

FINANCIAL MARKET

Contents as per **CBSE** syllabus



- Financial Markets - **Meaning & functions.**
- **Money market** and its instruments,
- **Capital market** and its types, methods of floatation,
- Stock Exchange - **Functions** and trading procedure,
- **Securities and Exchange Board of India (SEBI)** - **Objectives** and functions



MEANING

- **Link the savers & investors** by mobilizing funds between them, Known as **allocative function**.
- Allocates or direct funds available for investment into their most **productive investment** opportunity.

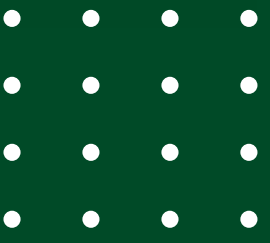
Two consequences of allocation function :-

- The **rate of return** offered to households would be higher,
- **Scarce resources** are allocated to those firms which have **higher productivity** for economy.

Alternative mechanisms :- Banks or financial market,

- Financial market is a **creation & exchange** of **financial assets**.





Concept of financial market



MONEY MARKET

- **Short term** funds deals in monetary assets whose maturity is upto **1 year**,
- **Low risk, unsecured, highly liquid, no physical location.**

MONEY MARKET INSTRUMENTS :-

1). Treasury Bills :-

- **Borrowed by government** maturing in less than 1 year,
- Known as **zero coupon bonds**,
- **Issued by RBI** in the form of **promissory notes**,
- Issued at **price** which is **lower** than their face value & **repaid at par**,
(Difference is called discount)
- Available for a minimum amount of **₹25000** and in **multiple** thereof.



2). Commercial paper :-

- Short term, unsecured promissory note, Negotiable & transferable **by endorsement** & delivery with a fixed maturity period, (**15 days to 1 year**)
- Issued by **large & creditworthy company**,
- **Issued at lower rate** of interest than market rates.



3). Call money :-

- Repayable on demand, **1 day to 15 days** maturity period,
- used for **inter-bank transactions**,
- Maintains **cash reserve ratio**,
- Interest rate paid on call money loans is known as the **call rate**,
- **Inverse relationship** between call rates & others short term instruments,
- Call rate are **highly volatile**.



4). Certificate of deposit (CD) :-

- Unsecured, short term,
- **Issued by** commercial bank & development financial institutions,
- **Issued to** individual, coorporations, companies,
- During **tight liquidity** when the deposit growth of banks is **slow** but the demand for the **credit is high**.



5). Commercial bill :-

- Finance the **credit sales** of firm,
- The seller(Drawer) draws the bill & the buyer(Drawee) accepts it called **trade bill**,
- Bills can be discounted with a bank **before** the bill mature,
- Trade bills is accepted by **commercial bank**.



CAPITAL MARKET

- Long term funds, debt & equity,
- Available at reasonable cost,
- Divided into two parts- Primary & Secondary Market,
- Consist of development banks, commercial banks & stock exchanges,
- Directs these savings into their most productive use leading to growth & development of the economy.

PRIMARY MARKET

1. Sale of securities by new companies or new issue of securities by existing companies. (New issue market)
2. Sold by the company to the investors,
3. Flow of funds is from savers to investors, Promotes capital formation,
4. Only buying takes place, Securities can't be sold,
5. Prices are determined & decided by the management of company,
6. There is no fixed geographical location.

SECONDARY MARKET

1. Trading of existing share only, (Stock Market or Stock Exchange)
2. Ownership is exchange between investors, The company is not involved at all,
3. Enhances liquidity of shares,
4. Both buying & selling takes place on the stock exchange,
5. Prices are determined by demand & supply for securities,
6. Located at specified places.

CAPITAL MARKET

1. **Participants** :- Financial institutions, Bank corporate entities, foreign investors, **retail investors**.
2. **Instruments** :- Equity, debentures, bonds, preference shares, etc.
3. The value of units securities is generally low i.e., 5,10,100 or so.
4. **Medium and long term** securities.
5. **Low degree** of liquidity.
6. **Riskier** with respect to returns and principal repayment.
7. Yields **higher return** by way of capital gain, dividends, bonds.

MONEY MARKET

1. **Participants** :- RBI, banks, Financial institutions, finance companies, individual investors.
2. **Instruments** :- Treasury bills, trade bill reports, commercial paper, CODs.
3. Huge some of money as the instruments are quite expensive.
4. **One year maximum** or issued for **single day**,
5. **High degree** of liquidity.
6. **Safer with minimum risk**, due to shorter duration and also soundness of the issuer.
7. **Very low returns** than the capital market.

Methods of Floatation



1). Offer through prospectus :-

- Involves inviting subscription from the public through issue of prospectus,
- The issue may be **underwritten** & also are required to be **listed** on at least one stock exchange.

2). Offer for sale :-

- Through **intermediaries** like issuing **houses** or **stock brokers**, A company sell securities at an **agreed price** to brokers, who **resell** them to **investing public**.

3). Private placement :-

- Allotment of securities **by a company** to **institutional investors** & some **selected individuals**.

4). Right issue :-

- **Privilege** given to **existing shareholders**,
- They are offered the **right** to buy **new shares** in **proportion** to the **number of shares** they already possess.

5). e- IPOs :-

- A company issue capital to the public **through the online system** of stock exchange **has to enter into agreement** with stock exchange.

STOCK EXCHANGE

According to securities contract act 1956,

- Any **body of individuals**,
- Whether **incorporated or not**,
- Constituted for the **purpose of**,
- **Assisting, regulating or controlling** the business of,
- **Buying & selling or dealing** in securities.

FUNCTION OF A STOCK EXCHANGE :-

1). Providing liquidity & marketability to existing securities :-

- Creation of **continuous market** where securities are **bought & sold**,
- It gives **investors the chance to disinvest & reinvest**.

2). Pricing of securities :-

- Share prices on stock exchange are **determined by the forces of demand & supply**.



3). Safety of transactions :-

- Membership is well regulated & its dealings are well defined according to the existing legal framework.



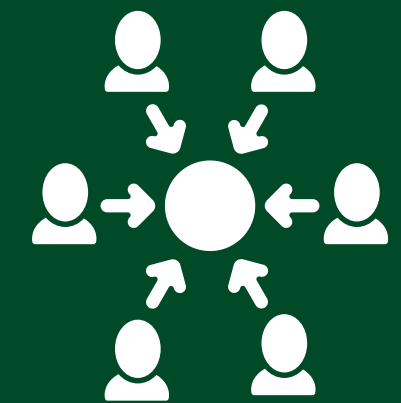
4). Contribution to economic growth :-

- The process of disinvestment & reinvestment savings get channelised into their most productive investment avenues.



5). Spreading of equity cult :-

- Ensuring wider share ownership by regulating new issues, better trading practices & taking effective steps in educating the public about investment.



6). Providing scope for speculation :-

- Provides sufficient scope within the provisions of law for speculative activity in a restricted & controlled manner.



TRADING & SETTLEMENT PROCEDURE

- Trading in securities executed through an **online, screen based** electronic trading system,
- Trading in securities is done through **brokers** who are **members of stock exchange**.

STEPS IN THE TRADING & SETTLEMENT PROCEDURE :-

1). An investor has to first enter into an agreement with registered broker or sub broker, Certain other details :-

- PAN, (**Mandatory**)
- Date of birth & address,
- Educational qualification & occupation,
- Residential status,
- Bank account details,
- Depository account details,
- Name of other broker with whom registered,
- Client code number.



STEP-2

2). Investor open a demat account (Beneficial owner account) with depository participant & also bank account for cash transactions in the securities market.

STEP-3

3). Then place an order, clear instructions have to be given, an order confirmation slip is issued.

STEP-4

4). Broker will go online & connect to the main stock exchange & match the share & best prices available.

STEP-7

7). The investor has to deliver the share sold or pay cash immediately after receiving the contract note or before make payment, this is called the pay - in day.

STEP-6

6). After the trade within 24 hours the broker issue a contract note, a unique order code is mentioned, it is legally enforceable & helps to settle disputes / claims.

STEP-5

5). An order will be executed, broker will issue a trade confirmation slip to the investors.

STEP-8

8). Cash is paid on securities are delivered on pay - in day, which is before T+2 day, The settlement cycle is on T+2 day on a rolling settlement basis.

STEP-9

9). On T+2 day, on the exchange will deliver the share or make payment to other broker, this is called pay - out-day.

STEP-10

10). The broker can make directly delivery to the investor's demat account, the investor can instruct to depository participant directly deliver in his beneficial owner account.



DEMATERIALIZATION & DEPOSITORIES

- The **process** of holding securities in an electronic form is called **dematerialisation**,
- **SEBI** has made it **mandatory**, settlement procedures to take place in **demit form**,
- Enable shares to be **transferred** to some other account just like cash,
- these demat securities can be **pledge** or **hypothecated** to **get loans**,
- **No danger of loss, theft or forgery** of share certificates.

WORKING OF THE DEMAT SYSTEM :-

1). A **depository participant (DP)** either bank, broker, financial service company identified.

2). **Account opening form & documentation** may be completed.

3). **Physical certificate** is given to depository participant along with **dematerialisation request form**.

4). If shares are **applied in public offer**, details of DP and demat A/C to be given & the **share on allotment** would **automatically be credited** to the **demat A/C**.

5). If **shares** are to be **sold**, the DP is to be instructed to **debit the account**.

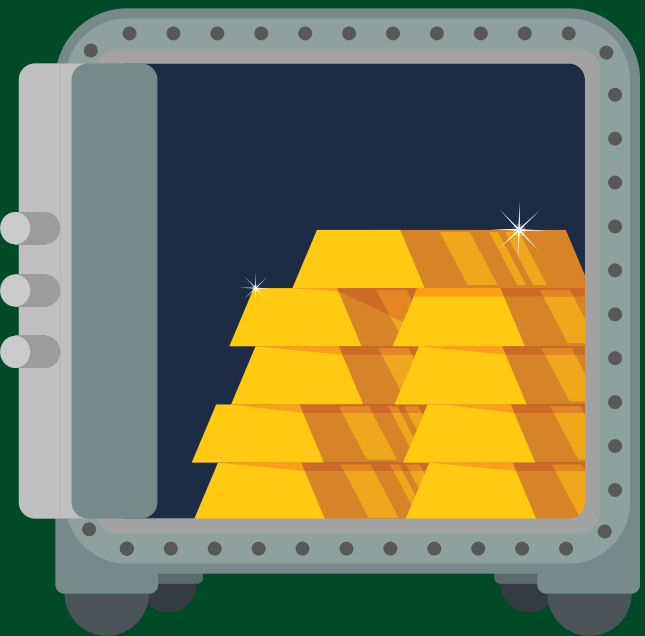
6). Broker then **gives instruction** to his **Dp** for delivery of shares.

7). Broker **receives payment** and **pay the person** for the shares sold.

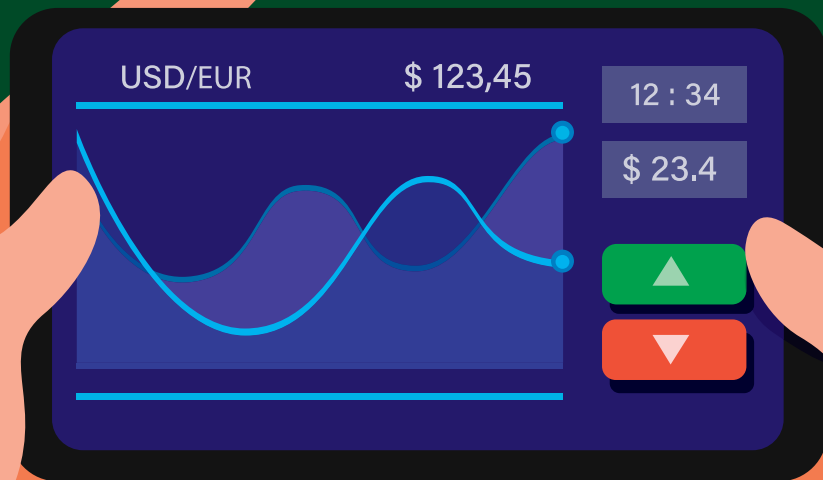
8). All these transactions are to be completed within **2 days**, i.e., delivery of shares and payment received from the buyer is on a **T+2 basis**, settlement period.

DEPOSITORY :-

- It is like a **bank** and keeps securities in **electronic form**,
- **No paper work** relating to share certificates, transfer, forms, etc,
- All transactions of the investors are settled with **greater speed, efficiency**,
- Two depositories - **National Securities Depositories Limited (NSDL)**
 - ↪ **First and large, promoted as IDBI, UIT & national stock exchange.**
 - **Central Depository Services Limited (CDSL)**
 - ↪ **Second & promoted by Bombay stock exchange, Bank of India.**
- The depository participant (DP) serves as an intermediary between the **investor** & the **depository**.



Electronic trading system advantage



Transparency

- Allow participants to see the prices able to see **full market** during **real time**.

Efficiency

- **Display information** on prices & also **capital market developments** that influences share prices.

Efficiency of operations

- There is **reduction in time, cost & risk of error**.

Improving the liquidity

- **All over the country & even abroad, people can participate** through **brokers** or **members** without knowing each other.

One trading platform

- A single trading platform has been provided as business is **transacted at the same time** in all the trading Centres.

SECURITIES & EXCHANGE BOARD OF INDIA

- Established by the government of India on **12 april, 1988**.
- An **interim administrative body** to promote orderly & healthy **growth of securities** market & for investor protection.
- Function under the overall administrative control of the **ministry of finance**.

REASONS FOR THE ESTABLISHMENT :-

- **Lead to variety of malpractices includes :-**
 - Unofficial private placements,
 - Unofficial premium on new issues,
 - Violation of rules & regulations,
 - Rigging of price,
 - Non adherence of provisions,
 - Delay in delivery of shares.
- **These malpractices & unfair trading practices have eroded investor confidence & multiplied investor grievances.**
- **Therefore government set up separate body known as SEBI.**

PURPOSE & ROLE OF SEBI :-

i). To the issuers :-

- Aims to provide market place, **Confidently look forward** to raise finance in an **easy, fair & efficient manner**.

ii). To the investors :-

- Provide **protection** of their **rights & interest** through **adequate, accurate & authentic** information.

ii). To the intermediaries :-

- Offer a **competitive, professionalised & expanding market** with **adequate infrastructure**, able to render **better service** to both.

OBJECTIVES OF SEBI :-

Regulate stock exchanges & to **promote** orderly functioning.

To **protect** the **right & interests** of investors, to **guide & educate** them.

To **prevent trading malpractices** & achieve a balance between **self regulation & statutory regulation**.

Regulate & **develop** a **code of conduct & fair practices** by intermediaries, making them **competitive & professional**.

FUNCTIONS OF SEBI

REGULATORY FUNCTIONS :-

1

Registration of brokers, sub-brokers, other players in the market.

2

Registration of collective investment scheme & mutual funds.

3

Regulation of stock brokers, portfolio exchange, underwriters & merchant bankers.

4

Registration of takeover bids by companies.

**5**

Calling by information by undertaking inspection, conducting enquiries & audit of stock exchanges & intermediaries.

6

Levying fee or other charges for carrying out the purpose of the act.

7

Performing & exercising such power under securities contract Act 1956, as may be delegated by the government of India.

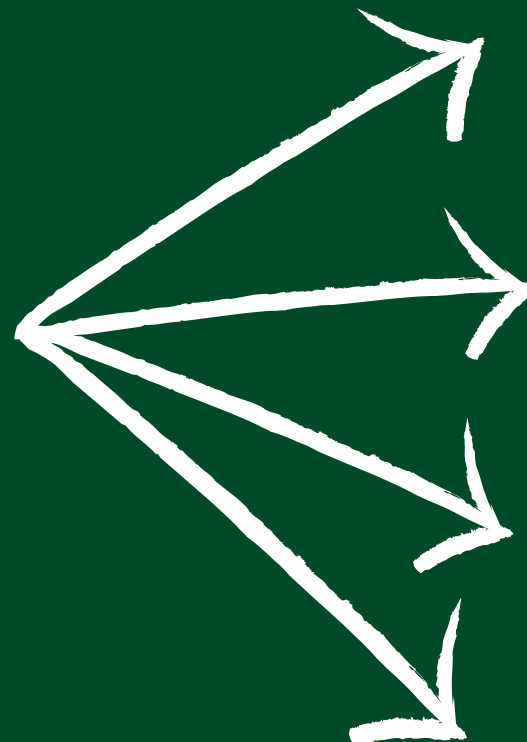
DEVELOPMENT FUNCTION

Training of intermediaries.

Conducting research & publishing information useful to market participants.

Undertaking measures to develop the capital markets by adapting flexible approach.

PROTECTIVE FUNCTION

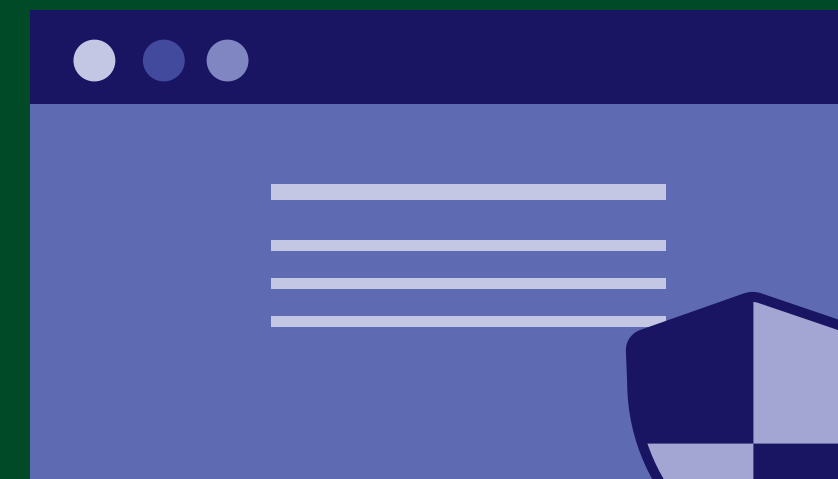


1). Prohibition of fraudulent & unfair trade practices.

2). Controlling insider trading & imposing penalties.

3). Undertaking steps for investor protection.

4). Promotion of fair practices & code of conduct.



ORGANISATION STRUCTURE OF SEBI

- Activities into **five operational departments** headed by an executive director.
- Formed **two** advisory committees :-
 - **Primary market advisory committee,**
 - **Secondary market advisory committee.**

OBJECTIVES OF TWO COMMITTEES



1). To advise SEBI, for **regulation of intermediaries** ensuring **investors protection** in the primary market.

2). **Development** of primary market in India.

3). **Disclosure** requirements for companies.

4). **Changes in legal framework** to introduce **simplification & transparency.**

5). **Development & regulation** of secondary market.

