NCERT SOLUTIONS

CLASS - 12th

Class :12th

Subject : Business Studies

Chapter : 10

Chapter Name : Financial Markets

Q1 What is a Treasury Bill?

Answer. Treasury Bill is a short term promissory note issued by the Reserve Bank of India on behalf of the Central Government of India. In India, treasury bills are issued for a minimum period of 91 days and the maximum duration of these bills is 364 days. Generally, these bills are brought by commercial banks, LIC, UTI, non-banking financial companies, etc. They are also called Zero-Coupon Bonds.

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Q2 Name the segments of the National Stock Exchange (NSE)

Answer. The National Stock Exchange provides trading in the following two segments -

→ Wholesale Debt Market Segment : This segment provides a platform for a variety of the fixed income securities issued by the central government. It may include government securities, treasury bills, floating rate bonds, development loans, mutual funds etc.

→ Capital Market Segment : It provides a platform for trading in equity shares, preference shares debentures and government retail securities. The trading is done transparently.

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Q3 State any two reasons why investing public can expect a safe and fair deal in the stock market. (Point w.r.t safety of Transactions – Functions of the Stock Exchange)

Answer. i. Safety of transaction: The stock exchange has fixed rules and regulations for providing membership to the companies and their are legal rules for guiding them. This ensures that the general public gets a safe and fair deal on the market.

ii. Providing Liquidity and Marketability to Existing Securities: The stock market is the secondary market for the regular dealing in securities. It provides a platform for the sale and purchase of securities. It gives investors the chance to disinvest and reinvest. This provides both liquidity and easy marketability to already existing securities in the market.

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Q4 What is the common name for Beneficiary Owner Account, which is to be opened by the investors for trading in securities?

Answer. Demat account is the common name for Beneficiary Owner Account, which is to be opened by the investors for trading in securities.

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Q5 Name any two details that need to be provided by the investor to the broker while filling a client registration form.

Answer. Address proof and identity proof need to be provided by the investor to the broker while filling a client registration form.

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Q1 What are the functions of the Financial Market?

Answer. The financial markets play an important role in the utilisation of resources of the economy by providing the following services -

i. Mobilisation of savings and channeling them into the most Productive Uses: A financial market provides various types of investments to choose from and thus helps in the mobilisation of funds from the household sector to the industrial sector. Hence it helps in channeling the resources.

ii. Facilitating Price Discovery: The market forces of demand and supply help in determining the price of the securities in the stock market. The demand is created by the industrial sector while the supply is created by the household sector.

iii. Providing Liquidity to Financial assets: Financial markets help in the sale and purchase of securities of the financial assets easily. Thus it provides liquidity to the financial assets as they can be converted into cash in a short duration. Holders of assets can readily sell their financial assets through the mechanism of the financial market.

iv. Reducing the cost of transactions: The financial markets provide important information regarding the securities which are traded in the market. It thus helps in saving time, money and efforts of the buyers and sellers in gathering the information. It serves as a common platform where buyers and sellers can meet for fulfillment of their individual needs.

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Q2 “Money Market is essentially a Market for short term funds.” Discuss.

Answer. Money market is the market for dealing in short term securities whose maturity period range upto one year. Hence it deals in the more liquid securities which serve as close substitutes for money. It is a market where low risk, unsecured and short term debt instruments that are highly liquid are issued and actively traded everyday. These securities are traded generally over the telephone or Internet and has no physical location. The securities are issued in order to provide funds for temporary and short term needs of the organisation. The major participants in the market are the Reserve Bank of India (RBI), Commercial Banks, Non-Banking Finance Companies, State Governments, large Corporate Houses and Mutual Funds.

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Q3 Distinguish between Capital Market and Money Market.

Answer.

Basis	Capital market	Money market

Participants	Its participant are generally financial institutions, banks, corporate entities, foreign investors etc.	Its participants are generally RBI, banks, financial institutions and finance companies.
Instruments	Its major instruments are equity shares, debentures, bonds, preference shares etc.	Its major instruments are short term debt instruments such as T-bills, trade bills reports, commercial paper and certificates of deposit.
Investment outlay	The investment in this market don't need huge funds. Thus people can invest funds with small amounts.	The investment in these markets requires more funds as they are more expensive.
Duration	These securities deal in medium to long term funds having a time duration of more than one year.	These securities are short term with a time period beginning from one day upto one year.

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Q4 What are the functions of the Stock Exchange?

Answer. Functions of Stock Exchange are as follows:

i. Providing Liquidity and Marketability to Existing Securities: Stock exchanges help in the sale and purchase of securities of the securities easily. Thus it provides liquidity to the shares, debentures and other securities as they can be converted into cash in a short duration. Holders of assets can readily sell their securities through the mechanism of the stock exchanges.

ii. Pricing of securities: In a share market, the prices are determined by the forces of demand and supply. The demand is created by the businesses and the supply is created by the household sector. Such a valuation provides important instant information to both buyers and sellers in the market.

iii. Safety of transaction: The stock exchange has fixed rules and regulations for providing membership to the companies and their are legal rules for guiding them. This ensures that the general public gets a safe and fair deal on the market.

iv. Contributes to economic growth: A stock exchange deals in the existing securities and provides a platform for sale and purchase of securities. This disinvestment and reinvestment helps in channeling the resources to their most productive channels. This leads to capital formation and economic growth.

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Q5 What are the objectives of SEBI?

Answer. 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 :

→ To regulate stock exchanges and the securities industry to promote their orderly functioning.

→ To protect the rights and interests of investors, particularly individual investors and to guide and educate them.

→ To prevent trading malpractices and achieve a balance between self regulation by the securities industry and its statutory regulation.

→ 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.

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Q6 State the objective of NSE.

Answer. The 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.

→ 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.

→ It ensured that all the investors over the country get 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.

→ 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.

→ One of the objectives of NSE includes enabling shorter settlement cycles and book entry settlements.

→ NSE aimed at meeting the international standards and benchmarks of stock exchange.

Q7 Name the document prepared in the process of online trading of securities that is legally enforceable and helps to settle disputes/claims between the investor and the broker.

Answer. Trading account

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Q1 Explain the various Money Market instruments.

Answer. 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.

Treasury Bill (T-Bills): Treasury Bill refers to a promissory note used for short term borrowing by the government. They are the most commonly used money market instrument. They are auctioned and issued by the Reserve Bank of India on behalf of the Central Government. T-bills are available for a minimum of Rs 25,000 and in multiples thereof. Generally, three types of treasury bills are issued 91-days, 182-days and 364-days. T-Bills are issued at a discount and redeemed at par.

Call Money: Call money is an instrument used for interbank transactions. Through call money, the banks borrow from each other to meet any shortage of funds required to maintain CRR. That is, any bank in shortage of funds borrows from other bank having surplus funds. Call money have a very short maturity period ranging from one day to fifteen days. Interest paid on such loans is known as call rate. Call rate is highly volatile and varies from day to day. There exists a negative relationship between call rate and other money market instruments such as Commercial Papers and Certificate of Deposits. That is, as the call rate rise, other instruments of money market become cheaper and their demand increases.

Commercial Paper (CPs): Commercial paper is an unsecured short term money market instrument. It is a negotiable and transferable promissory note with a maturity period ranging from a minimum of 15-days to a maximum of one year. They were introduced in India in 1990. CPs are mainly issued by large and creditworthy companies to raise short-term funds. Large companies view Commercial Papers as an alternative to bank borrowings and borrowings through capital market. The rate of interest payable on Commercial Papers is lower than the market rates. Generally, companies use Commercial Papers for bridge financing. That is, to raise the funds required to meet the floatation cost incurred on long term borrowings in the capital market.

Certificate of Deposit (CDs): Certificate of Deposits are time deposits which are negotiable and unsecured in nature. They are bearer instruments for a short and specified time period ranging from one month to more than five years. CDs are a secured form of investment, which are issued to individuals, corporations and companies by the commercial banks and development financial institutions. Herein, higher interests are offered for higher deposits. They are issued to meet the demand for credit in times of tight liquidity position. For example, when a person buys a CD by depositing a specific amount, he receives a certificate wherein the term of deposit, the interest rate applicable and the date of maturity is written. On the date of maturity, the individual gets entitled to receive the principle amount and the earned interest on it.

Commercial Bill: Commercial bill also known as bank bill or bill of exchange refers to the instrument used to finance the working capital requirements of a firm. It is a short term negotiable instrument. Companies use Commercial Bills to finance their credit sales. For example, when an individual makes credit sales, the buyer becomes liable to make the payment on a specified future date. Herein, the seller draws a bill of exchange and gives it to the buyer mentioning a specific maturity period. Once the bill is accepted by the buyer it becomes a marketable instrument which can be discounted with a bank. For instance, if the seller requires funds before the maturity period, he can discount the bill with a commercial bank.

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Q2 Explain the recent Capital Market reforms in India.

Answer. 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 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 the 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 ‘Bombay Stock Exchange’ (BSE). In the subsequent years stock exchanges were developed in Ahmedabad, Calcutta and Madras.

In the 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, Ahmedabad, 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 issues of securities as well as secondary markets. It is a single window exchange which provides a convenient, transparent and efficient avenue for capital market investment.

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Q3 Explain the objectives and functions of the SEBI.

Answer. 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 :

→ To regulate stock exchanges and the securities industry to promote their orderly functioning.

→ To protect the rights and interests of investors, particularly individual investors and to guide and educate them.

→ To prevent trading malpractices and achieve a balance between self regulation by the securities industry and its statutory regulation.

→ 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.

Functions of SEBI:

a. Regulatory Functions

→ Registration of brokers and sub brokers and other players in the market.

→ Registration of collective investment schemes and Mutual Funds.

→ Regulation of stock brokers, portfolio exchanges, underwriters and merchant bankers and the business in stock exchanges and any other securities market.

→ Regulation of takeover bids by companies.

→ Calling for information by undertaking inspection, conducting enquiries and audits of stock exchanges and intermediaries.

→ levying fee or other charges for carrying out the purposes of the Act.

→ Performing and exercising such power under Securities Contracts (regulation) Act 1956, as may be delegated by the Government of India.

b. Development Functions

→ Training of intermediaries of the securities market.

→ Conducting research and publishing information useful to all market participants.

→ Undertaking measures to develop the capital markets by adapting a flexible approach.

c. Protective Functions

→ Prohibition of fraudulent and unfair trade practices like making misleading statements, manipulations, price rigging etc.

→ Controlling insider trading and imposing penalties for such practices.

→ Undertaking steps for investor protection.

→ Promotion of fair practices and code of conduct in securities market.

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Q4 India's largest domestic investor life Insurance Corporation of India has once again come to government's rescue by subscribing 70% of Hindustan Aeronautics' `4,200-crore initial public offering.

a. Which market is being reflected in the above case?

b. State which method of floatation in the above identified market is being highlighted in the case?

c. Explain any two other methods of floatation.

Answer.

→ Primary market is being reflected in the above case.

→ E- IPO method of floatation in the above identified market is being highlighted in the case.

E-IPOs: It is a system of issuing securities through an online system. If a company decides to offer its securities through an online system it is required to get 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.

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

Offer through Prospectus: The most commonly used method for raising funds in primary market is offer through prospectus. It involves inviting the subscriptions from the 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.

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.

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Q5 lalita wants to buy shares of Akbar Enterprises, through her broker khushvinder. She has a Demat Account and a bank account for cash transactions in the securities market. Discuss the subsequent steps involved in the screen-based trading for buying and selling of securities in this case..

Answer. The following steps are involved in the screen-based trading for buying and selling of securities:

→ If an investor wishes to buy or sell any security he has to first approach a registered broker or sub-broker and enter into an agreement with him. The investor has to sign a broker-client agreement and a client registration form before placing an order to buy or sell securities. He also has to provide certain other details and information. These include:

→ PAN number (This is mandatory)

→ Date of birth and address.

→ Educational qualification and occupation.

→ residential status (Indian/ NrI).

→ Bank account details.

→ Depository account details.

→ Name of any other broker with whom registered.

→ Client code number in the client registration form. The broker then opens a trading account in the name of the investor.

→ The investor has to open a ‘demat’ account or ‘beneficial owner’ account with a depository participant (DP) for holding and transferring securities in the demat form. He will also have to open a bank account for cash transactions in the securities market.

→ The investor then places an order with the broker to buy or sell shares. Clear instructions have to be given about the number of shares and the price at which the shares should be bought or sold. The broker will then go ahead with the deal at the above mentioned price or the best price available. An order confirmation slip is issued to the investor by the broker.

→ The broker then will go on-line and connect to the main stock exchange and match the share and best price available.

→ When the shares can be bought or sold at the price mentioned, it will be communicated to the broker’s terminal and the order will be executed electronically. The broker will issue a trade confirmation slip to the investor.

→ After the trade has been executed, within 24 hours the broker issues a Contract Note. This note contains details of the number of shares bought or sold, the price, the date and time of deal, and the brokerage charges. This is an important document as it is legally enforceable and helps to settle disputes/claims between the investor and the broker. A Unique Order Code number is assigned to each transaction by the stock exchange and is printed on the contract note.

→ Now, the investor has to deliver the shares sold or pay cash for the shares bought. This should be done immediately after receiving the contract note or before the day when the broker shall make payment or delivery of shares to the exchange. This is called the pay-in day.

→ Cash is paid or securities are delivered on pay-in day, which is before the T+2 day as the deal has to be settled and finalised on the T+2 day. The settlement cycle is on T+2 day on a rolling settlement basis, w.e.f. 1 April 2003.

→ On the T+2 day, the exchange will deliver the share or make payment to the other broker. This is called the pay-out day. The broker then has to make payment to the investor within 24 hours of the pay-out day since he has already received payment from the exchange.

→ The broker can make delivery of shares in demat form directly to the investor’s demat account. The investor has to give details of his demat account and instruct his depository participant to take delivery of securities directly in his beneficial owner account.

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