

**UNIT-II**  
**CHAPTER**  
**4**

**INTRODUCTION TO FINANCIAL MARKETS**

**INTRODUCTION**

A financial market is a market in which people trade financial securities and derivatives such as futures and options at low transaction cost. Within the financial sector, the term "financial markets" is often used to refer just to the markets that are used to raise finance. It is a place where risk and return are correlated. Financial transactions may take place either at a specific place or location, e.g. stock exchange. This chapter throws some light on the concept of financial market, its functions and the types of various financial derivatives.

**I. CHOOSE THE CORRECT ANSWERS**

- 1. Financial market facilitates business firms**
  - a) To raise funds
  - b) To recruit workers
  - c) To make more sales
  - d) To minimize fund requirement
- 2. Capital market is a market for**
  - a) Short Term Finance
  - b) Medium Term Finance
  - c) Long Term Finance
  - d) Both Short Term and Medium Term Finance
- 3. Primary market is also called as**
  - a) Secondary market      b) Money market
  - c) New Issue Market      d) Indirect Market
- 4. Spot Market is a market where the delivery of the financial instrument and payment of cash occurs**
  - a) Immediately      b) In the future
  - c) Uncertain      d) After one month
- 5. How many times a security can be sold in a secondary market?**
  - a) Only one time      b) Two time
  - c) Three times      d) Multiple times

**ANSWERS**

1	a)	2	c)	3	c)	4	a)	5	d)
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**II. VERY SHORT ANSWER QUESTIONS:**

- 1. What are the components of organized sectors?**
  - ❖ Regulators
  - ❖ Financial Institutions
  - ❖ Financial Markets
  - ❖ Financial Services
- 2. Write a note on financial market.**
  - ❖ A market wherein financial instruments such as financial claims, assets and securities are traded is known as a 'Financial Market'.
  - ❖ It is of an intangible concept
  - ❖ Buyers and sellers usually participate in an exchange of assets such as equities, bonds, derivatives and currencies.
- 3. What is equity market?**
  - ❖ It is the financial market for trading in Equity shares of Companies
  - ❖ A equity market is a market in which shares are issued and traded either through exchanges or over the counter markets.
  - ❖ It is also known as stock market.
  - ❖ In Indian stock market, equities are available for trading at the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE).
- 4. What is debt market?**
  - ❖ It is the financial market for trading in Debt Instrument

- ❖ The Debt Instrument includes Government Bonds or Securities, Corporate Debentures or Bonds.
- ❖ Indian Debt Market is one of the largest in Asia.

### 5. How is price decided in a secondary market?

- ❖ The determination of the price of the traded financial asset is done through the interaction of buyers and sellers
- ❖ The prices are decided based on the demand and supply.

## III. SHORT ANSWER QUESTIONS:

### 1. Give the meaning and definition of financial market.

#### Meaning:

A market wherein financial instruments such as financial claims, assets and securities are traded is known as a 'financial market'.

#### Definition:

According to Brigham, Eugene F, "The place where people and organizations wanting to borrow money are brought together with those having surplus funds is called a financial market."

### 2. Differentiate spot market from future market.

Spot Market	Future Market
Spot market is a market where the delivery of the financial instrument and payment of cash occurs immediately	Future Market is a market where the delivery of asset and payment of cash takes place at a pre-determined time frame in future
Settlement is completed immediately	Settlement will be done by two or more installments

### 3. Write a note on Secondary Market.

- ❖ Secondary market is where investors buy and sell securities they already own.
- ❖ Secondary Market is the market for securities that are already issued.
- ❖ Stock Exchange is an important institution in the secondary market.
- ❖ In Secondary market, securities are sold by and

transferred from one investor or speculator to another.

### 4. Bring out the scope of financial market in India.

- ❖ The financial market provides financial assistance to individuals, agricultural sectors, industrial sectors, service sectors, financial institutions like banks, insurance sectors, provident funds and the government as a whole.
- ❖ With the help of the financial market all the above stated individuals, institutions and the Government can get their required funds in time.
- ❖ Through the financial market the institutions get their short term as well as long term financial assistance.
- ❖ It leads to the overall economic development.

## IV. LONG ANSWER QUESTIONS:

### 1. Distinguish between new issue market and secondary market.

Basis For comparison	New Issue Market	Secondary Market
1. Meaning	The market place for new shares is called primary market. (Initial Issues Market)	The place where formerly issued securities are traded is known as Secondary Market. (Resale Market)
2. Buying	Direct	Indirect
3. Financing	It supplies funds to budding enterprises and also to existing companies for expansion and diversification	It does not provide funding to companies
4. How can securities be sold?	Only once	Multiple times

5. Buying and Selling between	Company and Investors	Investors
6. Gained person	Company	Investors
7. Intermediary	Underwriters	Brokers
8. Price	Fixed price	Fluctuates, depends on the demand and supply force
9. Organizational difference	Not rooted to any specific spot or geographical location	It has physical existence

## 2. Enumerate the different kinds of financial markets.

Types of Financial Markets

Financial Markets can be classified in different ways. They are as follows:

### a. On the Basis of Type of Financial Claim

**(i) Debt Market** is the financial market for trading in Debt Instrument (i.e. Government Bonds or Securities, Corporate Debentures or Bonds)

**(ii) Equity Market** is the financial market for trading in Equity Shares of Companies.

### b. On the Basis of Maturity of Financial Claim

**(i) Money Market** is the market for short term financial claim (usually one year or less) E.g. Treasury Bills, Commercial Paper, Certificates of Deposit

**(ii) Capital Market** is the market for long term financial claim more than a year E.g. Shares, Debentures.

### c. On the Basis of Time of Issue of Financial Claim

**(i) Primary Market** is a term used to include all the institutions that are involved in the sale of securities for the first time by the issuers (companies). Here the money from investors goes directly to the issuers.

**(ii) Secondary Market** is the market for securities that are already issued. Stock Exchange is an important institution in the secondary market.

### d. On the Basis of Timing of Delivery of Financial Claim

**(i) Cash/Spot Market** is a market where the delivery of the financial instrument and payment of cash occurs immediately. i.e. settlement is completed immediately.

**(ii) Forward or Futures Market** is a market where the delivery of asset and payment of cash takes place at a pre-determined time frame in future.

### e. On the Basis of the Organizational Structure of the Financial Market

**(i) Exchange Traded Market** is a centralized organization (stock exchange) with standardized procedures.

**(ii) Over-the-Counter Market** is a decentralized market (outside the stock exchange) with customized procedures. The above classification is not rigid. One market may come under more than one category.

## 3. Discuss the role of financial market.

A financial market is of great use for a country as it helps the economy in the following manner:

### (i) Savings Mobilization

Obtaining funds from the savers or 'surplus' units such as household individuals, business firms, public sector units, Government is an important role played by financial markets.

### (ii) Investment

Financial market plays a key role in arranging the investment of funds thus collected, in those units which are in need of the same.

### (iii) National Growth

Financial markets contribute to a nation's growth by ensuring an unfettered flow of surplus funds to deficit units. Flow of funds for productive purposes is also made possible. It leads to overall economic growth.

**(iv) Entrepreneurship Growth**

Financial markets contribute to the development of the entrepreneurial class by making available the necessary financial resources.

**(v) Industrial Development**

The different components of financial markets help an accelerated growth of industrial and economic development of a country and thus contributing to raising the standard of living and the society's well-being.

**4. What are the functions of Financial Markets?****I. Intermediary Functions**

The intermediary functions of a financial market include the following:

**(i) Transfer of Resources:** Financial markets facilitate the transfer of real economic resource from lenders to ultimate borrowers.

**(ii) Enhancing Income:** Financial markets allow lenders earn interest/dividend on their surplus investible funds and thus contributing to the enhancement of the individual and the national income.

**(iii) Productive Usage:** Financial markets allow for the productive use of the funds borrowed and thus enhancing the income and the gross national production.

**(iv) Capital Formation:** Financial markets provide a channel through which new savings flow to aid capital formation of a country.

**(v) Price Determination:** Financial markets allow for the determination of the price of the traded financial asset through the interaction of buyers and sellers.

**(vi) Sale Mechanism:** Financial market provides a mechanism for selling of a financial asset by an investor so as to offer the benefits of marketability and liquidity of such assets.

**(vii) Information:** The activities of the participants in the financial market result in the generation and the consequent dissemination of information to the various segments of the markets, so as to reduce the cost of transaction of financial assets.

**II. Financial Functions**

The financial functions of a financial market include the following:

- (i)** Providing the borrowers with funds so as to enable them to carry out their investment plans
- (ii)** Providing the lenders with earning assets so as to enable them to earn wealth by deploying the assets in productive ventures
- (iii)** Providing liquidity in the market so as to facilitate trading of funds.

**5. Discuss the various types of Financial markets?**

Types of Financial Markets

Financial Markets can be classified in different ways. They are as follows:

**a. On the Basis of Type of Financial Claim**

**(i) Debt Market** is the financial market for trading in Debt Instrument (i.e. Government Bonds or Securities, Corporate Debentures or Bonds)

**(ii) Equity Market** is the financial market for trading in Equity Shares of Companies.

**b. On the Basis of Maturity of Financial Claim**

**(i) Money Market** is the market for short term financial claim (usually one year or less) E.g. Treasury Bills, Commercial Paper, Certificates of Deposit

**(ii) Capital Market** is the market for long term financial claim more than a year E.g. Shares, Debentures.

**c. On the Basis of Time of Issue of Financial Claim**

**(i) Primary Market** is a term used to include all the institutions that are involved in the sale of securities for the first time by the issuers (companies). Here the money from investors goes directly to the issuers.

**(ii) Secondary Market** is the market for securities that are already issued. Stock Exchange is an important institution in the secondary market.

**d. On the Basis of Timing of Delivery of Financial Claim**

**(i) Cash/Spot Market** is a market where the delivery of the financial instrument and payment

of cash occurs immediately. i.e. settlement is completed immediately.

(ii) **Forward or Futures Market** is a market where the delivery of asset and payment of cash takes place at a pre-determined time frame in future.

**e. On the Basis of the Organizational Structure of the Financial Market**

(i) **Exchange Traded Market** is a centralized organization (stock exchange) with standardized procedures.

(ii) **Over-the-Counter Market** is a decentralized market (outside the stock exchange) with customized procedures. The above classification is not rigid. One market may come under more than one category.

**ADDITIONAL QUESTIONS:**

**I. CHOOSE THE CORRECT ANSWERS:**

1. **The basic purpose of financial management is \_\_\_\_\_.**

- a) Assets Maximization      b) Sales Maximization  
c) Wealth Maximization      d) All of the above

2. **Finance functions are \_\_\_\_\_.**

- a) Planning of funds      b) Raising of funds  
c) Allocation of Resources      d) All of the above

3. **Which of the following is the limitation of profit maximization?**

- a) Financial management ignores time value of money  
b) Financial management overlooks quality  
c) Ignores social responsibility of business  
d) All of these

4. **\_\_\_\_\_ is the financial market for trading in Equity Shares of Companies.**

- a) Equity Market      b) Capital Market  
c) Primary Market      d) None of the above

5. **Which of the following are dealt with Money Market?**

- a) Treasury Bills      b) Commercial Paper  
c) Certificates of Deposit      d) All of the above

6. **Which of the following is Marketable Assets?**

- a) Shares of Listed Companies  
b) Government Securities  
c) Bonds of Public Sector Undertakings  
d) All of these

7. **Raising funds for short-term purpose is \_\_\_\_\_.**

- a) Economical      b) costly  
c) beneficial      d) None of these

8. **Payment after a specific date is \_\_\_\_\_ in case of bank credit.**

- a) Compulsory      b) Not compulsory  
c) Undefined      d) None of these

9. **Public deposit cannot be for more than \_\_\_\_\_.**

- a) one year      b) two year  
c) three year      d) four year

10. **The finance manager is responsible for \_\_\_\_\_.**

- a) Proper utilization of funds  
b) arrangement of financial resources  
c) acquiring capital assets of the organization  
d) Efficient management of capital

11. **Assertion (A): Accounting information refers to only events which are concerned with business firm.**

**Reason (R): Accounting information is presented in financial statements.**

**Codes:**

- (A) (A) is correct, but (R) is wrong.  
(B) Both (A) and (R) are correct.  
(C) (A) is wrong, but (R) is correct.  
(D) Both (A) and (R) are wrong.

12. **Assertion (A): Sinking fund is a charge against Profit and Loss Account.**

**Reason (R): Sinking fund is created for repayment of a long term liability.**

In the context of the above statements, which one of the following is correct?

**Codes:**

- (A) (A) is correct, but (R) is wrong.  
(B) Both (A) and (R) are correct.

- (C) (A) is wrong, but (R) is correct.  
 (D) Both (A) and (R) are wrong.

**13. Assertion (A):** As the proportion of one variable factor in a combination with fixed factor is increased, after a point the marginal product of the factor will diminish.  
**Reason (R):** Beyond the level of optimum combination of inputs leads to this.

**Codes:**

- (A) (R) is appropriate reason of (A).  
 (B) (R) is not appropriate reason of (A).  
 (C) (A) and (R) are not related with each other.  
 (D) (A) is independent of (R).

**14. Statement A:** An Equity market is also known as a Stock market.

**Statement B :** An equity market is a market in which shares are issued and traded either through exchanges or over the counter markets.

- (A) (A) is correct, but (R) is wrong.  
 (B) Both (A) and (R) are correct.  
 (C) (A) is wrong, but (R) is correct.  
 (D) Both (A) and (R) are wrong

**15. Assertion (A) :** Exchange Traded Market is a centralized organization with standardized procedures.

**Reason (R):** All the financial markets are considered for savings mobilization

- (A) (A) is correct, but (R) is wrong.  
 (B) Both (A) and (R) are correct.  
 (C) (A) is wrong, but (R) is correct.  
 (D) Both (A) and (R) are wrong

ANSWERS									
1	c)	2	d)	3	d)	4	a)	5	d)
6	d)	7	a)	8	b)	9	c)	10	d)
11	b)	12	b)	13	a)	14	b)	15	b)

## II. MATCH THE FOLLOWING:

**1. Match List I with List II:**

List I	List II
Capital Market	Commercial Bills
Primary Market	ii. Spot Market
Cash Market	iii. New Issue Market
Money Market	iv. Long Term Finance

	a)	b)	c)	d)
a)	4	3	1	2
b)	3	4	1	2
c)	3	2	1	4
d)	4	3	2	1

**2. Match List I with List II:**

List I	List II
Primary Market	Pre-determined Time
Secondary Market	Indirect Buying and Selling
Future Market	Direct Buying and Selling
Capital Market	Shares and debentures

	a)	b)	c)	d)
a)	4	3	1	2
b)	3	4	1	2
c)	3	2	1	4
d)	4	3	2	1

**3. Find the odd one out:**

- a) Money Market  
 b) Capital Market  
 c) Over-the-counter Market  
 d) Primary Market

**Reason:** Over-the Counter Market is a decentralised market and all the others come under centralized market.

**4. Find the odd one out:**

- Regulators  
 Financial Institutions  
 Financial Services  
 Debt market

**Reason :** Except debt market, all the others are the components of organized sectors.

**5. Find the odd one out:**

- a) Planning of funds  
 b) Raising of funds  
 c) Allocation of Resources  
 d) Sales Maximisation

**Reason :** In the above statement except sales maximisation all the others are the financial functions of management.

ANSWERS									
1	d)	2	c)	3	c)	4	d)	5	d)



## II. VERY SHORT ANSWER QUESTIONS:

### 1. What is Capital Market?

Capital Market is the market for long term financial claim more than a year  
E.g : Shares and Debentures.

### 2. What is Over-the- Counter Market?

It is a decentralized market that is outside the stock exchange with customized procedures.

### 3. What is meant by primary market?

- ❖ It is term include all the institutions that are involved in the sale of securities for the first time by the companies.
- ❖ The money from investors goes directly to the issuers.

### 4. What is meant by Money market?

It is a market for the short term financial claim.  
E.g- Treasury Bills, Commercial Paper, Certificates of Deposits.

### 5. What is meant by Cash Market?

- ❖ It is a market where the delivery of cash occurs immediately.
- ❖ The settlement will be placed immediately.
- ❖ It is also known as Spot Market.

### 6. What is meant by Physical asset?

- ❖ Physical assets are not useful for further production of goods or for earning income.
- ❖ E. Land and Building, Gold, Silver
- ❖ Physical assets are used only for consumption
- ❖ Physical assets cannot be used for further production.

## III. SHORT ANSWER QUESTIONS:

### 1. Enumerate the scope of Indian Financial Market:

- ❖ The financial market provides financial assistance to individuals, agricultural sectors, industrial sectors, service sectors, as a whole.

- ❖ With the help of the financial market all the above stated individuals, institutions and the Government can get their required funds in time.
- ❖ Through the financial market the institutions get their short term as well as long term financial assistance.
- ❖ It leads to the overall economic development.

### 2. Write a note on Financial Assets:

- ❖ In any financial transaction, there should be a creation or transfer of financial asset.
- ❖ The basic product of any financial system is the financial asset.
- ❖ A financial asset is one which is used for production or consumption or for further creation of assets.
- ❖ For instance, a buys equity shares and these shares are financial assets since they earn income in future.
- ❖ If a building is bought for residence purposes, it becomes a physical asset.
- ❖ If the same is bought for hiring, it becomes a financial asset.

### 3. What are the types of financial assets?

Financial assets can be classified differently under different circumstances. One such classification is:

#### (i) Marketable Assets

Marketable assets are those which can be easily transferred from one person to another without much hindrance. Example: Shares of Listed Companies, Government Securities, Bonds of Public Sector Undertakings etc.

#### (ii) Non-Marketable Assets

On the other hand, if the assets cannot be transferred easily, they come under this category. Example: Bank Deposits, Provident Funds, Pension Funds, National Savings Certificates, Insurance Policies etc.