6. What are the objectives of the SEBI?

Ans: The overall objective of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market. The objectives of SEBI are:

- To regulate the activities of stock exchange.

- To protect the rights of investors and ensuring safety to their investment.

- To prevent fraudulent and malpractices by having balance between self-regulation of business and its statutory regulations.

- To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

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7. **State the objectives of the NSE.**

Ans: National Stock Exchange of India was incorporated in the year1992. It was recognised as Stock Exchange in 1993 and started operations in 1994. It was established by leading banks, financial institutions, insurance companies and financial intermediaries. NSE was established with the following objectives.

(i) NSE aimed at setting up a single nationwide trading system for providing the trading facility in all types of securities. Such a system increases the confidence of the investors.

(ii) It ensured that all the investors over the country get an easy and equal access through an appropriate communication network. It increases the liquidity of the securities. Under the system of regional stock exchange, the number of people involved in the transaction was limited. As against this, NSE incorporates transactions from investors from the entire country and thereby, increases the liquidity of the securities.

(iii) By using an electronic trading system, NSE aims at providing a fair, efficient and transparent securities market. Any person can get information regarding the trading of various securities from the local terminals of NSE. Thereby, it helps in reducing fraud in trading.

(iv) One of the objectives of NSE includes enabling shorter settlement cycles and book entry settlements.

(v) NSE aimed at meeting the international standards and benchmarks of stock exchange.

8. What is the OTCEI?

Ans: Over the Counter Exchange of India (OTCEI) was incorporated in 1990 under the Companies Act, 1956 and was recognised as a stock exchange under the Securities Contracts Regulation Act, 1956. It commenced operations in the year 1992. It aims at providing the small and medium companies an easy access to the capital market. OTCEI is a fully computerised and single window exchange system. OTCEI is modelled along the lines of NASDAQ, the OTC exchange in USA. OTC was promoted by UTI, ICICI, IDBI, LIC, IFCI, GIC and SBI financial services. It does not involve a geographical area rather, trading takes place through its counters or offices through telephones and other modes of communication. It acts as a place where buyers meet the sellers and negotiate for an acceptable terms of trade. It provides a convenient, transparent and efficient avenue for capital market investment. It incorporates an exclusive list of companies as only those companies which have an issued capital of 30 lakh or more can be listed on OTCEI. It provides liquidity to the securities along with practicing a fair trade system. It also aims at providing cheaper and easy means of trade to public as well as small companies.

Long Answer Type:

1. Explain the various Money Market Instruments.

Ans: Money Market refers to the market where short term funds are traded. Herein, short term funds are in the form of monetary assets having a maturity period of maximum one year. The following are some of the common money market instruments.

1. Promissory Note:

The promissory note is the earliest types of bill. It is a written promise on the part of a businessman today to another a certain sum of money at an agreed future data. Usually, a promissory note falls due for payment after 90 days with three days of grace. A promissory note is drawn by the debtor and has to be accepted by the bank in which the debtor has his account, to be valid. The creditor can get it discounted from his bank till the date of recovery. Promissory notes are rarely used in business these days, except in the USA.

2. Bill of Exchange or Commercial Bills:

Another instrument of the money, market is the bill of exchange which is similar to the promissory note, except in that it is drawn by the creditor and is accepted by the bank of the debater. The creditor can discount the bill of exchange either with a broker or a bank. There is also the foreign bill of exchange which becomes due for payment from the date of acceptance. The rest of the procedure is the same as for the internal bill of exchange. Promissory notes and bills of exchange are known as trade bills.

3. Treasury Bill:

But the major instrument of the money markets is the Treasury bill which is issued for varying periods of less than one year. They are issued by the Secretary to the Treasury in England and are payable at the Bank of England. There are also the short-term government securities in the USA which are traded by commercial banks and dealers in securities. In India, the treasury bills are issued by the Government of India at a discount generally between 91 days and 364 days. There are three types of treasury bills in India—91 days, 182 days and 364 days.

4. Call and Notice Money:

There is the call money market in which funds are borrowed and lent for one day. In the notice market, they are borrowed and lent upto 14 days without any collateral security. But deposit receipt is issued to the lender by the borrower who repays the borrowed amount with interest on call. In India, commercial banks and cooperative banks borrow and lend funds in this market but mutual funds and all-India financial institutions participate only as lenders of funds.

5. Inter-bank Term Market:

This market is exclusively for commercial and cooperative banks in India, which borrow and lend funds for a period of over 14 days and upto 90 days without any collateral security at market-determined rates.

6. Certificates of Deposits (CD):

Certificates of deposits are issued by commercial banks at a discount on face value. The discount rate is determined by the market. In India the minimum size of the issue is Rs. 25 lakhs with the minimum subscription of Rs. 5 lakhs. The maturity period is between 3 months and 12 months.

7. Commercial Paper (CP):

Commercial papers are issued by highly rate companies to raise short-term working capital requirements directly from the market instead of borrowing from the banks. CP is a promise by the borrowing company to repay the load at a specified date, normally for a period of 3 months to 6 months. This instrument is very popular in the USA, UK, Japan, Australia and a number of other countries. It has been introduced in India in January 1990.

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2. What are the methods of floatation in Primary Market?

Ans: The following are the various methods through which floating of new issues can be done.

(i) Offer through Prospectus: The most commonly used method for raising funds in primary market is offer through prospectus. It involves inviting the subscriptions from public by issue of prospectus. A prospectus is published as advertisements in newspapers, magazines, etc. It provides such information as the purpose for which the fund is being raised, company's background and future prospects, its past financial performance, etc. Such information helps the public and the investors to know about the company as well as the potential risk and the earnings involved. Such issues need to be listed on one of the stock exchanges and should be in accordance with the guidelines and rules listed under the Companies Act and SEBI disclosure.

(ii) Offer through Sale: As against offer through prospectus, under the offer through sale method, the company does not issue securities directly to the public rather they are issued through intermediaries such as brokers, issuing houses, etc. That is, under offer through sale, securities are issued in two steps, first the company sells its securities to the intermediaries at the face value and later the intermediaries resell the securities to the investing public at a higher price than the face value to earn profit.

(iii) Private Placement: Under this method, the securities are sold only to some selected individuals and big institutional investors rather than to the public. The companies either allot the securities themselves or they sell the securities to intermediaries who in turn sell them to selected clients. This method saves the company from various mandatory or non-mandatory expenses such as cost of manager fees, commission, underwriter fees, etc. Thus, the companies which cannot afford the huge expenses related to public issue often go for private placement.

(iv) Rights Issue: Under the Companies Act 1956, it is the right of the existing shareholders of a company to subscribe to the new shares issued by it. The existing shareholders are offered subscription of new shares of the company in proportion to the number of shares possessed by them.

(v) e-IPOs: It is system of issuing securities through online system. If a company decides to offer its securities through an online system it is required to gets into an agreement with the stock exchange. This is called Initial Public Offer (IPO). Company appoints brokers for accepting applications and placing orders. A company can apply to get listed in any stock market except from the one through which it has already offered securities. Herein, the lead manager looks upon the various activities and coordinates them.

3. Explain the recent Capital Market reforms in India.

Ans: A capital market refers to the market that deals in the trading of medium and long-term securities. That is, it deals in those securities that have a maturity period of greater than or equal to one year. Capital market comprises of instruments such as equity and preference shares, debentures, bonds, mutual funds, public deposits, etc. A capital market can be divided in two parts namely, Primary Market and Secondary Market. Primary market deals with issue of new securities. Issue of new securities in the primary market directs funds towards those entrepreneurs who either want to start a new enterprise or wish to expand the existing one. Secondary market, on the other hand, deals in the sale and purchase of the existing securities. That is, it deals in the trading of those securities that were initially issued in the primary market.

The history of capital market in the form of stock exchange dates back to the eighteenth century. The Government of India introduced the Companies Act in 1850 with the aim of generating investor interest in corporate securities. The first stock exchange was set up in India in the year 1875 as 'The Native Share and Stock Brokers Association' in Bombay. Later it was renamed as 'Bombay Stock Exchange' (BSE). In the subsequent years stock exchanges were developed in Ahemdabad, Calcutta and Madras.

In 1990s, the Indian secondary market only consisted of regional stock exchanges wherein, first being the BSE. However, after the reforms of 1991, the Indian Stock Market acquired a three-tier system. This consisted of Regional Stock Exchanges, National Stock Exchange and Over the Counter Exchange of India (OTCEI).

Regional Stock Exchange: The first Regional Stock Exchange was developed in Ahemdabad as Ahmedabad Stock Exchange (ASE) in 1894. Similarly, in 1908, Calcutta Stock Exchange (CSE) was established. Subsequently in the later years other regional stock exchanges were established in Calcutta, Madras, Ahemdabad, Delhi, Hyderabad and Indore. Recently, regional stock exchanges were developed in Coimbatore as Coimbatore Stock Exchange and in Meerut as Meerut Stock Exchange. Currently, there are 22 regional stock exchanges in India.

National Stock Exchange: The NSE is the latest technology driven stock exchange which was recognised in 1993. It started its operations in 1994 with trading in money market securities. Later, it also expanded its trading operations in capital market segment. NSE was set up in order to establish a nationwide platform for trading in all types of securities. It ensured development of fair and efficient securities market. Within the span of its existence, NSE has transformed the Indian capital market and has been able to take the stock market to the investor's door step. It has provided a wide screen-based automated trading system across the nation ensuring equal access to all the investors.

Over the Counter Exchange of India (OTCEI): OTCEI is a company which was set up in 1990 under the Companies Act,1956 but later was recognised as a stock exchange under the Securities Contracts Regulation Act, 1956. It commenced its operations in trading in 1992 and is modelled along the lines of NASDAQ, the OTC exchange in USA. It aims at providing the small companies an easy access to the capital market. OTCEI provides a screen based nationwide trading system, that acts as a place where buyers meet the sellers and negotiate for an acceptable terms of trade. Herein, dealers can trade both in new issue of securities as well as secondary market. It is a single window exchange which provides a convenient, transparent and efficient avenue for capital market investment.

4. Explain the objectives and functions of the SEBI.

Ans: The Securities and Exchange Board of India was established in 1988 in order to encourage an orderly and healthy growth of the securities market. SEBI was set with an overall objective of investor protection and to promote the development and regulation of the functions of the securities market. The following are the listed objectives.

(i) Regulation: The main objective of SEBI was to regulate the functioning of the stock exchange and the securities market. It aims at providing a place where the issuers of securities (i.e. companies) can raise funds in an easy and confident manner.

(ii) Protection: SEBI educates the investors by providing them valuable information regarding various securities and companies. It provides them with the guidelines related to efficient investment. It provides them adequate and reliable information about the companies and thereby, helps them in taking wise and informed investment decisions.

(iii) Prevention: To combat the malpractice in trading of securities was the basic reason for the establishment of SEBI. Malpractice such as insider trading, violation of rules and regulations, non-adherence to Companies Act, etc. erodes the confidence of investors. SEBI aims at checking these malpractices by creating a balance between the self-regulation of a business and the legal statutory regulations.

(iv) Code of Conduct: Through efficient regulation, SEBI aims at developing a code of conduct for fair trade practices by intermediaries such as brokers, merchant bankers, underwriters, etc. This helps in making them competitive and professional.

To attain the aforementioned objectives, SEBI perform 3 main functions namely, Regulatory, Development and Protective functions. The following are the functions performed by SEBI.

(i) Regulatory Functions:

• *Registration*: One of the regulatory functions performed by SEBI is the registration of the brokers, sub-brokers, agents and other players in the market. Registration of collective mutual schemes and Mutual Funds is also done by SEBI.

• *Regulating the Work*: SEBI regulates the working of the stock brokers, underwriters, merchant bankers and other market intermediaries. It frames rules and regulations for the working of the intermediaries. SEBI also regulates the takeover bids by the companies. It conducts regular enquires and audits of stock exchange and intermediaries.

• *Regulation by Legislation*: SEBI performs and exercise various other powers which are delegated by the Government of India under the Securities Contracts (Regulation) Act, 1956. Besides, it levies fee or other charges for carrying out the purposes of the Act.

(ii) Development Functions:

• ***Training*:** SEBI promotes the training and development of the intermediaries of the securities market in order to promote healthy growth of the securities market.

• ***Research*:** By conducting research in the required and important areas of the securities market, SEBI publishes useful information. This helps the investors and other market players to make wise investment decisions.

• ***Flexible Approach*:** SEBI has adopted a flexible and adaptive approach such permitting internet trading, IPOs, etc. Such measures promote the development of capital market.

(iii) Protective Functions:

• *Prohibition*: SEBI prohibits fraudulent and unfair trade practices. It prevents the spreading of misleading and manipulative statements which are likely to affect the working of the securities market. SEBI educates the investors by providing them valuable information regarding various securities and companies so as to enable them to make wise investment decisions.

• *Checks on Insider Trading*: Insider trading refers to a situation where an individual connected with the company leaks out crucial information regarding the company. Such information may adversely affect its share prices. SEBI keeps a strict check on such insider trading.

• *Promotion and Protection*: SEBI encourage fair trade practices and promotes a code of conduct for the intermediaries. It undertakes step for investor protection and education. It also checks the manipulation of price of securities.

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5. Explain the various segments of the NSE.

Ans: The National Stock Exchange is the technology driven stock exchange which was incorporated in 1992. It was recognised as a stock exchange in 1993 and started operations in the year 1994. NSE provides trading in two main segments namely, Whole Sale Debt Market Segment and Capital Market Segment.

(i) Whole Sale Debt Market Segment: This segment provides a platform for trading in fixed income securities such as state development loans, bonds issued by public sector undertaking, corporate debentures, commercial paper, mutual funds, central government securities, zero coupon bonds, treasury bills, etc. NSE started operations in Whole Sale Debt Market in June 1994. It is the first fully screen based system for trading in debt market. That is, it is the first computer based trading system. Trading in the debt market involves two parties- trading members (which are the recognised brokers of NSE) and the participants (i.e.

the buyers and sellers of securities). The transactions among the participants are settled through members. For instance, the members place an order for the seller of a security which is then suitably matched by another member for buyer of a security wishing to purchase that security. An order remains in the system until it is suitably matched. This segment of NSE is also known as NEAT (National Exchange for Automated trading).

(ii) Capital Market Segment: Under this segment, NSE deals with trading in equity shares, preference shares, debentures, exchange traded funds as well as retail Government securities. It provides an efficient and transparent platform for a fair trading system. The capital market segment commenced its working in November 1995. The trading system of NSE Capital Market segment is also known as the National Exchange for Automated Trading - Capital Market (NEAT- CM). The trading operations of the Capital Market segment remain the same as in the Whole Sale Debt market system.

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