Class XII Business Studies

10.1 CONCEPT OF FINANCIAL MARKETS

Business is a part of an economic system that consists of two main sectors–*households* which save funds and *business firms* which invest these funds. Households can buy the shares and debentures offered by a business using financial markets.

A financial market is a market for the creation and exchange of financial assets.

– Creation of financial assets takes place when a company issues new shares and debentures.

– Exchange of financial assets implies purchase and sale of existing shares, debentures and bonds.

A financial market helps to link the savers and the investors by mobilising funds between them. In doing so it performs the 'allocation function'. Allocation function of financial market refers to allocating or directing funds available for investment into most productive investment opportunity. The process by which allocation of funds is done is called ***'financial intermediation'.***

Households *(Savers)* → **Financial Markets** → **Business Firms** *(Investors)*

10.1.1 Functions of Financial Markets

Financial markets perform the following functions :

1. **Mobilisation of Savings and Channeling them into the Most Productive Uses :** A financial market facilitates the transfer of savings from savers to investors. A financial market acts as a link between the savers and the investors by mobilising funds between them. It offers to savers the different investments options and thus helps to channelise or invest surplus funds into the most productive use.
2. **Facilitate Price Discovery :** Price of anything is determined with the help of the market forces of demand and supply. In the financial market, the households who saves money are suppliers of funds and business firms make demand. The interaction between them helps to establish price for the financial assets (*e.g.*, shares or debentures).
3. **Provide Liquidity to Financial Assets :** Financial market facilitates easy purchase and sale of financial assets. So, it provides liquidity to financial assets as they can be easily converted into cash whenever necessary.
4. **Reduce the Cost of Transactions :** A financial market provides a common platform where buyers and sellers can meet. It provides valuable information about price, cost and availability of securities. It helps in saving time, effort and money of both buyers and sellers of financial assets.

10.2 CLASSIFICATION OF FINANCIAL MARKETS

On the basis of the maturity of financial instruments traded, financial markets are classified into *money market* and *capital market*. Instruments with a maturity of less than one year are traded in the money market. Instruments with longer maturity are traded in the capital market.

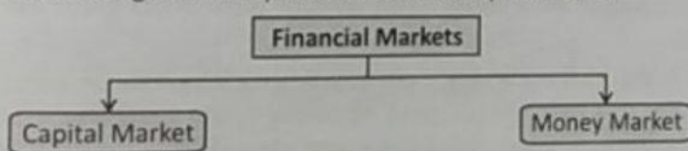

Fig. Classification of Financial Markets

10.2.1 A Meaning of Money Market

Money market is the market for short-term funds which deals in monetary assets whose maturity period is upto one year, *e.g.*, Treasury bills, commercial paper, call money, etc.

10.2.2 Features of Money Market

Following are the features of money market :

(a) In this market, low risk, unsecured and short-term debt instruments are issued and actively traded everyday.
(b) It helps in raising short-term funds for meeting shortages of cash and obligations; and the temporary deployment of excess funds for earning returns.
(c) It has no physical location.
(d) Trade in money market is conducted over the telephone and through internet.
(e) The instruments of money market are highly liquid.
(f) It's major participants are the Reserve Bank of India (RBI), Commercial Banks, Non-Banking Finance Companies, State Governments, etc.

Types of Financial Markets

Basis	Money Market	Capital Market
1) Meaning	It is a market for short term funds Features :- low risk, highly liquid, unsecured, short term debt instruments	It is market which provides arrangement for medium & long term funds
2) Instruments	Treasury bills, Call money, commercial bill etc	shares, debentures, bonds
3) Duration	It deals in monetary assets whose maturity period is upto 1 year	The maturity period of these securities is more than one year
4) Participants	RBI, central & state govt, commercial bank	Stock exchange, financial institution, commercial banks
5) Investment Outlay	Investment requires huge sums of money & these are quite expensive	Investments doesnot require huge funds as value units is generally le[illegible]
6) Liquidity	High degree of liquidity	Less liquid
7) Safety	Much safer, minimum risk of default	riskier both with respect to returns & repayment of p[illegible]
8) Expected Return	Rate of Return is less	yields higher returns for investors

4) Capital formation	flow of funds from savers to investor, directly promotes capital formation	enhances encashability of securities, indirectly promotes capital formation
5) Price determination	Price determined by management of company	Demand & supply of securities
6) Location	No fixed geographical location	specified places.

Methods of Floating New Issue in Primary Market

1) Offer through prospectus / Initial Public offering (IPO)

→ popular method of public companies
→ Invites subscription through issue of prospectus
→ prospectus is direct appeal to investors to raise capital through advertisement

→ Contents of prospectus according to SEBI guidelines
→ must be listed in one of the stock exchange

2) offer for sale

→ not issued directly, but offered for sale through intermediary like brokers, issuing house

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Assignment - 1

Q1. Define Financial Markets.

Q2. Define Capital Market.

Q3. List the types of financial market.

Q4. Define Money market.

Q5. List the functions of financial market.

Q6. List the classification of Capital markets.

Q7. Define Primary market.

Q8. Define Secondary market.

Q9. Differentiate between Money market and Capital market on the basis of

a) participants

b.) Duration

c) instruments

d.) Safety

e) Liquidity

f) Expected return

Q10. How can you differentiate Primary market from Capital market?

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Assignment - 2

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Q1. Define Stock exchange as per SCRA, 1956. (1)

Q2. List the functions of Stock exchange. (3)

Q3. Differentiate between Primary market and Secondary market on the basis of (6)

a) Securities traded
b) buying and selling
c) Capital Formation
d) Price determination
e) Location
f) Company Involvement

Q4. Who issues Commercial paper? (1)

Q5. Who issues Commercial bill? (1)

Q6. Who issues treasury bill? (1)

Q7. Who issues Certificate of deposits? (1)

Q8. Who issues Call money? (1)

Q9. What is the duration of treasury bills (1)

Q10. What is the duration of Call money? (1)

Q11. What is the duration of Commercial papers? (1)

Q12. Give examples of floatation cost. (1)

Q13. Define floatation cost. (1)

Q14. Which instrument is an alternative to bank borrowing in case of large and credit worthy companies? (1)

Q15. What is other name of treasury bill? (1)

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Q1. What is the nature of treasury bill? (1)

Q2. Which ~~three~~ two money market instruments are promissory notes? (1)

Q3. Which money market instrument is bills of exchange? (1)

Q4. In which money market instrument the drawer and drawee exists. (1)

Q5. What is the purpose of issuing treasury bills? (1)

Q6. List the two objectives of issuing Commercial papers. (1)

Q7. What is the purpose of issuing commercial bill? (1)

Q8. When is Certificate of deposits are issued by Commercial banks? (1)

Q9. What is the minimum amount for which the treasury bills can be issued? (1)

Q10. Why is treasury bills called as 'Zero Coupon bond'? (1)

Q11. RBI issues treasury bills on behalf of ________. (1)

Q12. Define bridge financing. (1)

Q13. The interest rate paid on call money is known as ________. (1)

Q14. To whom Certificate of deposits can be issued (three parties) (1)

Q15. The minimum period ____ days and maximum period ~~day~~ for call money. (1)

Q16. Write the full form of SCRA, 1956 (1)