Class 12 Business Studies
Notes
CHAPTER – 10
FINANCIAL MARKETS

Introduction

Financial Intermediation = process of allocating funds from saving surplus units (E.g. households) to saving deficit units (e.g. industries, government etc).

• Alternatives = Banks or Financial markets
Financial Markets are the institutional arrangements by which savings generated in the economy are channelised into avenues of investment by industry, business and the government. It is a market for the creation and exchange of financial assets.

Functions of Financial Market

1.Mobilization of savings and channelising them into the most productive uses:

• Facilitates transfer of savings from the savers to the investors.

• Financial markets help people to invest their savings in various financial instruments and earn income and capital appreciation.

• Facilitate mobilization of savings of people and their channelisation into the most productive uses.
2. Facilitate Price Discovery:

• Price of anything depends upon the demand and supply factors.

• Demand and supply of financial assets and securities in financial markets help in deciding the prices of various financial securities; where business firms represent the demand and the households represent the supply.
3. Provide liquidity to financial assets:

• Financial markets provide liquidity to financial instruments by providing a ready market for the sale and purchase of financial assets.

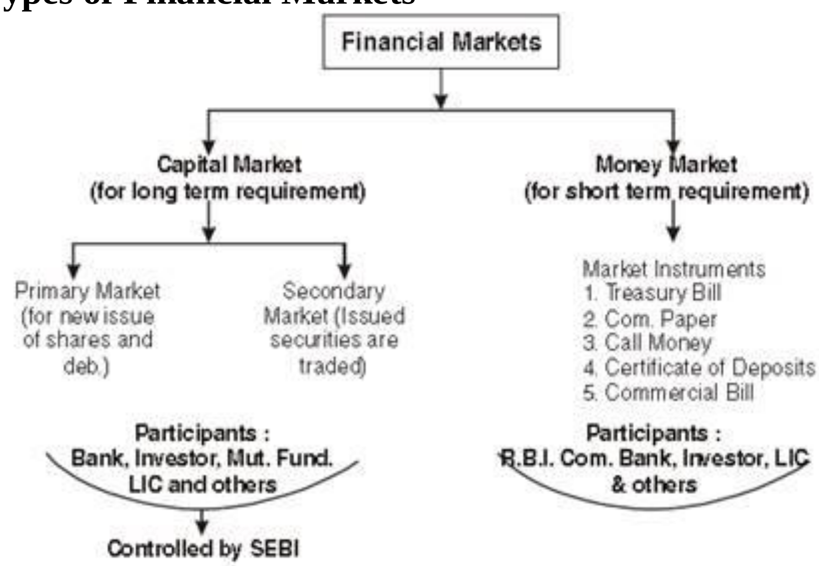
• Whenever the investors want, they can invest their savings into long term investments and whenever they want, they can sell the investments/ instruments and convert them into cash.

4. Reduce the cost of transactions:

• By providing valuable information to buyers and sellers of financial assets, it helps to saves time, effort and money that would have been spent by them to find each other.

• Also investors can buy/sell securities through brokers who charge a nominal commission for their services. This way financial markets facilitate transactions at a very low cost.

Types of Financial Markets



Money Market

Market for financial securities with maturity period of less than one year.

• Mkt for low risk, unsecured and short term debt instruments that are highly liquid are traded everyday.
• No plysical location bye conducted over the telephone and the internet.
• Helps to:

o raise short term funds

o Temporary deployment of funds .

The main instruments of money market are as follows:

l. Treasure Bills: They are issued by the RBI on behalf of the Central Government to meet its short-term requirement of funds. They are issued at a price which is lower than their face value and arc repaid at par. They are available for a minimum amount of Rs.25000 and in multiples thereof. They are also known as Zero Coupon Bonds. They are negotiable instruments i.e. they are freely transferable.

2. Commercial Paper: It is a short term unsecured promissory note issued by large credit worthy companies to raise short term funds at lower rates of interest than market rates. They are negotiable instruments transferable by endorsement and delivery with a fixed maturity period of 15 days to one year.

3. Call Money: It is short term finance repayable on demand, with a maturity period of one day to 15 days, used for interbank transactions. Call Money is a method by which banks borrow from each other to be able to maintain the cash reserve ratio as per RBI. The interest rate paid on call money loans is known as the call rate.

4. Certificate of Deposit: It is an unsecured instrument issued in bearer form by Commercial Banks & Financial Institutions. They can be issued to individuals. Corporations and companies for raising money for a short period ranging from 91 days to one year.

5. Commercial Bill: It is a bill of exchange used to finance the working capital requirements of business firms. A seller of the goods draws the bill on the buyer when goods are sold on credit. When the bill is accepted by the buyer it becomes marketable instrument and is called a trade bill. These bills can be discounted with a bank if the seller needs funds before the bill maturity.

Capital Market

Facilities and institutional arrangements through which long term securities are raised and invested- both debt and equity.
• Nature of Capital Markets:
a. Important component of Financial markets b. Two segments(primary and secondary) c. 2 forms(organized and unorganized) d. long term securities e. Satisfies long term requirements of funds f. Performs trade-off functions g. Creates dispersion in business ownership h. Helps in capital formation i. Creates liquidity

• Features Of Capital Market Instruments:
a. Provide long term funds
b. Lesser outlay required as unit value of instruments is low
c. Duration more than 1 year
d. Liquidity
e. Lower safety
f. Higher expected returns as compared to short term securities

The capital market can be divided into two parts:

1. Primary Market

2. Secondary Market

Primary Market

• New issues markets
• Transfers investible funds from savers to entrepreneurs.
• Funds used for setting up new projects, expansion, diversification, modernization of existing projects, mergers and take overs etc.

Methods of Floatation of New Issues in Primary Market

1. Offer through Prospectus: It 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 newspapers and magazines.

2. Offer for Sale: Under this method, securities are offered for sale through intermediaries like issuing houses or stock brokers. The company sells securities to intermediary/broker at an agreed price and the broker resells them to investors at a higher price.

3. Private Placements: It refers to the process in which securities are allotted to institutional investor and some selected individuals.

4. Rights Issue: It refers to the issue in which new shares are offered to the existing shareholders in proportion to the number of shares they already possess.

5. e-IPOs: It is a method of issuing securities through an on-line system of stock exchange. A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the stock exchange. This is called an e-initial public offer. SEBI's registered brokers have to be appointed for the purpose of accepting applications and placing orders with the company.

Secondary Market

1.Refers to a market where existing securities are bought and sold.

2.The company is not involved in the transaction at all. It is between two investors. **Features of Secondary market are:** 1) Creates liquidity 2) Fixed location 3) Comes after primary market 4) Encourages new investment

Difference between Primary Market and Secondary Market

Basis	Primary Market	Secondary Market
Securities	Only new securities are traded	Existing securities are traded
Price of Securities	Prices of securities are determined by the management of the company.	Prices are determined by the forces by the demand and supply of the securities.
Purchase and Sale	Securities are sold to investors directly by the company or through intermediary.	Investors exchange ownership of securities.
Place of Market	There is no fixed geographical location.	Located at specified places.
Medium	Only buying of securities takes place.	Both buying and selling of securities can take place.

Stock Exchange/Share Market

A Stock Exchange is an institution which provides a platform for buying and selling of existing securities. It facilitates the exchange of a security i.e. share, debenture etc. into money and vice versa. Following are some of the important functions of a Stock Exchange:

a. Gives liquidity and marketability to existing securities
b. Pricing of securities(dd and ss)
c. Safety of transactions(membership = regulated + dealings well defined)
d. Contributes to economic growth (ensures that savings are channelized to most

productive investment avenues)
e. Spreading of equity cult(ensures wider share ownership)
f. Provides scope for speculation (in a restricted and controlled environment)

Trading Procedure on a Stock Exchange

1. Selection of Broker: in order to trade on a Stock Exchange first a broker is selected who should be a member of stock exchange as they can only trade on the stock exchange.

2. Placing the order: After selecting a broker, the investors specify the type and number of securities they want to buy or sell.

3. Executing the order: The broker will buy or sell the securities as per the instructions of the investor.

4. Settlement: Transactions on a stock exchange may be carried out on either cash basis or carry over basis (i.e. badla). The time period for which the transactions are carried forward is referred to as accounts which vary from a fortnight to a month. All transactions made during one account are to be settled by payment for purchases and by delivery of share certificates, which is a proof of ownership of securities by an individual. Earlier trading on a stock exchange took place through a public outcry or auction system which is now replaced by an online screen based electronic trading system. Moreover, to eliminate, the problems of theft, forgery, transfer, delays etc. an electronic book entry from a holding and transferring securities has been introduced, which is called process of de materialisation of securities.

Difference between Capital and Money Market

Basis	Capital Market	Money Market
Participants	Financial Institutions, Banks, Corporate Entities, foreign investors and individuals.	RBI, Banks Institutions and finance companies.
Instruments traded	Equity shares, bonds preferences and debentures, call money etc.	Treasury Bills, Trade Bills commercial paper
Investment Outlay	Does not necessarily require a huge financial outlay.	Entails huge sum of money as the instruments are quite

		expensive.
Duration	Deals in medium and long term securities having a maturity period of one year.	Deals in short term funds having a maturity period upto one year.
Liquidity	Securities are less liquid as money market securities.	Money markets instruments are highly liquid
Expected	High return	Low return
Safety	Capital Market Instruments are riskier both with respect to return and repayment.	Money market instruments are generally much safer with a minimum risk of default.

Depository Services and DEMAT Accounts: Keeping in the mind the difficulties to transfer of shares in physical form, SEBI has developed a new system in which trading in shares is made compulsory in electronic form Depository services system and D-Mat Account are very basis of this system.

Depository Services: Just like a bank keeps money in safe custody for customers, a depository also is like a bank and keeps securities(e.g. shares, debentures, bonds, mutual funds etc.) in electronic form on behalf of the investor. In the depository a securities account can be opened, all shares can be deposited, they can be withdrawn/ sold at any time and instruction to deliver or receive shares on behalf of the investor can be given**.** At present there are two depositories in India: NSDL. (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.). which are known as "Depository Participants". (DPs)

Services provided by Depository

Dematerialisation (usually known as demat) is converting physical certificates to electronic form. Rematerialisation, known as remat, is reverse of demat, i.e getting physical certificates from the electronic securities.

Transfer of securities, change of beneficial ownership.

_ Settlement of trades done on exchange connected to the Depository. Now a days on-line paper-less trading in shares of the company is compulsory in India. Depository services is the name of that mechanism. In this system transfer of ownership in shares take place by means of book entry without the physical delivery of shares. When an investor wants to deal in shares of any company he has to open a Demat account. There

are four players who participate in this system.

1. The Depository: A depository is an institution which holds the shares of an investor in electronic form. There are two depository institutions in India these are NSDL and CDSL.

2. The Depository Participant: He opens the account of Investor and maintains securities records.

3. The Investor: He is a person who wants to deal in shares whose name is recorded

4. The Issuing Company: That organization which issues the securities. This issuing company sends a list of the shareholders to the depositories.

Benefits of Depository Services

- Sale and Purchase of shares and stocks of any company on any stock Exchange.
- Saves time.
- Lower transaction costs
- Ease in trading.
- Transparency in transactions.
- No counterfeiting of security certificate
- Physical presence of investor is not required in stock exchange.
- Risk of mutilation and loss of security certificate is eliminated.

Demat Account

Demat (Dematerialized) account refers to an account which an Indian citizen must open with the depository participant (banks, stockbrokers) to trade in listed securities in electronic form. The securities are held in the electronic form by a depository.

Benefits of Demat Account

1. Reduces paper work.
2. Elimination of problems on transfer of shares such as loss, theft and delay.
3. Exemption of stamp duty when transfer of shares.

4. The concept of odd lot stand abolished.
5. Increase liquidity through speedy settlement.
6. Attract foreign investors and promoting foreign investment.
7. A single demat account can hold investments in both equity and debt instruments.
8. Traders can work from anywhere.
9. Automatic credit into demat account for shares arising out of bonus/split/consolidation % merger.
10. Immediate transfers of securities.
11. Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them.

Opening of Demat Account

A Demat account is opened on the same lines as that of a bank account. Prescribed account opening forms available with the DP, need to be filled in. Standard agreement is to be signed by the client and the DP, which details the rights and obligation of both parties. Along with the form, the client is required to attach photograph, attested copies of residence proof and proof of identity need to be submitted.

Securities and Exchange Board of India (SEBI)

SEBI was established by Government of India on 12 April 1988 as an interim administrative body to promote orderly and healthy growth of securities market and for investor protection. It was given a statutory status on 30 January1992 through an ordinance which was later replaced by an Act of Parliament known as the SEBI Act, 1992. It seeks to protect the interest of investors in new and second hand securities.

Objectives of SEBI

1. To regulate stock exchange and the securities market to promote their orderly functioning.

2. To protect the rights and interests of investors and to guide & educate them.

3. To prevent trade mal practices such as internal trading.

4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc.

Functions of SEBI

1. Protective Functions :a) Prohibit fraudulent & unfair trade practices in secondary market (e.g. Price rigging & misleading statement) .**b)** Prohibit insider trading. **c)** Educate investors Promote fair practice & code of conduct in securities market

2.Development Functions : a) Promotes training of intermediaries of the securities market . b) Investor education c) Promotion of fair practices code of conduct of all SRO‘s. d) Conducting research & publish information useful to all market participants

3. Regulation Functions : a) Registration of brokers and sub brokers & other players in the mkt. b)) Registration of collective investment schemes & mutual funds. c) Regulation of stock bankers & portfolio exchanges & merchant bankers.