

CHAPTER 10

FINANCIAL MARKETS

Syllabus

- *Financial Markets : Concept, Functions and Types*
- *Money market and its instruments*
- *Capital market and its types (primary and secondary), methods of floatation in the Primary Market.*
- *Stock Exchange - Functions and trading procedure*
- *Securities and Exchange Board of India (SEBI) - objectives and functions*

Objectives :

After going through this unit, the student/learner would be able to :

- *Understand the concept of financial market.*
- *Explain the functions of financial market.*
- *Understand the capital market and money market as types of financial markets.*
- *Understand the concept of money market.*
- *Describe the various money market instruments.*
- *Discuss the concept of the capital market.*
- *Explain primary and secondary markets as types of the capital market.*
- *Differentiate between the capital market and the money market.*
- *Discuss the methods of floating new issues in the primary market.*
- *Distinguish between the primary and the secondary markets.*
- *Give the meaning of a stock exchange.*
- *Explain the functions of a stock exchange.*
- *Discuss the trading procedure in a stock exchange.*
- *Give the meaning of depository services and demat account as used in the trading procedure of securities.*
- *State the objectives of SEBI.*
- *Explain the functions of SEBI*

Chapter Analysis

The analysis given here gives you an analytical picture of this chapter and will help you to identify the concepts of the chapter that are to be focussed more from exam point of view.

Average number of Questions asked in last 3 years

| Exam | 2016 | | 2017 | | 2018 | |
|--------------------------|-------|-----------|-------|-----------|-------|-----------|
| | Delhi | All India | Delhi | All India | Delhi | All India |
| V.S.A. (1 mark) | | | | | 1 Q | 1 Q |
| S.A.I (3 marks) | 1 Q | 1 Q | | | | |
| S.A.II & L.A (4/5 marks) | 3 Qs | 3 Qs | 1 Q | 1 Q | | |
| E.T. (6 marks) | | | | | | |

In 2016, SA I type questions were based on functions of SEBI. SA II type questions were based on functions of financial markets, functions of secondary markets and floatation of new issues.

In 2017, SA II type questions were based on differences between money market and capital market.

In 2018, 1 mark questions were based on types of money market instruments

On the basis of the above analysis, the following topics can be considered as important.

- Maximum weightage is of functions of SEBI and money market instruments.
- Maximum VSA, SA I, SA II, LA and ET type questions were asked from functions of SEBI, secondary markets and money market instruments.



TOPIC-1 Financial Markets

Quick Review

- **Functions of the Financial Market :**
 - **Facilitates price discovery :** Price is determined where demand and supply of funds interact.
 - **Mobilisation of savings and channelising them into the most productive use :** Facilitates transfer of savings from the savers to the investors.
 - **Provides liquidity to financial assets :** Facilitates easy purchase and sale of financial assets.
 - **Reducing the cost of transaction :** Save time, effort and money by providing valuable information about securities.
- **Types of Financial Markets :** (i) Money Market; (ii) Capital Market.

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Very Short Answer Type Questions

(1 mark each)

- Q. 1. What is meant by Financial Market?

[SQP 2014]

Ans. A Financial Market is a market for the creation and exchange of the financial assets. 1

- Q. 2. What is meant by Financial Intermediation?

[Outside Delhi Comptt. Set I, II, III 2013]

Ans. Financial Intermediation is the process by which allocation of funds is done. 1

- Q. 3. State any one consequence of a well-performed allocative function of the financial market.

[Delhi Set I, II, III 2013]

Ans. (i) The rate of return offered to the investors would be higher.

(ii) Scarce resources will be allocated to those firms who have highest productivity for the economy.

(Any one) 1



Short Answer Type Questions-I

(3 marks each)

- Q. 1. Differentiate between 'Capital Market' and 'Money Market' on the basis of :

- (i) Investment Outlay;
- (ii) Safety; and
- (iii) Liquidity. [Delhi Comptt. Set I, II, III 2017]

OR

Differentiate between 'Capital Market' and 'Money Market' on the basis of :

- (i) Liquidity;
- (ii) Instruments; and
- (iii) Expected Return.

[Outside Delhi Comptt. Set I 2017]

OR

Differentiate between 'Capital Market' and 'Money Market' on the basis of :

- (i) Safety;
- (ii) Liquidity; and
- (iii) Duration. [Outside Delhi Comptt. Set II 2017]

OR

Differentiate between 'Capital Market' and 'Money Market' on the basis of :

- (i) Participants;
- (ii) Instruments; and
- (iii) Safety. [Outside Delhi Comptt. Set III 2017]

Ans. Difference between Capital Market and Money Market :

| S. No. | Basis | Capital Market | Money Market |
|--------|--------------------------|---|--|
| (i) | Participants | The participants are financial institutions, banks, corporates, foreign investors and retail investors. | The participants are RBI, financial institutions, banks and corporates. |
| (ii) | Instruments | Instruments traded are shares, debentures and bonds. | Instruments traded are treasury bill, commercial paper, certificates of deposit, call money and commercial bill. |
| (iii) | Investment outlay | Investment outlay is small. | Investment outlay is large. |
| (iv) | Duration | It deals in medium term and long term securities. | It deals in short term securities |
| (v) | Liquidity | Capital market securities are comparatively less liquid. | Money market securities are comparatively more liquid. |
| (vi) | Expected return | The investment in capital markets generally yields a higher return. | The expected rate of return of the money market is less. |
| (vii) | Security/Safety | Capital market instruments are risky with respect to returns and principal repayment. | Money market instruments are generally much safer with a minimum risk of default. |
| (viii) | Meaning | It refers to the facilities and institutional arrangements through which funds, both debt and equity are invested and raised. | It is the market where low risk, unsecured, highly liquid short term debt instruments are issued and traded. |
| (ix) | Location | There is no fixed geographical area. All the institutions, banks, foreign investors, etc. constitute primary market. | There is a fixed geographical area and working hours. |

[CBSE Marking Scheme, 2017] 3

- Q. 2. 'Financial Market plays an important role in the allocation of scarce resources in an economy by performing many important functions.' Explain any three such functions.

[Delhi Set I, II, III 2015] [Delhi Set I, II, III 2014] [Outside Delhi Set I, II, III 2014; Foreign Set I, II, III 2014]

OR

Explain any four functions of the financial market. [SQP 2015]

OR

Explain any three functions of the financial markets. [Outside Delhi Set I, III 2013]

OR

'Financial market plays an important role in the allocation of scarce resources in an economy by performing many important functions. Explain any four such functions.

[Outside Delhi Set I 2011]

OR

Describe any four functions of the financial market.

[Outside Delhi Comptt. Set II 2013; Set II 2011; Delhi Comptt. Set I 2011]

Ans.

Following are the functions of Financial Market :

① ~~Channe~~ Mobilisation of Savings and Channelling them into their most productive uses.
Financial Markets provide to the savers the choice of different investments and helps to channelise the savers' surplus funds into their most productive investment avenues. This leads to greater productivity for the economy and promotes the habit of savings and investment.

2) Providing liquidity to the Financial Assets.
The Financial Market provides a mechanism where the

financial assets can be bought or sold. This provides liquidity to the financial assets as they can be easily convert into cash whenever required

- 3) **Reducing the Cost of Transactions.**
Financial Markets help to save the time, money and efforts of the investors and the firms that would have been spent trying to find each other. It provides a common platform where the buyers and sellers can meet for the fulfilment of their individual needs

[Topper's Answer 2015] 3

Detailed Answer : Refer to Q. 1 of Short Answer Type Question-II.



Short Answer Type Question-II

(4 marks)

- Q. 1. State the functions of the Financial Market.

[Delhi Set II 2016]

OR

State the functions performed by the Financial Market.

[Outside Delhi Set I 2016] [Foreign Set III 2016]

OR

"A financial market is for the creation and exchange of financial assets." Explain any two of its functions. [SQP 2016]

Ans. Functions of Financial Market :

- (i) It mobilises savings and channelises them into most productive use by facilitating transfer of savings from savers to investors.
- (ii) It facilitates price discovery for financial assets by interaction of forces of demand and supply.
- (iii) It provides liquidity to financial assets as the securities can be easily converted into cash.
- (iv) 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.

[CBSE Marking Scheme, 2016] $1 \times 4 = 4$

Detailed Answer : Functions performed by Financial Market :

- (i) **Mobilisation of savings and channelising them into the most productive uses :** A financial

market facilitates the transfer of savings from savers to the investors. It gives savers the choice of different investments and thus helps to channelise surplus funds into the most productive use.

- (ii) **Facilitate price discovery :** 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.
- (iii) **Provide liquidity to the financial assets :** Financial markets facilitate easy purchase and sale of financial assets. In doing so, they provide liquidity to financial assets, so that they can be easily converted into cash whenever required. Holders of assets can readily sell their financial assets through the mechanism of the financial market.
- (iv) **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. The financial market is thus, a common platform where buyers and sellers can meet for fulfillment of their individual needs.



Essay Type Question

(6 marks)

- Q. 1. Explain the functions of Financial Market.

[Delhi Comptt. Set III, Outside Delhi Comptt. Set II, 2015]

Ans. Refer to Q. 1 of Short Answer Type Question-II.

$1\frac{1}{2} \times 4 = 6$



TOPIC-2

Money Market and Its Instruments

Quick Review

➤ **Types of money market instruments :** Following are the money market instruments :

- **Commercial paper :**
 - (i) It is issued by the large and credit worthy companies.
 - (ii) Maturity period is 15 days to 1 year.
 - (iii) Issued at discount and redeemed at par.
 - (iv) Used for bridge financing.
- **Call money :**
 - (i) A bank borrows call money from other bank.
 - (ii) Used to maintain cash reserve ratio.
 - (iii) Maturity period is from 1 day to 15 days.
- **Certificate of deposit :**
 - (i) Issued by the commercial banks and the financial institutions.
 - (ii) Used to meet high demand for credit.
- **Commercial bill :**
 - (i) Issued by firms to meet working capital requirements.
 - (ii) Trade bill, when accepted by bank, becomes commercial bill.
- **Treasury bill :**
 - (i) Issued by RBI on behalf of the Government of India.
 - (ii) Issued at discount and redeemed at par.
 - (iii) Maturity period is from 14 days to 364 days.
 - (iv) Also called Zero Coupon Bonds.



Very Short Answer Type Questions

(1 mark each)

U Q. 1. What is meant by a 'Commercial Paper'?

[Delhi Comptt. Set I, II, III 2017]
[Outside Delhi Comptt. Set II 2017]

Ans. It is a short term, unsecured, negotiable promissory note with a fixed maturity period which is issued by large and credit worthy companies to raise short term funds at lower rates of interest than the market rate.

[CBSE Marking Scheme, 2017] 1

R Q. 2. What is meant by 'Call Money'?

[Outside Delhi Comptt. Set I 2017]

Ans. Call money is the method by which banks borrow from each other to be able to maintain the cash reserve ratio. It is repayable on demand, with a maturity period of one day to fifteen days. [CBSE Marking Scheme, 2017] 1

U Q. 3. What is meant by a 'Treasury Bill'?

[Outside Delhi Comptt. Set III 2017]

Ans. Treasury Bill : It is an instrument issued by Reserve Bank of India on behalf of the Central government to meet its short term requirements of funds. It is highly liquid, has an assured yield and negligible risk of default.

[CBSE Marking Scheme, 2017] 1

U Q. 4. Give the meaning of 'Money Market'.

[Delhi Set III 2013]

Ans. Money Market is that financial market where short-term funds are raised and invested whose maturity period is less than one year. 1



Short Answer Type Questions-I

(3 marks each)

U Q. 1. 'Money market is essentially a market for short term funds'. In the light of this statement, state any three features of money market.

[SQP 2017]

Ans. Features of money market :

- (i) It is a market for short-term funds which deals

in monetary assets whose period of maturity is up to one year.

- (ii) Money market instruments are highly liquid.
- (iii) Money market instruments are less risky.

[CBSE Marking Scheme, 2017] 1 × 3 = 3

- [A] Q. 2. Saqib Ltd. is a large creditworthy company operating in the Kashmir Valley. It is an export oriented unit, dealing in exclusive embroidered shawls. The floods in the Valley have created many problems for the company. Many craftsmen and workers have been dislocated and raw material has been destroyed. The firm is therefore, unable to get an uninterrupted supply of raw material, and the duration of the production cycle has also increased. To add to the problems of the organisation, the suppliers of raw material, who were earlier selling on credit, are asking the company for advance payment or cash payment on delivery. The CEO of the company feels that taking a bank loan is the only option with the company to meet its short term shortage of cash. As a finance manager of the company, name and explain the alternative to bank borrowing that the company can use to resolve the crisis.

[SQP 2016]

Ans. Commercial Paper : It is a short-term unsecured promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period. It is issued by the large and creditworthy companies to raise short-term funds at lower rate of interest than market rates. The issuance of commercial paper is an alternative to bank borrowing for large companies that are generally considered to be financially strong.

[CBSE Marking Scheme, 2016] 1 + 2 = 3

- [U] Q. 3. Give the meaning of the following money market instruments :

- (i) Certificate of Deposit and
(ii) Commercial Bill.

[Delhi Comptt. Set I, II, III 2014]

OR

Give the meaning of the following money market instruments :

- (i) Treasury Bill and
(ii) Call Money.

[Outside Delhi Comptt. Set I, II, III 2014]

OR

Explain the following money market instruments :

- (i) Treasury Bill
(ii) Commercial Paper and
(iii) Call Money. [Foreign Set III 2014]

OR

Explain :

- (i) Commercial Paper and
(ii) Certificate of Deposit as money market instruments.

[Delhi Comptt. Set I, II 2012]

OR

Explain :

- (i) Treasury Bill

- (ii) Call Money as money market instruments.

[Outside Delhi Set I, II, III 2012]

OR

Explain :

- (i) Call Money
(ii) Commercial Bill as money market instruments.

[Delhi Comptt. Set III 2012]

OR

Explain the following money market instruments :

- (i) Treasury Bill and
(ii) Commercial Paper. [Delhi Set I 2010]

OR

Explain the following money market instruments :

- (i) Certificate of Deposit,
(ii) Call Money. [Outside Delhi Set I 2010]

OR

Explain the following money market instruments : [Outside Delhi Set II 2010]

- (i) Commercial Papers.
(ii) Commercial Bill.

OR

What is meant by 'Money Market'? Explain any two instruments used in Money Market.

[Delhi Set I 2010] [Delhi Comptt. Set I 2010]

Ans. Money Market is a market for short-term funds which deals in monetary assets whose period of maturity is upto one year.

Following are the money market instruments :

- (i) **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. It is primarily used by Commercial Banks to maintain a minimum cash balance known as Cash Reserve Ratio (CRR) as stipulated by the RBI.
(ii) **Treasury Bills :** Treasury bills (T-Bills) are issued by the Reserve Bank of India on behalf of the Government of India as a short-term liability, and sold to the banks and to the public. The issue period ranges from 14 to 364 days. T-Bills are negotiable instruments, i.e., they are freely transferable. They are issued at a discount and redeemable at par.

- (iii) **Trade Bills/Commercial Bills :** Trade bills are bills drawn by one business firm to another to finance credit sales. They are self-liquidating as the drawee has to honour them on the date of maturity. They are freely marketable. If the seller requires funds before the maturity, he can get it discounted with the bank. It is known as commercial bill after acceptance of the trade bill by a Commercial Bank.

- (iv) **Commercial Paper :** A commercial paper is an unsecured promissory note, issued by a corporate firm with a fixed maturity period which varies from 15 days to 12 months. Since a CP is unsecured, it is issued only by highly creditworthy, reputed leading firms. The original purpose of commercial paper is to provide short-term funds for seasonal and working capital.

- (v) **Certificate of Deposit** : These are unsecured short term negotiable instruments issued in bearer form. These are issued by the banks against deposits kept by companies and

institutions. The tenure ranges from 91 days to one year. These help to mobilise large amount of money for short period. (Any two)

$$1\frac{1}{2} + 1\frac{1}{2} = 3$$



Short Answer Type Question-II

(4 marks)

- A Q. 1.** 'Ganesh Steel Ltd.' is a large and credit worthy company manufacturing steel for the Indian market. It now wants to cater to the Asian market and decides to invest in new hi-tech machines. Since the investment is large, it requires long-term finance. It decides to raise funds by issuing equity shares. The issue of equity shares involves huge floatation cost. To meet the expenses of floatation cost, the company decides to tap the money market.

- Name and explain the money-market instrument the company can use for the above purpose.
- What is the duration for which the company can get funds through this instrument?
- State any other purpose for which this instrument can be used.

[Delhi Set I, II, III 2015]

OR

'Mission Coach Ltd.' is a large and credit worthy company manufacturing coaches for Indian Railways. It now wants to export these coaches to other countries and decides to invest in new hi-tech machines. Since the investment is large, it requires long-term finance. It decides to raise funds by issuing equity shares. The issue of equity shares involves huge floatation cost. To meet the expenses of floatation cost, the company decides to tap the money market.

- Name and explain the money market instrument the company can use for the above purpose.
- What is the duration for which the company can get funds through this instrument?
- State any other purpose for which this instrument can be used.

[Outside Delhi Set I, II, III 2015]

Ans.

(a) The money market instrument that can be used for this purpose is Commercial Paper.

Commercial Paper are short-term, unsecured promissory note, negotiable and transferable by endorsement and delivery within a fixed maturity period.

(b) The duration for which the company can get funds from this instrument is One day to Fifteen days. It is a short-term source of fund.

(c) This instrument can be used as an Alternative to Bank Financing. It is used by credit worthy companies to meet its short term requirements of funds. They are issued at rates lower than the market rates.

[Topper's Answer 2015] 4

Detailed Answer :

- (i) Commercial Paper

It is an instrument issued by large and credit worthy companies to raise short-term funds at lower rates of interest than market rates. It is an

unsecured, negotiable promissory note with a fixed maturity period.

- 15 days to one year.
- It can also be used for seasonal and working capital needs.



Essay Type Question

(6 marks)

- U Q. 1.** Explain the following money market instruments :

- Call Money,
- Treasury Bill,

- Commercial Paper,
- Certificate of Deposit. [Delhi Set I, II, III 2013]

Ans. Refer to Q. 3 of Short Answer Type Questions-I.

$$1\frac{1}{2} \times 4 = 6$$



TOPIC-3

Capital Market and its Types (Primary and Secondary)

Quick Review

➤ **Components of Capital Market :**

- **Primary Market :** It refers to the market wherein securities (shares, debentures) are sold for the first time. It is also known as new issue market. The various methods of floatation are :
 - (i) **Offer through prospectus :** Company invites subscription from public through the issue of prospectus by advertising in newspapers and magazines.
 - (ii) **Offer for sale :** Securities are offered for sale through intermediaries like stock brokers, banks, etc.
 - (iii) **Private placement :** Company allots securities to the institutional investors and to the selected individuals.
 - (iv) **Right issue :** Company offers its existing shareholders to buy new shares in proportion to their existing shares.
 - (v) **e-IPOs :** Company issues securities to public through the on-line system of the stock exchange.
- **Secondary Market :** It refers to the market for sale and purchase of previously issued securities. It is also known as stock exchange.



Very Short Answer Type Questions

(1 mark each)

- U Q. 1. List any two characteristics of Secondary Market. [SQP 2014]

Ans. Characteristics of Secondary market :

- (i) It is a market for purchase and sale of existing securities.
- (ii) Both buying and selling of securities can take place.
- (iii) It is located at specified places.
- (iv) The price of securities is determined by the demand and supply of the securities.

(Any two) $\frac{1}{2} \times 2 = 1$

- R Q. 2. Give the meaning of Capital Market. [Delhi Set II 2013]

OR

What is meant by 'Capital Market'?

Ans. Capital market includes all those organisations, institutions and instruments that provide long-term and medium-term funds through shares, bonds, debentures, etc. It consists of development banks, commercial banks and stock exchanges. 1

- R Q. 3. Give the meaning of secondary market.

[Delhi Set III 2013]

Ans. It is the market for the purchase and sales of existing securities. 1

- U Q. 4. State the essential function of 'Primary Market'. [Outside Delhi Set I, II, III 2013]

Ans. To facilitate the transfer of investible funds from the savers to entrepreneurs seeking to establish new enterprises or expanding existing ones through the issue of securities for the first time. 1

- R Q. 5. What is meant by 'allocative function' performed by financial market?

[Outside Delhi Comptt. Set I, II, III 2013]

Ans. Allocative function performed by the financial market means that financial market helps to link the savers and investors by mobilising funds and investing them into the most productive channels. 1



Short Answer Type Questions-I

(3 marks each)

- U Q. 1. Differentiate between the two segments of financial market on any three basis.

[Delhi Comptt. Set I, II, III 2013]

Ans. Refer to Q. 3 of Long Answer Type Questions. 3

- R Q. 2. What is meant by 'Capital Market'? Name the two segments of Capital Market.

[Outside Delhi Comptt. Set I 2010]

Ans. **Capital Market :** Refer to Q. 2 of Very Short Answer Type Questions.

Two segments of capital market :

- (i) **Primary Market :** Primary market refers to the market wherein securities are sold for the first time. It is also known as New Issue Market. The securities through which a company can raise capital in primary market are : Equity Shares, Preference Shares, Debentures, etc.
- (ii) **Secondary Market :** Secondary market refers to the market for sale and purchase of previously issued securities. It is also known as the Stock Market or Stock Exchange. In this market, securities are exchanged between the investors.

1 + 1 + 1 = 3



Short Answer Type Questions-II

(4 marks each)

Q. 1. State any four methods of floatation of new issues in the primary market.

[Delhi & Outside Delhi Set III 2016]

[Foreign Set I 2016]

Ans. Methods of floatation in the primary market:

- (i) Offer through Prospectus is a method of floating new issues by inviting subscriptions from the public through issue of prospectus.
- (ii) Offer for Sale is a method in which the securities are not issued directly to the public but through intermediaries like issuing houses or stock brokers.
- (iii) Private Placement refers to the allotment of securities by a company to institutional investors and some selected individuals.
- (iv) Rights Issue is the privilege given to existing shareholders to subscribe to new issue of shares in proportion to the number of shares they already hold.
- (v) e-IPO refers to issuing securities through the online system of stock exchange. (Any four)

[CBSE Marking Scheme, 2016] 1×4=4

Detailed Answer : There are various methods of floating new issues in the primary market :

- (i) **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 the newspapers and in the magazines. The issues may be underwritten and also are required to be listed on at least one recognised stock exchange. The contents of the prospectus have to be in accordance with the provisions of the Companies Act and SEBI Disclosure and Investor Protection Guidelines.
- (ii) **Offer for Sale :** Under this method, securities are not issued directly to the public but are offered for sale through the intermediaries like issuing houses or stock brokers. In this case, a company sells securities in bulk at an agreed price to brokers who, in turn, resell them to the investing public.
- (iii) **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.

(iv) **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.

(v) **e-IPOs :** A company proposing to issue capital to the public through the online system of the stock exchange has to enter into an agreement with the stock exchange. This is called an Initial Public Offer (IPO). SEBI registered brokers have to be appointed for the purpose of accepting applications and placing orders with the company. The issuer company should also appoint a registrar to the issue having electronic connectivity with the exchange. The issuer company can apply for listing of its securities on any exchange other than the exchange through which it has offered its securities. The lead manager co-ordinates all the activities amongst intermediaries connected with the issue.

Q. 2. State any four functions of 'Secondary Market'.

[Outside Delhi Set II 2016]

Ans. Functions of Secondary Market are :

- (i) It provides liquidity and marketability to existing securities by allowing the investors a chance to disinvest and reinvest.
- (ii) It determines the price of securities on the basis of the forces of demand and supply.
- (iii) It ensures safety of transactions as the transactions carried out within an existing legal framework.
- (iv) It contributes to economic growth as it indirectly promotes capital formation.
- (v) It spreads equity cult and ensures wider share of ownership.
- (vi) It provides scope for speculation within the provisions of law. (Any four) 1×4=4

[CBSE Marking Scheme, 2016]

Detailed Answer :

Functions of Secondary Market :

- (i) **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.
- (ii) **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.

(iii) **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.

(iv) **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.

(v) **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.

(vi) **Providing Scope for Speculation** : The stock exchange provides sufficient scope within the provisions of law for speculative activity in a restricted and controlled manner. It is generally accepted that a certain degree of healthy speculation is necessary to ensure liquidity and price continuity in the stock market.



Long Answer Type Questions

(5 marks each)

Q. 1. Differentiate between 'Primary Market' and 'Secondary Market' on any five basis.

[Outside Delhi Set I, III 2014]

Ans. Difference between Primary Market and Secondary Market : Basis Primary Market Secondary Market

| S. No. | Basis | Primary Market | Secondary Market |
|--------|------------------------------------|---|--|
| (i) | Types of securities | There is sale of new securities issued by new companies or existing companies to investors. | There is only trading or marketing of existing second-hand securities. |
| (ii) | Involvement of the issuing company | Securities are issued and sold by the company to the investors directly or through an intermediary. | Securities are transferred between the investors only. The company is not involved. |
| (iii) | Capital formation | Primary market contributes directly for capital formation by mobilising the funds from the savers to the investors. | Enhances encashability (liquidity) of shares i.e., the secondary market indirectly promotes capital formation. |
| (iv) | Nature of Transactions | Only buying of securities take place in the primary market. Securities can't be sold. | Both buying and selling of securities can take place on the stock exchanges i.e., in the secondary market. |
| (v) | Price | Prices of securities are fixed and decided by the management of the company. | Prices of securities are fixed by the demand and supply factors of stock exchange market. |

1 × 5 = 5

Q. 2. What is meant by 'Capital Market'? Name the two types of capital market and differentiate between the two on any four basis.

[Outside Delhi Comptt. Set II 2014]

Ans. **Meaning of Capital Market** : Capital Market means the facilities and institutional arrangements through which long-term funds, both debt and equity, are raised and invested.

Types of Capital Market : Primary market and secondary market.

Difference between Primary Market and Secondary Market :

| S. No. | Basis | Primary Market (New Issue Market) | Secondary Market (Stock Exchange) |
|--------|---------------------|---|---|
| (i) | Securities traded | There is sale of securities by new companies for further (new) issues of securities by existing companies to investors. | There is trading of existing securities only. |
| (ii) | Purpose | Securities are sold by the company to the investor directly (or through an intermediary) | Ownership of existing securities is exchanged between investors. The company is not involved at all. |
| (iii) | Capital formation | The flow of funds is from savers to investors, i.e. the primary market directly promotes capital formation. | Enhances encashability (liquidity) of securities, i.e., the secondary market indirectly promotes capital formation. |
| (iv) | Buying/Selling | Only buying of securities takes place in the primary market. Securities cannot be sold by the investors. | Both the buying and the selling of securities can take place on the stock exchange. |
| (v) | Price determination | Prices are determined and decided by the management of the company. | Prices are determined by demand and supply of the securities. |
| (vi) | Location | There is no fixed geographical location. | Located at specified places. |

(Any four)

[CBSE Marking Scheme, 2014] $\frac{1}{2} + \frac{1}{2} + 4 = 5$

Q. 3. Differentiate between 'Capital Market' and 'Money Market' on the following basis :

- (i) Participants,
- (ii) Instruments,
- (iii) Investment outlay,
- (iv) Duration and
- (v) Liquidity. [Delhi Set I 2014]

OR

Differentiate between 'Capital Market' and 'Money Market' on the basis of :

- (i) Safety,
- (ii) Expected return,
- (iii) Meaning,
- (iv) Instruments and
- (v) Duration. [Delhi Set II, III 2014]

OR

Differentiate between 'Capital Market' and 'Money Market' on the following basis :

- (i) Expected Return
- (ii) Security

- (iii) Liquidity
- (iv) Duration and
- (v) Instruments

[Outside Delhi Comptt. Set I 2014]

OR

Differentiate between 'Capital Market' and 'Money Market' on the following basis :

- (i) Participants,
- (ii) Instruments,
- (iii) Investment outlay,
- (iv) Duration and
- (v) Liquidity. [Delhi Comptt. Set I 2014]

OR

Differentiate between 'Capital Market' and 'Money Market' on the basis of the following :

- (i) Safety
- (ii) Expected Return
- (iii) Investment outlay
- (iv) Participants
- (v) Duration. [Foreign Set I, II, III 2014]

Ans.

| S. No. | Basis | Capital Market | Money Market |
|--------|-------------------|---|--|
| (i) | Participants | The participants are financial institutions, banks, corporates, foreign investors and retail investors. | The participants are RBI, financial institutions, banks and corporates. |
| (ii) | Instruments | Instruments traded are shares, debentures and bonds. | Instruments traded are treasury bill, commercial paper, certificates of deposit, call money and commercial bill. |
| (iii) | Investment outlay | Investment outlay is small. | Investment outlay is large. |
| (iv) | Duration | It deals in medium term and long term securities. | It deals in short term securities |
| (v) | Liquidity | Capital market securities are comparatively less liquid. | Money market securities are comparatively more liquid. |
| (vi) | Expected return | The investment in capital markets generally yields a higher return. | The expected rate of return of the money market is less. |
| (vii) | Security/Safety | Capital market instruments are risky with respect to returns and principal repayment. | Money market instruments are generally much safer with a minimum risk of default. |
| (viii) | Meaning | It refers to the facilities and institutional arrangements through which funds; both debt and equity are invested and raised. | It is the market where low risk, unsecured, highly liquid short term debt instruments are issued and traded. |
| (ix) | Location | There is no fixed geographical area. All the institutions, banks, foreign investors, etc. constitute primary market. | There is a fixed geographical area and working hours. |

[CBSE Marking Scheme, 2014] $1 \times 5 = 5$

Q. 4. Explain any four methods of floating new issues in the primary market.

[Outside Delhi Comptt. Set I, II 2013; [Delhi Comptt. 2011; Outside Delhi Set I 2010]

OR

Define primary market. State any four methods of issuing securities in the primary market.

[SQP 2011]

Ans. Primary market is a market in which new securities are issued for the first time to the investors.

The methods of floating new issues in the primary market are :

- (i) **Offer through Prospectus** : It is the method of floating new issues by inviting subscriptions from the public through issue of prospectus.
- (ii) **Offer for Sale** : It is the method in which the securities are not issued directly to the public but through intermediaries like issuing houses or stock brokers.
- (iii) **Private Placement** : It refers to the allotment of securities by a company to institutional investors and some selected individuals.

- (iv) **Rights Issue** : It is the privilege given to existing shareholders to subscribe to new issue of shares in proportion to the number of shares they already hold.

- (v) **e-IPO** : It refers to issuing securities through the online system of stock exchange.

$$1 \times 5 = 5$$



Essay Type Questions

(6 marks each)

- Q. 1. Distinguish between Money Market and Capital Market on the basis of :

- (i) Participants
- (ii) Instruments
- (iii) Safety and
- (iv) Expected return. [Delhi Comptt. Set I 2015]

OR

Distinguish between Money Market and Capital Market on the basis of :

- (i) Investment outlay
- (ii) Duration
- (iii) Liquidity and
- (iv) Instruments. [Delhi Comptt. Set II 2015]

OR

Distinguish between Money Market and Capital Market on the basis of :

- (i) Participants
- (ii) Instruments
- (iii) Duration and
- (iv) Safety.

[Outside Delhi Comptt. Set III 2015]

Ans. Difference between Capital Market and Money Market : Refer to Q. 3 of Long Answer Type Questions. 6

- Q. 2. Distinguish between Primary Market and Secondary Market.

[Outside Delhi Comptt. Set I 2015]

Ans. Difference between Primary Market and Secondary Market : Refer to Q. 2 of Long Answer Type Questions. 6



TOPIC-4

Stock Exchange-Functions and Trading Procedure

Quick Review

- **Functions of a Stock Exchange :**
 - Provides liquidity and marketability to existing securities.
 - Ensures safety of transactions.
 - Contributes to economic growth.
 - Spreads out equity cult.
 - Determines price of securities.
 - Provides scope for speculation.
- **Trading Procedure on a Stock Exchange :**
 - Selecting a broker.
 - Opening a demat account.
 - Placing an order.
 - Executing an order.
 - Settlement of transaction.



Very Short Answer Type Questions

(1 mark each)

- Q. 1. Reshu's father has gifted her shares of a large cement company, with which he had been working. The securities were in physical form. She already has a bank account and does not possess any other forms of securities. She wished to sell the shares and approached a registered broker for the purpose. Mention one mandatory detail which she will have to provide with the broker. [SQP 2016]

Ans. Permanent Account Number (PAN).

[CBSE Marking Scheme, 2016] 1

- Q. 2. State any one function of stock exchange.

[Delhi Set II 2012]

Ans. Providing liquidity and marketability of existing securities.

[CBSE Marking Scheme, 2012] 1

Short Answer Type Question-I

(3 marks)

- Q. 1. 'Efficient functioning of stock exchange creates a conducive climate for active and growing primary market for new issues as well as for an active and healthy secondary market.' In the light of this statement, state any three functions of a stock exchange.

[Delhi Comptt. Set I 2015]

OR

'The Stock Exchange performs many vital functions in today's commercial world.' Explain any three such functions.

[Outside Delhi Set I 2015]

OR

Stock exchange not only contributes to the economic growth, but performs many other functions. Explain any three such functions.

[Outside Delhi Set I, II, III 2014]

OR

Explain any three functions of stock exchange.

[Outside Delhi Set II 2013]

Ans. Functions of Stock Exchange are :

- (i) It provides liquidity and marketability to existing securities.
- (ii) It determines the price of securities by forces of demand and supply.
- (iii) It ensures safety of transactions as the transactions are carried out within an existing legal framework.
- (iv) It contributes to economic growth as it indirectly promotes capital formation.

- (v) It spreads equity cult ensuring wider share ownership.

- (vi) It provides scope for speculation within the provisions of law. (Any three)

[CBSE Marking Scheme, 2015] $1 \times 3 = 3$ **Detailed Answer :****Functions of Stock Exchange :**

- (i) **Providing liquidity and marketability :** Stock exchange provides common platform to buyers and sellers to buy and sell securities.
- (ii) **Pricing of securities :** The forces of demand and supply in a stock market determine the price of a financial security.
- (iii) **Safety of transaction :** Stock exchange regulates membership and transactions by well-defined legal framework. Thus, ensures safety of transaction for the investors.
- (iv) **Contributing to economic growth :** Through the process of disinvestment and reinvestment, the savings are channelised into the productive investments leading to the capital formation and economic growth.
- (v) **Spreading of equity cult :** Stock exchange ensures wider share ownership by providing better trading practices, educating people about new investment and regulating new issues.
- (vi) **Providing scope for speculation :** Stock exchange provides certain degree of healthy speculation to ensure liquidity and price increase in securities.

Short Answer Type Questions-II

(4 marks each)

- Q. 1. State the first four steps which are involved in the screen-based trading for buying and selling of securities in the secondary market.

[SQP 2018]

Ans. Following are the first four steps in the screen-based trading for buying and selling of securities in the secondary market :

- (i) The investor has to approach a registered broker or sub-broker and sign a broker-client agreement and a client registration form before placing an order to buy or sell securities.
- (ii) The investor has to open a "demat" account or "beneficial owner" account with a depository participant for holding and transferring securities in the demat form.

- (iii) The investor then places an order with the broker to buy or sell shares; the broker will go ahead with the deal and issue the order confirmation slip to the investor.

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

[CBSE Marking Scheme, 2018] $1 \times 4 = 4$

- Q. 2. State any four functions of 'Stock Exchange.'

[Foreign Set I, II; Delhi Set I 2016]

Ans. Refer to Q. No. 1 of Short Answer Type Question-I.

4

? Long Answer Type Questions

(5 marks each)

- Q. 1. Explain the trading procedure on a stock exchange.

[Delhi Comptt. Set II 2014; SQP 2013]

Ans. Trading procedure on a stock exchange is as follows :

- (i) **Selection of a Broker** : A SEBI registered broker, who is a member of a stock exchange, is selected to buy/sell securities on behalf of the investor. The broker can be an individual, partnership firm or corporate.
- (ii) **Opening a Demat Account** : There are two depositories in India - NSDL (National Securities Depositories Ltd.) and CDSL (Central Depository Services Ltd.). A demat account is opened by the investor with depository participant (bank stock broker) to trade in listed securities in electronic form and maintain the balance of securities with depositories.
- (iii) **Placing the order** : The order to buy or sell specific security is to be communicated to the broker either personally or through telephone, e-mail, etc.
- (iv) **Executing the order** : The broker buys or sells the specified securities as instructed by the investor and they issue a contract note.

It contains the name & prices of securities, details of the parties, brokerage charged, etc.

- (v) **Settlement** : A T+2 rolling settlement cycle is followed in Indian stock market. Delivery of shares is made in dematerialised form and each exchange has its own clearing house which assumes all settlement risk.

[CBSE Marking Scheme, 2014] $1 \times 5 = 5$

- Q. 2. Explain any five functions of Stock Exchange.

[Delhi Comptt. Set III 2014; Outside Delhi Comptt. Set III 2014]

OR

Explain any five functions of a stock exchange.

[Delhi Comptt. Set II 2012; Delhi Set I 2010; SQP 2011]

OR

In today's commercial world, the stock exchange performs many vital functions which lead the investors towards positive environment. Explain it, by giving four reasons.

[Delhi Set I 2011]

OR

Explain any four functions of stock exchange.

[Delhi Comptt. Set I, II, III 2013]

- Ans.** Refer to Q. 1 of Short Answer Type Question-I.
(Any five) $1 \times 5 = 5$

? Essay Type Question

(6 marks)

- Q. 1. Explain any four functions of stock exchange.

[Delhi Set I, II, III 2013; Outside Delhi Set I, II, III 2012]

- Ans.** Refer to Q. 1 of Short Answer Type Question-I.

6



TOPIC-5

Securities and Exchange Board of India (SEBI) – Objectives and Functions

Quick Review

- **Securities and Exchange Board of India (SEBI)** : It was established by the Indian Government in 1988 under the administrative control of the Ministry of Finance, Government of India. Later, it became a statutory body under the SEBI Act, 1992.
- **Reasons for establishment of the SEBI** :
 - Price Rigging.
 - Unofficial private placement.
 - Delay in delivery of shares.
 - Violation of stock exchange's rules and regulation.
 - Unofficial premium on new shares.
- **Objectives of SEBI** :
 - To regulate stock exchanges.

- To protect investor's rights and interests.
 - To prevent trading malpractices.
 - To develop the code of conduct.
- **Functions of the SEBI :**
- I. Regulatory Functions :**
- (i) Registration of players in the market.
 - (ii) Registration of investment schemes.
 - (iii) Regulation of intermediaries.
 - (iv) Regulation of takeover bids.
 - (v) Calling for information.
 - (vi) Levying fees.
 - (vii) Others as delegated by the Govt. of India.
- II. Developmental Functions :**
- (i) Training of intermediaries.
 - (ii) Conducting research.
 - (iii) Developing capital markets.
- III. Protective Functions :**
- (i) Prohibition of unfair trade practices.
 - (ii) Controlling insider trading.
 - (iii) Investors' protection.
 - (iv) Promotion of fair practices and code of conduct.
- **Depository services :**
- Opening a demat account.
 - De-materialisation.
 - Re-materialisation.
 - Record of securities.
 - Settlement of transactions.
 - Facilitating loan against the securities.
 - Freezing demat account.
- **Players in depository system :**
- Depository.
 - Depository participant.
 - Beneficial owner.
 - Issuer.



Very Short Answer Type Questions

(1 mark each)

- [A] Q. 1. SEBI recently called for information and issued a show cause notice to NSE and its 14 officials seeking explanation on the Preferential Access allegations at the Exchange's co-location facility. State the function that SEBI performed by doing so. [SQP 2018]

Ans. The following function was performed by SEBI- Calling for information by undertaking inspection, conducting enquiries and audits of stock exchanges and intermediaries. – Regulatory Function.

[CBSE Marking Scheme, 2018] 1

- [A] Q. 2. ABC Ltd. issued prospectus for the subscription of its shares for ₹ 500 crores in 2008. The issue was oversubscribed by 20 times. The company issued shares to all the applicants on pro-rata basis. Later, SEBI inspected the prospectus and found some misleading statement about

the management of the company in it. SEBI imposed a penalty of ₹ 5 crores and banned its three executive directors for dealing in securities market for three years. Identify the function and its type performed by SEBI in the above case. [SQP 2017]

Ans. Protective function. Prohibition of fraudulent and unfair trade practices.

[CBSE Marking Scheme, 2017] 1

- [U] Q. 3. State any one 'Developmental Function' of Securities and Exchange Board of India (SEBI). [Outside Delhi Set I, III 2012]

Ans. (i) Training of intermediaries.

(ii) Conducting research and publishing information useful to all market participants.

(iii) Developing capital markets. (Any one)

[CBSE Marking Scheme, 2012] 1

Q. 4. State any one 'Protective Function' of Securities and Exchange Board of India (SEBI).

[Outside Delhi Set II 2012]

- Ans. (i) Prohibition of fraudulent and unfair trade practices like asking misleading statements, manipulations, price rigging, etc.
(ii) Controlling insider trading.
(iii) Protecting investors' interest.

Q. 5. State any one 'Regulatory Function' of Securities and Exchange Board of India (SEBI).

[Delhi Set I, II 2012]

Ans. Registration of Collection Investment Schemes and Mutual Funds.

[CBSE Marking Scheme, 2012] 1



Short Answer Type Questions-I

(3 marks each)

Q. 1. Mr. Sanjay Nehra was the Chairman of 'Taran Bank.' The bank was earning good profits. Shareholders were happy as the bank was paying regular dividends. The market price of their shares was also steadily rising. The bank was about to announce taking over of 'Vena Bank.' Mr. Sanjay Nehra knew that the share price of 'Taran Bank' would rise on this announcement. Being a part of the bank, he was not allowed to buy shares of the bank. He called one of his rich friends Sudhir and asked him to invest ₹5 crores in the shares of his bank promising him the capital gains. As expected the share prices went up by 40% and the market price of Sudhir's shares was now ₹7 crores. He earned a profit of ₹2 crores. He gave ₹1 crore to Mr. Sanjay Nehra and kept ₹1 crore with himself. On regular inspection and by conducting enquiries of the brokers involved, Securities and Exchange Board of India (SEBI) was able to detect this irregularity. The SEBI imposed a heavy penalty on Mr. Sanjay Nehra. By quoting the lines from the above paragraph, identify and state any two functions that were performed by SEBI in the above case.

[Delhi Set I 2016]

OR

Mr. Vikas Mehra was the Chairman of 'IBM Bank.' The Bank was earning good profits. Shareholders were happy as the bank was paying regular dividends. The market price of their shares was also steadily rising. The bank was about to announce the taking over of 'UK Bank.' Mr. Vikas Mehra knew that the share price of 'IBM Bank' would rise on this announcement. Being a part of the Bank, he was not allowed to buy shares of the bank. He called one of his rich friends Mukand and asked him to invest ₹4 crores in shares of his bank promising him the capital gains. As expected after the announcement, the share prices went up by 50% and the market price of Mukand's shares was now ₹6 crores. Mukand earned a profit of ₹2 crores. He gave ₹1 crore to Vikas Mehra and kept ₹1 crores with him. On regular inspection and by conducting enquiries of the brokers involved, Securities and Exchange Board of India (SEBI) was able to detect this irregularity. SEBI imposed a heavy

penalty on Vikas Mehra. Quoting the lines from the above paragraph, identify and state any two functions performed by SEBI in the above case.

[Outside Delhi Set I 2016]

OR

Mr. Aditya Gupta was the chairman of 'Vandan Bank'. The Bank was earning good profits. Shareholders were happy as the bank was paying regular dividends. The market price of their shares was also steadily rising. The bank announced taking over of 'Karur Bank'. Aditya Gupta knew that the share price of Vandan Bank would rise on this announcement. Being a part of the bank, he was not allowed to buy shares of the bank. He called one of his rich friends Nimesh and asked him to invest ₹6 crores in the shares of his bank promising him the capital gain. As expected, the share prices went up by 40% and the market price of Nimesh's shares was now ₹8.4 crores. He had earned a profit of ₹2.4 crores. He gave ₹1.2 crores to Mr. Aditya Gupta and kept ₹1.2 crores with him. On regular inspection and by conducting enquiries of the brokers involved, Securities and Exchange Board of India (SEBI) was able to detect this irregularity. SEBI imposed a heavy penalty on Aditya Gupta. By quoting the lines from the above paragraph, identify and state any two functions that were performed by SEBI in the above case.

[Foreign Set-I, 2016]

Ans. Lines from the Paragraph :

- (i) "He called one of his rich friends Sudhir and asked him to invest ₹ 5 crores in shares of his bank."
(ii) "On regular inspection and by conducting enquiries of the brokers involved, SEBI was able to detect this irregularity".

Functions that were performed by SEBI in the above case were :

- (a) **Regulatory function** : 'On regular inspection and by conducting enquiries of the brokers involved, Securities and Exchange Board of India (SEBI) was able to detect this irregularity.' SEBI can call

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

- (b) **Protective function** : 'The SEBI imposed a heavy penalty on Vikas Mehra. SEBI controls insider trading and imposes penalties for such practices.

$$1\frac{1}{2} \times 2 = 3$$

[CBSE Marking Scheme, 2016]

- Q. 2. Keeping in mind the emerging nature of the securities market in India, Securities and Exchange Board of India (SEBI) was entrusted with the twin task of regulation and development of securities market. Out of this, state the developmental functions of Securities and Exchange Board of India (SEBI).

[Outside Delhi Comptt. Set I 2015]

Ans. Developmental Functions of SEBI :

- (i) It trains intermediaries of the securities market.
- (ii) It conducts research and publishes information useful to all the market participants.
- (iii) It undertakes measures to develop the capital markets by adopting a flexible approach.

[CBSE Marking Scheme, 2015] $1 \times 3 = 3$

- Q. 3. Supriya's grandmother, who was unwell, called her and gave her a gift packet. Supriya opened the packet and saw many crumpled share certificates inside. Her grandmother told her that they had been left behind by her late grandfather. As no trading is now done in physical form, Supriya wants to know the process by adopting which she is in a position to deal with these certificates.

- (i) Identify and state the process.
- (ii) Also give two reasons to Supriya why dealing with shares in physical form had been stopped.

[SQP 2015]

Ans. (i) **De-materialisation** : It is a process where securities held by the investor in physical form are cancelled and the investor gives an electronic entry or number so that she/he can hold it as an electronic balance in an account.

- (ii) **Problems with dealing in physical form** :

- (a) Theft.
- (b) Fake/forged transfers.
- (c) Transfer delays.
- (d) Paperwork associated with share certificates or debentures held in the physical form.

(Any two)

$$2 + \frac{1}{2} + \frac{1}{2} = 3$$

[CBSE Marking Scheme, 2015]

- Q. 4. State any three Developmental Functions of SEBI. [Outside Delhi Set I, II, III 2013]

Ans. Developmental functions of SEBI are as follows :

- (i) **Training** : Training of intermediaries of securities markets for their professional growth.
- (ii) **Developing Capital Markets** : Undertaking measures to develop the capital markets by adopting a flexible approach.
- (iii) **Conducting Research** : SEBI encourages research for improving the functioning of capital market, for streamlining the activities of stock exchange, for developing and strengthening the capital markets, etc.

[CBSE Marking Scheme, 2013] $1 \times 3 = 3$

- Q. 5. State any three Protective Functions of SEBI? [Outside Delhi Set II 2013]

Ans. Three protective functions of SEBI are as follows:

- (i) Prohibition of fraudulent and unfair trade practices like making misleading statements, price rigging, etc.
- (ii) Controlling insider trading and imposing penalties for such practices.
- (iii) Undertaking steps for investors' protection like registration of brokers, audit of stock exchanges, registration of mutual funds, etc.

$1 \times 3 = 3$

- Q. 6. Explain any three objectives of Securities and Exchange Board of India.

[Delhi Comptt. Set I 2011]

Ans. Refer to Q. 1 of Long Answer Type Questions.

(Any three) $1 \times 3 = 3$



Short Answer Type Question-II

(4 marks)

- Q. 1. These days, the development of a country is also judged by its system of transferring finance from the sector where it is in surplus to the sector where it is needed the most. To give strength to the economy, SEBI is undertaking measures to develop the capital market. In addition to this, there is another market in which unsecured and short-term debt instruments are actively traded every day. These markets together help the savers and investors in directing the available funds into their most productive investment opportunity.

- (i) Name the function being performed by the market in the above case.
- (ii) Name the market segment other than the capital market segment in which unsecured and short-term debt instruments are traded. Also, give any three points of difference between the two.

[Delhi Set I, II, III 2017], [Outside Delhi Set I, II, III 2017]

Ans. (i) Mobilisation of savings and channeling them into the most productive uses/ Allocative function.

(ii) Money market

Difference between Capital Market and Money Market :

| S. No. | Basis | Capital Market | Money Market |
|--------|--------------------------|---|--|
| (i) | Participants | The participants are financial institutions, banks, corporates, foreign investors and retail investors. | The participants are RBI, financial institutions, banks and corporates. |
| (ii) | Instruments | Instruments traded are shares, debentures and bonds. | Instruments traded are treasury bill, commercial paper, certificates of deposit, call money and commercial bill. |
| (iii) | Investment outlay | Investment outlay is small. | Investment outlay is large. |
| (iv) | Duration | It deals in medium term and long term securities. | It deals in short term securities |
| (v) | Liquidity | Capital market securities are comparatively less liquid. | Money market securities are comparatively more liquid. |
| (vi) | Expected return | The investment in capital markets generally yields a higher return. | The expected rate of return of the money market is less. |
| (vii) | Security/Safety | Capital market instruments are risky with respect to returns and principal repayment. | Money market instruments are generally much safer with a minimum risk of default. |
| (viii) | Meaning | It refers to the facilities and institutional arrangements through which funds, both debt and equity are invested and raised. | It is the market where low risk, unsecured, highly liquid short term debt instruments are issued and traded. |
| (ix) | Location | There is no fixed geographical area. All the institutions, banks, foreign investors, etc. constitute primary market. | There is a fixed geographical area and working hours. |

(Any three) [CBSE Marking Scheme, 2017] 4



Long Answer Type Questions

(5 marks each)

- Q. 1.** “To promote orderly and healthy growth of the securities market and protection of the investors, Securities and Exchange Board of India was set up.” With reference to this statement, explain the objectives of Securities and Exchange Board of India.

[Outside Delhi Set II 2011]

Ans. Objectives of SEBI are :

- To regulate stock exchanges and the securities industry to promote their orderly functioning.
- To protect the rights and interests of the investors, particularly individual investors and to guide and educate them.
- To prevent trading malpractices and achieve a balance between self-regulation and 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.

- (v)** To provide a market place in which the issuers can raise finances in an easy, fair and efficient manner.

[CBSE Marking Scheme, 2011] $1 \times 5 = 5$

- Q. 2.** What does the abbreviation ‘SEBI’ stand for? Explain the term Sensex. How many shares are included in the Sensex? [SQP 2011]

Ans. SEBI : Securities and Exchange Board of India.
Sensex : Sensex stands for Sensitivity Index. Sensex is the benchmark index of BSE. It is a useful guide for investors in the stock market. If the Sensex rises, it indicates that the market is doing well and investors become optimistic of the future performance of the economy. Sensex includes shares of thirty companies, most actively traded in. $2 + 2 + 1 = 5$

- Q. 3.** State any five regulatory functions of Securities and Exchange Board of India.

[Delhi Set I, II, Outside Delhi 2010]

Ans. Regulatory functions of Securities and Exchange Board of India are :

- (i) It registers brokers and sub-brokers and other players in the market.
- (ii) It registers collective investment schemes and mutual funds.
- (iii) It regulates stock brokers, portfolio exchanges, underwriters and merchant bankers.
- (iv) It regulates takeover bids by the companies.

- (v) It calls for information by undertaking inspection, conducting enquiries and audit of stock exchanges and intermediaries.
- (vi) It levies fee or other charges for carrying out the purposes of the SEBI Act, 1992.
- (vii) It performs and exercises such powers under Securities Contract (Regulation) Act, 1956 as may be delegated by the Government of India.

(Any five)

[CBSE Marking Scheme, 2010] 5



High Order Thinking Skills (HOTS) Questions

Q. 1. "Financial market performs an allocative function." How?

Ans. Financial markets channelise savings of the investors and make them available for the needs of the industry, hence they are said to perform the allocative function. 1

Q. 2. Certain instruments of money market are short-term, self-liquidating and used to finance credit sales. Name the instrument.

Ans. Commercial Paper. 1

Q. 3. Name the financial instrument issued by RBI on behalf of the central government.

Ans. Treasury bill. 1

Q. 4. Volvo Ltd. is proposing to issue capital through on-line system of stock exchange and has entered into an agreement with the Stock Exchange. What would this type of issue be called?

Ans. e-IPO (Electronic-Initial Public Offer) 1

Q. 5. A method (floating new issues) does not deal directly with public but operates through intermediaries like issuing houses and brokers. Name the Method.

Ans. Offer for sale. 1

Q. 6. How are the prices determined in stock exchange?

Ans. Prices are determined at the intersection point of demand and supply forces of securities. 1

Q. 7. State briefly, how SEBI acts as a watchdog of investors' interest.

Ans. By providing adequate and authentic information on a regular basis and regulating the activities of stock exchanges and brokers. 1

Q. 8. Name two depositories providing depository services in capital market.

Ans. (i) National Securities Depository Limited (NSDL).
(ii) Central Depository Services Limited (CDSL). 1

Q. 9. Name the process used to convert physical shares into electronic form.

Ans. De-materialisation. 1

Q. 10. What do you mean by insider trading? Explain with example.

Ans. When an insider of a company *i.e.*, Director, Promoter, or any person connected with the company has reasonable information, which is not available to the general public and deals in securities of the company *i.e.*, sale or purchase of securities with the intention of earning high profits, it is known as insider trading. For the

protection of investors, SEBI has issued directions for the prohibition of insider trading.

Example : Mr. X, one of the directors of PQR Ltd. knew that bonus shares were to be announced in the next meeting and he expected the price to rise. He bought 10,000 shares. By the end of next month the price increased by ₹ 9. He sold these shares and made a profit of ₹ 90,000. Thus, Mr. X gains because of his being an insider. This is known as insider trading. 2 + 2 = 4

Q. 11. Mr. Navin, Director of PQR Ltd., desires to modernise its factory by making a public issue of shares. He wishes to approach stock exchange, while his financial Advisor, Mr. Harish prefers to approach JMD Consultants for the new public issue of shares.

Please advise Mr. Navin whether to approach stock exchange or a consultant for new public issue of shares and why? Also, advice about any two methods which the company may adopt for new public issue of shares.

Ans. Mr. Navin should approach the consultant for the new public issue of shares because stock exchange deals in existing securities only. Hence, it is not worthwhile to approach any stock exchange. Following are the methods for the new public issue of shares :

(i) **Issuing Prospectus**

- (a) In this method, company issues a prospectus containing details regarding its future plans, purpose for raising funds, past performance, details regarding promoters, etc.
- (b) Prospectus is provided to help the potential investors understand and evaluate the earning potential and risk element in the proposed investment.

(ii) **Private Placement**

- (a) Here, the securities are allotted by a company to some select groups of persons. This method helps in raising capital more quickly than a public issue.
- (b) This is done by small or new companies to avoid the cost on account of public issue.
- (c) It is worth mentioning here that in the case of 'private placement', there is no need to issue formal prospectus and the terms of the issue can be negotiated between the company and the potential investors. 2 + 2 + 2 = 6

Know the Terms

- **Financial Market** : It is a market for the creation and exchange of financial assets. It brings lenders and borrowers together, making available funds to those who wish to pay for their use.
- **Money Market** : Market for short-term funds and securities having maturity upto one year.
- **Capital Market** : It refers to whole network of organisations, institutions through which medium and long-term funds; both debt and equity, are raised and invested.
- **Stock Exchange** : It is an institution which provides a platform for buying and selling of existing securities.
- **Depository** : It is an organisation which holds securities in electronic form at the request of investors through registered depository participant. Two main depositories in India are NSDL and CDSL.
- **Price Rigging** : Manipulating market prices of securities.
- **Insider Trading** : Insiders use the privileged information to make personal profits.
- **Bull** : A speculator who expects a rise in the prices.
- **Bear** : A speculator who expects a fall in the prices.
- **Sensex** : Benchmark index of BSE.
- **Nifty** : Benchmark index of NSE.
- **NASDAQ** : National Stock Exchange of New York.

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