Chapter 4
Introduction to Financial Markets

I. Choose the Correct Answer

Question 1.
Financial market facilitates business firms.
(a) To rise funds
(b) To recruit workers
(c) To make more sales
(d) To minimize fund requirement
Answer:
(a) To rise funds

Question 2.
Capital market is a market for
(a) Short Term Finance
(b) Long Term Finance
(c) Long term Finance
(d) Both Short Term and Medium Term Finance
Answer:
(c) Long term Finance

Question 3.
Primary market is also called as ________
(a) Secondary market
(b) Money market
(c) New Issue Market
(d) Indirect Market
Answer:
(c) New Issue Market

Question 4.
Spot Market is a market where the delivery of the financial instrument and payment of Cash occurs ________
(a) Immediately
(b) In the future
(c) Uncertain
(d) After one month
Answer:
(a) Immediately

Question 5.
How many times a security can be sold in a secondary market?
(a) Only one time
(b) Two time
(c) Three times
(d) Multiple times
Answer:
(d) Multiple times

II. Very Short Answer Questions

Question 1.
What are the components of organized sectors?
Answer:

1. Regulators
2. Financial Institutions
3. Financial Markets.
4. Financial Services

Question 2.
Write a note on financial market.
Answer:
A financial market is an institution or arrangement that facilitates the exchange of financial instruments such as equity shares, preference shares, debentures, deposits and loans, corporate stocks and bonds, government bonds, and more exotic instruments such as options and futures contracts.

Question 3.
What is equity market?
Answer:
Equity Market is the financial market for trading in Equity Shares of Companies.

Question 4.
What is debt market?
Answer:
Debt Market is the financial market for trading in Debt Instrument (i.e. Government Bonds or Securities, Corporate Debentures or Bonds).

Question 5.
How is price decided in a secondary market?
Answer:
Financial markets allow for the determination of the price of the traded financial asset

through the interaction of buyers and sellers. They provide a signal for. the allocation of funds in the economy, based on the demand and supply, through the mechanism called price discovery processes.

III. Short Answer Questions

Question 1.
Give the meaning and definition of financial market.
Answer:
Meaning: A market wherein financial instruments such as financial claims, assets and securities are traded is known as a'financial market'.
Definition: According to Brigham, Eugene F, "The place where people and organizations wanting to borrow money are-brought together with those having surplus funds is called a . financial market."

Question 2.
Differentiate spot market from future market.
Answer:
Spot Market:

Spot market is otherwise called cash market. it is a market where the delivery of the financial instrument and payment of cash occurs immediately, i.e. settlement is completed immediately.

Future Market:

Future market is otherwise called forward market. It is a market where the delivery of asset and payment of cash takes place at a predetermined time frame in future.

Question 3.
Write a note on Secondary Market.
Answer:
Secondary Market is the market for securities that are already issued. Stock Exchange is an important institution in the secondary market.

Question 4.
Bring out the scope of financial market in India.
Answer:
The financial market provides financial assistance to individuals, agricultural sectors, industrial sectors, service sectors, financial institutions like banks, insurance sectors, provident funds and the government as a whole. With the help of the financial market all the above stated individuals, institutions and the Government can get their required funds

in time. Through the financial market the institutions get their short term as well as long term financial assistance. It leads to the overall economic development.

IV. Long Answer Questions

Question 1.
Distinguish between new issue market and secondary market
Answer:

Basis For Comparison	New Issue Market	Secondary Market
Meaning	The market place for new shares is called primary market. (Initial Issues Market)	The place where formerly issued securities are traded is known as Secondary Market. (Resale Market)
Buying	Direct	Indirect
Financing	It supplies funds to budding enterprises and also to existing companies for expansion and diversification.	It does not provide funding to companies.
How can securities be sold?	Only once	Multiple times
Buying and Selling between	Company and Investors	Investors
Gained person	Company	Investors
Intermediary	Underwriters	Brokers
Price	Fixed price	Fluctuates, depends on the demand and supply force.
Organizational difference	Not rooted to any specific spot or geographical location.	It has physical existence.

Question 2.

Enumerate the different kinds of financial markets.
Answer:
Financial Markets can be classified in different ways.

(A) On the Basis of Type of Financial Claim

1. Debt Market is the financial market for trading in Debt Instrument (i.e. Government Bonds or Securities, Corporate Debentures or Bonds).
2. Equity Market is the financial market for trading in Equity Shares of Companies.

(B) On the Basis of Maturity of Financial Claim

1. Money Market is the market for short term financial claim (usually one year or less) E.g. Treasury Bills, Commercial Paper, Certificates of Deposit.
2. Capital Market is the market for long term financial claim more than a year E.g. Shares, Debentures.

(C) On the Basis of Time of Issue of Financial Claim

1. Primary Market is a term used to include all the institutions that are involved in the sale of securities for the first time by the issuers (companies). Here the money from investors goes directly to the issuers.
2. Secondary Market is the, market for securities that are already issued. Stock Exchange is an important institution in the secondary market.

(D) On the Basis of Timing of Delivery of Financial Claim

1. Cash/Spot Market is a market where the delivery of the financial instrument and payment of cash occurs immediately, i.e. settlement is completed immediately.
2. Forward or Futures Market is a market where the delivery of asset and payment of cash takes place at a pre-determined time frame in future.

(E) On the Basis of the Organizational Structure of the Financial Market

1. Exchange Traded Market is a centralized organization (stock exchange) with standardized procedures.
2. Over-the-Counter Market is a decentralized market (outside the stock exchange), with customized procedures.

Question 3.

Discuss the role of financial market.
Answer:

1. Savings Mobilization: Obtaining funds from the savers or 'surplus' units such as household individuals, business firms, public sector units, Government is an important role played by financial markets. .
2. Investment: Financial market plays a key role in arranging the investment of funds thus collected, in those units which are in need of the same.
3. National Growth: Financial markets contribute to a nation's growth by ensuring an ' unfettered flow of surplus funds to deficit units. Flow of funds for productive purposes is also made possible. It leads to overall economic growth.
4. Entrepreneurship Growth: Financial markets contribute to the development of the entrepreneurial class by making available the necessary financial resources.
5. Industrial Development: The different components of financial markets help an accelerated growth of industrial and economic development of a country and thus contributing to raising the standard of living and the society's well-being.

Question 4.
What are the functions of Financial Markets?
Answer:
(I) Intermediary Functions:

1. Transfer of Resources: Financial markets facilitate the transfer of real economic resource from lenders to ultimate borrowers.
2. Enhancing Income: Financial markets allow lenders earn interest/dividend on their surplus investible funds and thus contributing to the enhancement of the individual and the national income.
3. Productive Usage: Financial markets allow for the productive use of the funds borrowed and thus enhancing the income and the gross national production.
4. Capital Formation: Financial markets provide a channel through which new savings flow to aid capital formation of a country.
5. Price Determination: Financial markets allow for the determination of the price of, the traded financial asset through the interaction of buyers and sellers.
6. Sale. Mechanism: Financial market provides a mechanism for selling of a financial asset by an investor so as to offer the benefits of marketability and liquidity of such assets.
7. Information: The activities of the participants in the financial market result in the generation and the consequent dissemination of information to the various segments of the markets, so as to reduce the cost of transaction of financial assets.

(II) Financial Functions:

1. Providing the borrowers with funds so as to enable them to carry out their investment plans.
2. Providing the lenders with earning assets so as to enable them to earn wealth by deploying the assets in productive ventures.
3. Providing liquidity in the market so as to facilitate trading of funds.

Question 5.
Discuss the various types of financial markets,
Discuss the various types of financial assets,
Answer:
Financial assets can be classified differently under different circumstances. One such classification is:

1. Marketable assets
2. Non-marketable assets

Marketable Assets: Marketable assets are those which can be easily transferred from one person to another without much hindrance. Example: Shares of Listed Companies, Government Securities, Bonds of Public Sector Undertakings etc.
Non-Marketable Assets: On the other hand, if the assets cannot be transferred easily, they come under this category. Example: Bank Deposits, Provident Funds, Pension Funds, National Savings Certificates, Insurance Policies etc.