9. Money Market and Capital Market in India

Q. 1. Complete the following statements:

1) Development financial institutions were established to ....

a) provide short term funds.
b) develop industry, agriculture and other key sectors.
c) regulate the money market.
d) regulate the capital market.

2) Money market faces shortage of funds due to ....

a) inadequate savings.
b) growing demand for cash.
c) presence of unorganized sector.
d) financial mismanagement.

3) Individual investors have lost confidence in the capital market due to ....

a) lack of financial instruments.
b) high transaction costs.
c) low returns.
d) financial scams.

4) Commercial banks act as intermediaries in the financial system to ....

a) make profits
b) accelerate the country's economic growth.
c) mobilise the savings and allocating them to various sectors of the economy.
d) control the credit.

Q2. Complete the correlation:

1) Money market: Short term funds:: **Capital market**: Long term funds
2) **The Reserve Bank of India**: Central Bank:: SBI: Commercial Bank
3) Co-operative banks: Organized sector:: Indigenous bankers: **Unorganized sector**
4) Primary market: **New issues**: Secondary market: Old issues

3. Find the odd word:

1) Types of Bank Accounts:

Saving a/c, Demat ale, Recurring a/c, Current a/c
Ans. Demat a/c

2) Unregulated Financial intermediates:
Mutual fund, Nidhi, Chit fund, Loan Companies
Ans. Mutual fund

(3) Financial Assets:
Bonds, Land, Government securities, Derivatives.
Ans: Land

(4) Quantitative Tools: Bank rate, Open market operations, Foreign exchange rate, Variable
reserve ratios.
Ans. Foreign exchange rate.

Q. 4. Assertion and Reasoning:
1) Assertion (A): Money market economizes use of cash
Reasoning (R): Money market deals with financial instruments that are close substitutes of money
Options:
1) (A) is True, but (R) is False
2) (A) is False, but (R) is True
<u>**3) Both (A) and (R) are True and (R) is the correct explanation of (A)**</u>
4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

2) Assertion (A): Regional stock exchanges have witnessed a sharp decline in the volume of trade.
Reasoning (R): Investors prefer to trade in securities listed in premier stock exchanges like BSE, NSE etc.
Options:
1) (A) is True, but (R) is False
2) (A) is False, but (R) is True
<u>**3) Both (A) and (R) are True and (R) is the correct explanation of (A)**</u>
4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

3) Assertion (A): The unorganized sector of the money market lacks transparency.
Reasoning (R): Activities of the unorganized sector are largely confined to rural areas.
Options: 1) (A) is True, but (R) is False
2) (A) is False, but (R) is True
<u>**3) Both (A) and (R) are True and (R) is the correct explanation of (A)**</u>
4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

4) Assertion (A): Foreign exchange management and control is undertaken by commercial banks.

Reasoning (R): RBI has to maintain the official rate of exchange of rupee and ensure its stability.
Options: 1) (A) is True, but (R) is False
2) (A) is False, but (R) is True
3) Both (A) and (R) are True and (R) is the correct explanation of (A)
4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

Q. 5. Identify and explain the concepts from the given illustration:
1) Raghu's father regularly invests his money in stocks and bonds.
Ans. (A) Identified concept: Investment in Stock Market.

(B) Explanation of concept: Stock Market (Exchange) is an important constituent of the capital market which is an association or organization in which stocks, bonds, commodities, etc. are traded.

(2) Sara makes a monthly contribution to a fund jointly created by her friends. The collected fund is then given to a chosen member through lucky draw.
Ans. (A) Identified concept: Chit funds.
(B) Explanation of concept: Chit funds is a constituent of unorganized money market in India in which members make regular contribution to the fund. Bids or draws are made on the basis of a criteria mutually agreed upon by the members. Accordingly, the collected fund is given to the chosen member.

(3) Tina deposited a lump sum amount of 50,000 in the bank for a period of one year.
Ans. (A) Identified concept: Fixed deposit.
(B) Explanation of concept: A fixed deposit is a type of deposit in which the saver deposits a certain amount in the form of a deposit in a commercial bank for a fixed period of time and he can withdraw the amount from the deposit after a specified period.

(4) ABC bank provide demat facility, safe deposit lockers, internet banking facilities to its customers.
Ans: (A) Identified concept: Actually functions of commercial banks.
(B) Explanation of concept: Commercial banks provide many customer services to the customers. The function of providing these services is called ancillary functions of commercial banks.

Q. 6. Distinguish between:
1) Money market and Capital market.
Ans:

Money Market	Capital Market
1. Meaning: A type of financial market in which short-term finance is provided is called the money market.	A type of financial market in which the medium term and long term finance is provided is called the capital market.
2. Constituents: The Reserve Bank of India, commercial banks, co- operative banks, development financial institutions, Discount and Finance House of India, indigenous bankers, money lenders, unregulated non-bank financial intermediaries, etc. are the constituents of money market in India.	Government securities market, Industrial securities market, development financial institutions, financial intermediaries, etc. are the constituents of capital market in India.

(2) Demand Deposits and Time Deposits:
Ans.

Demand Deposits	Time Deposits
1. Meaning: Deposits that are withdrawn on demand are called demand deposits.	Deposits that are withdrawn after a certain period of time are called time deposits.
2. Types: Current deposits and savings deposits are the types of demand deposits.	Recurring deposits and fixed deposits are the types of time deposits.

(3) Organized Sector of Money Market and Unorganized Sector of Money Market
Ans.

Organized Sector of Money Market:	Unorganized Sector of Money Market
1. Meaning: The sector formed by the components of the money market that come under the direct control and supervision of the Reserve Bank of India is the organized sector of the money market.	The sector formed by the components of the money market that are not under the direct control and supervision of the Reserve Bank of India is the unorganized sector of the money market.
2. Rate of Interest: In the organized sector of money market, financing is available to borrowers at relatively low interest rates.	In the unorganized sector of money market, financing is available to borrowers at relatively high interest rates.

Q. 7. Answer the following:
1) Explain the problems faced by the money market in India.

Ans. The problems faced by the money market in India are as follows:
(1) Dual structure: The money market in India has a dual structure, i.e. organized sector of money market and unorganized sector of money market. The organized sector of money market includes the Reserve Bank of India, commercial banks, co-operative banks, development financial institutions, Discount and Finance House of India. etc. The unorganized sector of money market in India includes money lenders, indigenous bankers, unregulated non-bank financing intermediaries, etc. Due to this dual structure of the money market, there is a lack of transparency and stability in the Indian money market. There is a lack of coordination in the unorganized sector of the Indian money market. Also, the unorganized sector of the Indian money market does not come under the direct control and supervision of the Reserve Bank of India.
(2) Lack of uniformity in the rates of interest: The interest rate charged on the debt in the unorganized money market in India is relatively high. In the organized money market of India, there exists a difference in the rate of interest of commercial banks, co-operative banks, non-bank finance companies, development finance institutions, investment companies, etc. This lack of similarity in interest rate adversely affects the efficiency of the money market of India.

(3) Shortage of funds: Due to limited per capita income, lack of banking habits among the general public, over-emphasis on useless consumption expenditure, inadequate banking facilities in rural areas, etc., the savings rate among the people of India is low. Inadequate savings have led to a shortage of funds in the money market of India.

(4) Seasonal fluctuations: In India, during the peak season, i.e. from October to June, there is a huge demand for finance due to various reasons such as trading in agricultural products, investing in agro-based businesses, etc. During the peak season. the demand for finance in the money market is high and the supply is low, leading to an increase in lending rates. Demand for finance is relatively low in the post-harvest period, leading to lower borrowing rates. As a result, the money market of India, especially the unorganized sector, experiences significant fluctuations in seasonal interest rates and lending rates, adversely affecting the efficiency of the money market of India.

(5) Lack of financial inclusion: Banking facilities are not adequately accessible to the economically weaker lower income groups in India. As a result, people in this group do not have adequate savings and loan opportunities. As a result, there is a lack of financial inclusion in the money market of India.

(6) Delays in technological upgradation: It is essential to use the latest technology for the development and smooth functioning of the money market. Due to some delays in the improvement of technology in India, the functioning of the money market in India is hampered.

(2) Explain the functions of commercial banks.
Ans. The functions of commercial banks are as follows:
(**1) Accepting deposits:** Deposits are the main source of funds for commercial banks. Commercial banks accept the following types of deposits:
(A) Demand deposits: Demand deposits are deposits that are withdrawn on demand.
The following are the two types of demand deposits:

(a) Current deposits: Current deposits are generally kept in current account by businessmen, corporations and trusts. The account holder can deposit money in the current deposit account any number of times and withdraw as many times as demanded. Current deposit account holders are also given the facility of overdraft, i.e. facility to withdraw in excess of the balance in the account.

(b) Savings deposits: Savings deposits are held mainly by salaried class and small traders. The account holder can deposit money in the savings deposit account at any number of times and withdraw money as and when required.

(B) Term deposits: Deposits held for a fixed period are called term deposits. The following are the two types of term deposits:

(a) Recurring deposits: Recurring deposits are regularly kept in the recurring deposit account, especially by small savers. Recurring deposits encourage regular savings.

(b) Fixed Deposits: Fixed deposits are kept by the saver for a fixed period. The amount deposited by the saver can be withdrawn after the stipulated period. Interest is paid at the highest rate on fixed deposits.

(2) Providing Loans and advances: Commercial banks use deposits accepted from depositors to lend to needy persons. Commercial banks provide short, medium and long term loans to individuals and institutions for various purposes. The longer the loan period, the higher is the loan rate. Apart from this, commercial banks also offer cash credit, overdraft facility and also discount bills of exchange.

(3) Ancillary functions: Commercial banks provide various facilities like transfer of funds, collection of money, making periodical payments on behalf of the customers, safe deposit lockers, D-mat facility, internet banking facility, mobile banking facility, etc.

(4) Credit creation: Credit creation is an important function of commercial banks. Commercial banks create credit on the basis of primary deposits. Commercial banks use demand and term deposits to lend after meeting the cash reserve requirement. Commercial banks deposit the loan amount in the borrower's account when lending a loan. Thus, loans are made from primary deposits and secondary deposits are made while lending loans. Thus, commercial banks create credit.

3. Explain the role of capital market in India.
Ans. The role of the capital market in India is explained in the following points:

(1) Mobilization of long-term savings: Industrial organizations and the government need a large amount of funds for investment and financial resources. Availability of financial resources are insufficient to meet the demand for these funds. In such a case, the sale of securities by the capital market helps to bring together the long-term savings of different sections of the population.

(2) Provision of equity capital: The capital market provides equity capital to entrepreneurs. Entrepreneurs use the share capital to buy assets for the industry and to fund business operations.

(3) Operational efficiency: Capital market reduces the cost of transactions and simplifies the transaction process. Capital market helps financial transactions to achieve operational efficiency by reducing the time taken to buy and sell stocks.

(4) Quick valuation: Capital market helps to determine the fair and quick value of equities (shares) and debt (bonds and debentures).

(5) Integration: The capital market coordinates by consolidating the real and financial sector, equities and debt instruments, public sector and private sector, domestic and external funds, etc.

4) Explain the problems of the capital market in India.
Ans. The following are the problems of capital market in India:

(1) Financial Scams: Financial scams are on the rise in the Indian capital market. Rising financial scandals have increased the distrust of the general public and as a result, investors' confidence in investing in the capital market has waned. As a result, capital markets face irreparable losses in the form of declining public confidence.

(2) Insider trading and price manipulation: Since some individuals have access to confidential information of companies. Such individuals, for personal gains, buy and sell securities on the basis of the unpublished confidential information of companies. Some individuals deliberately raise or lower the price of shares by buying and selling shares of certain companies for personal gain. Such illegal transactions are adversely affecting the smooth functioning of the capital market of India.

(3) Inadequate debt instruments: In the capital market of India, debt instruments include bonds, debentures, etc. Due to narrow investor base, high cost of issuance, restrictions on entry of small and medium enterprises into the capital market, etc., there is relatively few trading in debt securities.

(4) Decline in the volume of trade: Capital market investors can trade online. As a result, capital market investors in various parts of the country prefer to invest in securities listed in premier stock exchanges like in the Bombay Stock Exchange and in the National Stock Exchange. As a result, there has been a sharp decline in trade in regional stock exchanges in India.

(5) Lack of information efficiency: If the company's current stock price incorporates all the information about the company, then a market is said to be informationally efficient. However, the efficiency of information in the Indian stock market is relatively low compared to other developed countries. As a result, investors do not get the expected return on investment and thus lose faith in the capital market.

Q. 8. Answer in detail:
1) Explain the role of money market in India.
Ans: The role of money market in India can be explained with the help of the following points:

(1) Meeting the short term requirements of the borrower: Due to the money market, the short term financial needs of the borrower are met at realistic interest rates.

(2) Liquidity management: Money market facilitates better management of liquidity and money in the economy by the monetary authorities. As a result, the country enjoys economic stability and economic development.

(3) Portfolio management: Money market deals with different types of financial instruments that are designed to suit the risk and return preferences of investors. This enables the investors to manage portfolio to minimize the risks and to maximise the returns.

(4) Equilibrating mechanism: Money market leads to rational allocation of financial resources. The money market accelerates savings in the investment stream. The money market helps to strike a balance between the demand for and the supply of short-term funds.

(5) Meeting the financial requirements of the government: Money market helps the government to fulfil its short term financial needs on the basis of the Treasury Bills.

(6) Implementation of monetary policy: The main objective of monetary policy is to manage the quantity of money in the economy. In India, monetary policy is implemented by the the Reserve Bank of India. Monetary policy makes it possible to meet the economic needs of different sectors of the economy and accelerate economic growth. The money market guides the Reserve Bank of India in developing appropriate interest rates. Thus, a fully developed money market in the economy helps in the successful implementation of monetary policy.

(7) Economising the use of cash: The money market is not about the actual money but about various financial instruments that are the close substitute to money. As a result, the money market helps to use cash sparingly.

(8) Promoting the growth of commerce, industry and trade: Local traders as well as international traders who are in the need of short term funds have the facility to discount bills of exchange in the money market. Money market provides working capital for agro-industries and small scale industries. As a result, the money market drives the growth of commerce, industry and trade in the country.

(2) Explain the functions of the RBI.
Ans. The functions of RBI are as follows:

(1) Issue of currency notes: The Reserve Bank of India has a monopoly on printing of all rupee notes except one rupee note and all coins. According to the Minimum Reserve Policy of 1957, the Reserve Bank of India has to reserve at least ₹200 crore. Of this, ₹115 crore is kept in terms of gold and ₹85 crore are kept in terms of foreign currency.

(2) Acting as a banker to the government: The Reserve Bank of India acts as a banker to the government. The Reserve Bank of India accepts deposits from the Central and State Governments and makes payments on their behalf as a representative of the Government. The Reserve Bank of India assists the government in managing public debt and provides advice on a number of financial issues.

(3) Acting as a banker to banks: The Reserve Bank of India has statutory control over all banks in India. All Scheduled Banks in India are required to reserve minimum cash with the Reserve Bank of India as per their demand and term liabilities. The Reserve Bank of India provides financial assistance to banks by discounting of eligible bills, providing advances against approved securities.

(4) Acting as a custodian of foreign exchange reserves: The Reserve Bank of India acts as the custodian of foreign exchange reserves. The Reserve Bank of India conducts the buying and selling of currencies of all member countries of the International Monetary Fund. The Reserve Bank of India helps in maintaining the official rate of exchange of rupee as well as ensure its stability.

(5) Controlling credit: As the Supreme bank in the country, the Reserve Bank of India controls the credit creation process of commercial banks. The Reserve Bank of India uses quantitative techniques to control the volume of credit, such as bank rates, open market operations, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). The Reserve Bank of India uses qualitative tools to regulate the use of credit, such as fixing margin requirements, credit rationing, moral suasion, etc.

(6) Collection and publication of data: The Reserve Bank of India collects and publishes statistical information related to banking and other financial sectors of the economy.

(7) Carrying out promotional and developmental functions: The Reserve Bank of India carries out promotional and developmental functions such as extending banking services in semi-urban and rural areas of India, providing financial securities to depositors, providing agricultural credit to farmers, providing industrial credit to boost industries.

(8) Performing other functions: The Reserve Bank of India acts as a clearing house for settling the accounts between its member banks. The Reserve Bank of India acts as the lender of last resort to all banks in India and provides liquidity to banks experiencing financial difficulties.