

CLASS 12 BUSINESS STUDIES
CHAPTER-10
FINANCIAL MARKETS

IMPORTANT QUESTIONS

VERY SHORT ANSWER QUESTIONS (1 or 2 Marks)

QUESTION 1.

Mecca Ltd. a reputed automobile manufacturer needs Rupees ten crores as additional capital to expand its business. Atul Jalan, the CEO of the company wanted to raise funds through equity. On the other hand the Finance Manager, Nimi Sahdev said that the public issue may be expensive on account of various mandatory and non- mandatory expenses. Therefore, it was decided to allot the securities to institutional investors. Name the method through which the company decided to raise additional capital.

Answer. The method of raising the additional capital is 'Private Placement'.

QUESTION 2.

An investor wanted to invest `20,000 in Treasury Bills for a period of 91days. When he approached the Reserve Bank of India for this purpose he came to know that it was not possible.

Identify the reason why the investor could not invest in the Treasury Bill.

Answer

The investor could not invest in the Treasury Bill as treasury bills can be bought for a minimum amount of Rs 25,000 and in multiples thereof.

QUESTION 3.

1. Name the kind of issue in which shares are offered to existing shareholder.

Answer. Right Issue.



QUESTION 4.

Give example of any two financial intermediaries.

Answer.

a) Banks. b) Financial markets.

QUESTION 5.

Give examples of any two money market instruments.

Answer. a) Commercial Paper. B) Treasury bills.

QUESTION 6.

Sika Ltd., a reputed industrial machines manufacturer, needs Rupees twenty crores as additional capital to expand the business. Mr. Amit Joshi, the Chief Executive Officer (CEO) of the company wants to raise funds through equity. The Finance Manager, Mr. Narinder Singh, suggested that the shares may be sold to investing public through intermediaries, as the same will be less expensive.

Name the method through which the company decided to raise additional capital.

(CBSE BOARD 2017)

Answer. The method through which the company decided to raise additional capital is 'Offer for Sale'.

SHORT ANSWER QUESTIONS (3 or 4 Marks)

QUESTION 7.

The Return on Investment (ROI) of a company ranges between 10-12% for the past three years. To finance its future fixed capital needs, it has the following options for borrowing debt:

Option 'A' : Rate of interest 9%

Option 'B' : Rate of interest 13%

Which source of debt, 'Option A' or 'Option B', is better? Give reasons in support of your answer. Also state the concept being used in taking the decision.

(CBSE BOARD 2018)



Answer:

Option A is better than Option B for the company to finance its future fixed capital needs. Reason: In Option A, Rate of return on investment (10–12%) > Rate of interest on borrowings (9%)

Concept used: Trading on equity

QUESTION 8.

The director of a newly established company having paid up equity share capital of 25 crores desires to get its shares traded at all India Level Stock exchange. As finance Manager of the company, Suggest the name of stock exchange for the purpose. Give any 3 reasons in support of your answer.

Answer. The company should get its share listed at OTCEI. The main features of OTCEI are the following-

- 1) Nation-wide listing, Listing on one exchange one can have transactions with all the counters in the whole country.
 - 2) Exclusive list of companies, on the OTCEI only those companies are listed whose issued capital is 30 Lakh or more.
 - 3) Investor's registration- All the investor doing transactions on the OTCEI have got to register themselves compulsorily.
 - 4) Transparency in transactions- All the transactions are done in the presence of the investor. The rates of buying and selling can be seen on the computer screen.
-

QUESTION 9.

State the protective functions of Securities and Exchange Board of India.

Answer

Protective functions of Securities and Exchange Board of India:

- i. One of the major objectives of SEBI is to check **malpractices such as insider trading**, violation of rules and non-adherence to the Companies Act.
- ii. SEBI provides **investors with information** about companies as required by them.



iii. SEBI provides **guidelines related to investment in securities**. In this way, it enables investors to take well-informed decisions.

iv. SEBI provides a **code of conduct** for the trade practices of various intermediaries such as brokers and merchant bankers. It keeps a check on the activities of these intermediaries and provides them a competitive environment.

QUESTION 10.

'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.

(CBSE BOARD 2015)

Answer. Functions of Stock Exchange are:

- (a) It provides liquidity and marketability to existing securities.
 - (b) It determines the price of securities by the forces of demand and supply.
 - (c) It ensures safety of transactions as the transactions carried out within an existing legal framework.
 - (d) It contributes to economic growth as it indirectly promotes capital formation.
 - (e) It provides scope for speculation within the provisions of law.
-

QUESTION 11.

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 Rs 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 Rs 8.4 crores. He had earned a profit of Rs 2.4 crores. He gave Rs 1.2 crore to Mr. Aditya Gupta and kept Rs 1.2 crore with him. On regular inspection and by conducting enquires 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 para identify and state any two functions that were performed by SEBI in the above case.
(CBSE BOARD 2016)

Answer. The two functions performed by SEBI in the given case are 'Regulatory Functions' and 'Protective Functions'.

The lines from the paragraph which indicate the functions performed are as follows.

Regulatory Functions: 'On regular inspection and by conducting enquires of the brokers involved'

Protective Functions: 'SEBI imposed a heavy penalty on Aditya Gupta'

QUESTION 12.

State any four functions of financial market.

(CBSE BOARD 2016)

Answer. A financial market refers to the market where the creation and exchange of financial assets such as shares and debentures takes place. The following are the functions of a financial market.

i) Transfer of Savings and Alternatives for Investment: A financial market acts a link between the savers and the investors. It provides a platform for the transfer of savings from the households to the investors. It also provides savers various alternatives for investment and thereby, directs the extra funds to the most productive investments.

ii) Establishes the Price: Similar to a commodity, the price of a financial asset is established through the forces of demand and supply for funds. Financial market provides a platform for the interaction of the demand of the funds (represented by the business firms) and the supply of funds (represented by the households). Thereby, it helps in determining the price of the asset being traded.

iii) Facilitates Liquidity: An asset or a security can be easily purchased and sold in a financial market. This renders liquidity to the assets. That is, through trading in the financial market assets can be easily converted into cash or cash equivalents.

iv) Reduced Cost of Transaction: By rendering information regarding the securities being traded, their price, availability, etc., a financial market helps in reducing the cost of transaction in terms of effort, money and time.



QUESTION 13.

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 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 everyday. These markets together help the savers and investors in directing the available funds into their most productive investment opportunity.

(a) Name the function being performed by the market in the above case.

(b) Also, explain briefly three other functions performed by this market.

(CBSE BOARD 2017)

Answer. (a) Allocative function

(b) Functions performed by Financial Markets

(i) Establishes the price- It provides a platform for the interaction of the demand and the supply of funds, thereby helping in determining the price of the asset being traded.

(ii) Facilitates liquidity- It renders liquidity to the assets by trading (sale and purchase of assets) in the financial market, the assets can easily be converted into cash or cash equivalents.

(iii) Reduces the cost of transaction- It provides useful information about the various securities that are traded. In this way, it helps in reducing the cost of transaction in terms of time, effort and money for both the buyers and sellers.

QUESTION 14.

State any four functions of 'Secondary - Market'.

(CBSE BOARD 2016)

Answer. The four functions of secondary market are enlisted below.

1. One of the basic functions of secondary market is to provide **liquidity and marketability** to the already existing financial assets and securities. It provides a ready platform for the trading of existing securities.

2. It enables a constant valuation of the securities and helps in building the demand and supply. In this way, it helps in determining the price of the securities.

3. It ensures safety and fairness in transactions.



4. It provides a platform for channelizing the savings to the most productive use. In this way, it facilitates growth and development of the economy.

QUESTION 15.

State any four functions of 'Stock Exchange.'

Answer. Stock Exchange refers to a market where buying and selling of the existing securities take place. The following are the main functions of a stock exchange.

(i) Provides Liquidity and Marketability: Stock exchange provides a ready platform for trading of existing securities. In other words, it provides a continuous market for the sale and purchase of securities. Through stock exchange, securities can be easily converted into cash whenever required. In addition, long-term securities can be converted into medium-term and short-term through stock exchange.

(ii) Determination of Prices: A stock exchange helps in establishing the price of the monetary assets that are traded in the market. It provides a platform for interaction for buyers and sellers of securities and thereby, helps in the determination of prices of the securities through the forces of demand and supply.

(iii) Facilitates Economic Growth: In a Stock Exchange the securities are continuously brought and sold. This continuous process of disinvestment and reinvestment helps in channelising the savings and the investments for the most productive use. This also enhances capital formation and economic growth.

(iv) Scope for Speculation: It is generally believed that certain degree of speculation is necessary for better liquidity and to maintain demand and supply of securities. Stock exchange provides a reasonable and controlled scope of speculation within the provisions of law.

QUESTION 16.

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 everyday. These markets together help the savers and investors in directing the available funds into their most productive investment opportunity.

(a) Name the function being performed by the market in the above case.



(b) 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.

Answer. a. The function being performed by the market is the Allocative function.

b. The market segment other than the capital market segment in which unsecured and short-term debt instruments are traded is called the Money Market. The three points of difference between the two are as follows:

Basis of Difference	Capital Market	Money Market
Time Span of Securities	Capital Market mainly deals in the trading of medium and long-term securities where in, the maturity period is more than one year.	Money Market deals in the trading of short-term securities wherein, the maturity period can vary from one day to a maximum of one year.
Liquidity	Capital market securities are liquid in nature as they are tradable on stock exchanges, but are less liquid in comparison to the money market securities.	The securities traded are highly liquid in nature.
Returns Expected	Expected returns are higher due to the possibility of capital gains in long-term and regular dividends or bonus.	Expected returns are lower due to shorter duration.
Instruments	Instruments traded in capital market comprise of equity shares, preference shares, debentures, bonds and other long term securities.	Instruments traded in money market comprise of treasury bills, commercial bills, certificate of deposits and other short-term securities.

LONG ANSWER TYPE QUESTIONS (5 OR 6 MARKS)

QUESTION 17.

**Distinguish between money market and capital market on the basis of: (a) Participants
(b) Instruments (c) Safety and (d) Expected return**



Answer. Difference between Capital Market and Money Market:

Basis	Money Market	Capital Market
1. Participants	The participants are RBI, financial institutions , banks, corporate.	The participants are financial institutions, banks, corporate, foreign investors and retail investors.
2. Instruments	Instruments traded are treasury bills, commercial paper, certificates of deposit, call money and commercial bill.	Instruments traded are shares, debentures and bonds.
3. Safety	Money market securities are comparatively safer.	Capital market securities are riskier than money market instruments.
4. Expected return	Money market securities yield comparatively less returns.	Generally yield a higher return than money market instruments.

QUESTION 18.

The director of a company wants to modernize its plants and machinery by making a public issue of Shares. They wish to approach stock exchange, while the finance manager prefers to approach a consultant for the new public issue of shares. Advise the directors whether to approach stock exchange or a consultant for new public issue of shares and why? Also advise about the different methods which the company may adopt for the new public issue of shares.

Answer: The directors should approach the consultant for the new public issue of shares as the company wish to make new public issue of shares to modernize its plants and machinery.

Following are the methods, which the company may adopt for the new public issue of shares:

i) Right Issue: Since it appears from the question that the company is an existing company, as it wants to modernize its plant and machinery, the company by statute is required to offer these shares first to the existing shareholders in proportion to their holdings. If the existing shareholders do not take these shares then company can resort to other methods as given below.

ii) Public Offer through Prospectus: Under this method, the company can directly offer its shares to the public at large after issuing prospectus.

iii) Offer for sale: In this case, an intermediary buys all the shares from the company at agreed price and offers it to the investors at a higher rate.

iv) Private Placement: in this case, also an intermediary buys the shares from the company but offers it to only a selected few for sale.

QUESTION 19.

Explain the objectives and functions of the SEBI.

Answer:

The Securities and Exchange Board of India was established in 1988 in order to encourage an orderly and healthy growth of the securities market. SEBI was set with an overall objective of investor protection and to promote the development and regulation of the functions of the securities market.

Objectives of SEBI:

The overall objective of SEBI is to protect the interests of investors and to promote the development of, and regulate the securities market. This may be elaborated as follows:

1. To regulate stock exchanges and the securities industry to promote their orderly functioning.
2. To protect the rights and interests of investors, particularly individual investors and to guide and educate them.
3. To prevent trading malpractices and to achieve a balance between self-regulation by the securities industry and its statutory regulation.
4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc., with a view of making them competitive and professional.

Functions of SEBI:

Keeping in mind the emerging nature of the securities market in India, SEBI was entrusted with the twin task of both regulation and development of the securities market.

Regulatory Functions:

1. Registration of brokers and sub brokers and other players in the market.
2. Registration of collective investment schemes and Mutual Funds.



3. Regulation of Stock Bankers and portfolio exchanges, and merchant bankers.
4. Prohibition of fraudulent and unfair trade practices.
5. Controlling insider trading and takeover bids and imposing penalties for such practices.
6. Calling for information by undertaking inspection, conducting enquiries and audits of stock exchanges and intermediaries.
7. Levying fee or other charges for carrying out the purposes of the Act.
8. Performing and exercising such power under Securities Contracts (Regulation) Act 1956, as may be delegated by the Government of India.

Development Functions:

1. Investor education
 2. Training of intermediaries
 3. Promotion of fair practices and code of conduct of all SRO's.
 4. Conducting research and publishing information useful to all market participants.
-

QUESTION 20.

What is a Treasury Bill?

Answer:

Treasury Bill is a short term promissory note issued by the Reserve Bank of India on behalf of the Central Government of India. They are issued to fulfil the short-term fund requirements of the Government of India. Maturity period of Treasury Bills ranges from 14 days to 364 days. Generally, these bills are brought by commercial banks, LIC, UTI, non-banking financial companies, etc. They are also called Zero-Coupon Bonds.

Treasury bills are highly liquid instruments because of the fact that the RBI is always ready to purchase these bills. Moreover, they are also considered to be the safest instrument as they are issued by the RBI. They are available for a minimum amount of Rs 25,000 and in multiples thereof. Treasury Bills are issued at a discount i.e. they are issued at a price which is lower than the face value and are redeemed at par. Herein, the discount (the difference between the price of issue and the redemption value) is the interest received at the time of redemption.

Objective of issuing T-Bills is to fulfill the short-term money borrowing needs of the government. T-bills have an advantage over the other bills such as:

1. Zero Risk weightage associated with them. They are issued by the government and sovereign papers have zero risk assigned to them.
 2. High liquidity because 91 days and 364 days are short term maturity.
 3. Transparency.
 4. The secondary market of T-Bills is very active so they have a higher degree of tradability.
-

