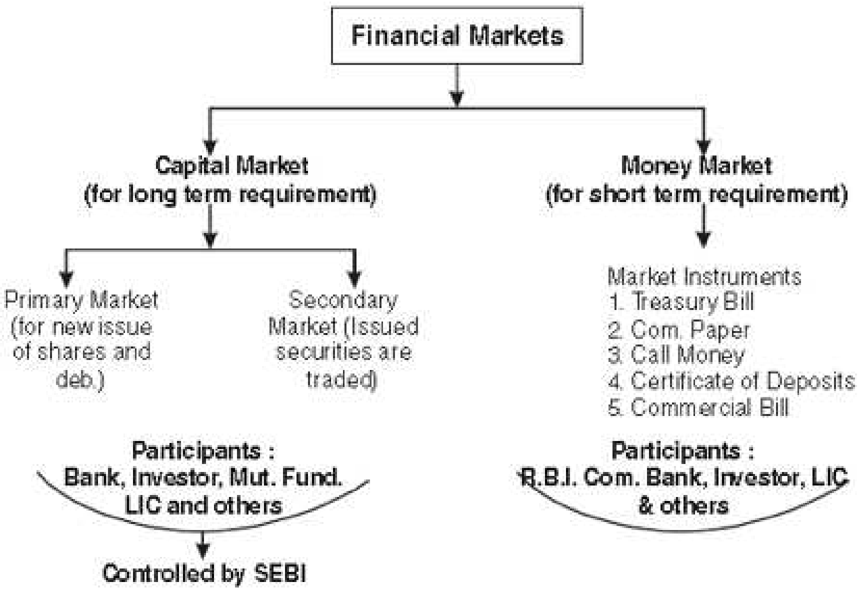
Chapter – 10
Financial Markets

- **Financial Market** is a market for creation and exchange of financial assets like shares, bonds etc. It helps in mobilizing savings and channelizing them into the most productive uses. It helps to link the savers and the investors by mobilizing funds between them. The persons or institutions by which allocation of funds is done are called Financial Intermediaries. They bring together borrowers and lenders and make funds available to those willing to pay for their use, Household (Savers)Business Firms(Investors)Banks and Financial Markets.

- **Functions of Financial Market:**
  1. **Mobilization of Savings and channeling them into the most productive uses:** Financial market facilitates the transfer of savings from, savers to investors and thus helps to channelize surplus funds into the most productive use.
  2. **Helps in Price Determination:** Financial Market helps in interact on of savers and investors which in turn helps in the determination of prices of the financial assets such as shares, debentures etc.
  3. **Provide Liquidity to Financial Assets:** Financial market facilitates easy purchase and sale of financial assets. Thus, it provides liquidity to them so that they can be easily converted into cash whenever required.
  4. **Reduce Cost of Transactions:** Financial market provides valuable information about securities which helps in saving tune, efforts and money and thus it reduces cost of transactions.
- **Types of Financial Markets:**



- **Money Market:** It is a market for short term funds/securities whose period of maturity is up to one year. The major participants in the money market are RBI, Commercial Banks. Non-Banking Finance Companies, State Government, Large Corporate Houses and Mutual Funds. The main instruments of money market are as follows:
  1. **Treasure Bills:** They are issued by the RBI on behalf of the Central Government to meet its short-term requirement of funds. They are issued at a price which is lower than their face value and arc repaid at par. They are available for a minimum amount of Rs.25000 and in multiples thereof. They are also known as Zero Coupon Bonds. They are negotiable instruments i.e. they are freely transferable.
  2. **Commercial Paper:** It is a short term unsecured promissory note issued by large credit worthy companies to raise short term funds at lower rates of interest than market rates. They are negotiable instruments transferable by endorsement and delivery with a fixed maturity period of 15 days to one year.
  3. **Call Money:** It is short term finance repayable on demand, with a maturity period of one day to 15 days, used for interbank transactions. Call Money is a method by which banks borrow from each other to be able to maintain the cash reserve ratio as per RBI. The interest rate paid on call money loans is known as the call rate.
  4. **Certificate of Deposit:** It is an unsecured instrument issued in bearer form by Commercial Banks & Financial Institutions. They can be issued to individuals. Corporations and companies for raising money for a short period ranging from 91 days to one year.
  5. **Commercial Bill:** It is a bill of exchange used to finance the working capital requirements of business firms. A seller of the goods draws the bill on the buyer when goods are sold on credit. When the bill is accepted by the buyer it becomes marketable instrument and is called a trade bill. These bills can be discounted with a bank if the seller needs funds before the bill maturity.
- **Capital Market:** It is a market for long term funds where debt and equity are traded. It consists of development banks, commercial banks and stock exchanges. The capital market can be divided into two parts:
  1. Primary Market
  2. Secondary Market
- **Primary Market:** It deals with the new securities which are issued for the first time. It is also known as the New Issue Market. The investors in this market are banks, financial institutions, insurance companies, mutual funds and individuals. It has no fixed geographical location and only buying of securities takes place in the primary market.
- **Methods of Floatation of New Issues in Primary Market:**
  1. **Offer through Prospectus:** It involves inviting subscription from the public through issue of prospectus. A prospectus makes a direct appeal to investors to raise capital through an advertisement in newspapers and magazines.

2. **Offer for Sale:** Under this method, securities are offered for sale through intermediaries like issuing houses or stock brokers. The company sells securities to intermediary/broker at an agreed price and the broker resells them to investors at a higher price.
3. **Private Placements:** It refers to the process in which securities are allotted to institutional investor and some selected individuals.
4. **Rights Issue**: It refers to the issue in which new shares are offered to the existing shareholders in proportion to the number of shares they already possess.
5. **e-IPOs**: It is a method of issuing securities through an on-line system of stock exchange. A company proposing to issue capital to the public through the on-line system of the stock exchange has to enter into an agreement with the stock exchange. This is called an e-initial public offer. SEBI's registered brokers have to be appointed for the purpose of accepting applications and placing orders with the company.

- **Secondary Market:** It is also known as the stock market or stock exchange where purchase and sale of existing securities takes place. They are located at specified places and both the buying as well as selling of securities takes place.

Difference between Primary Market and Secondary Market

Basis	**Primary Market**	**Secondary Market**
Securities	Only new securities are traded	Existing securities are traded
Price of Securities	Prices of securities are determined by the management of the company.	Prices are determined by the forces by the demand and supply of the securities.
Purchase and Sale	Securities are sold to investors directly by the company or through intermediary.	Investors exchange ownership of securities.
Place of Market	There is no fixed geographical location.	Located at specified places.
Medium	Only buying of securities takes place.	Both buying and selling of securities can take place.

- **Stock Exchange/Share Market:** A Stock Exchange is an institution which provides a platform for buying and selling of existing securities. It facilitates the exchange of a security i.e. share, debenture etc. into money and vice versa. Following are some of the important functions of a Stock Exchange:

1. **Providing liquidity and Marketability to Existing Securities:** Stock Exchange provides a ready and continuous market for the sale and purchase of securities.
2. **Pricing of Securities:** Stock Exchange helps in constant valuation of securities which provide instant information to both buyers and sellers and thus helps in pricing of securities which is based on the forces of demand & supply.
3. **Safety of Transaction:** The members of a stock exchange are well regulated, who are required to work within the legal framework. This ensures safety of transactions.

4. **Contributes to Economic Growth:** Stock exchange provides a platform by which savings get channelized into the most productive investment proposals, which leads to capital formation & economic growth.
5. **Spreading of Equity Culture:** Stock exchange helps in educating public about investments in securities which leads to spreading of Equity culture.
6. **Providing Scope for Speculation:** Stock exchange provides scope within the provisions of law for speculation in a restricted and controlled manner.

- **Trading Procedure on a Stock Exchange:**

1. **Selection of Broker:** in order to trade on a Stock Exchange first a broker is selected who should be a member of stock exchange as they can only trade on the stock exchange.
2. **Placing the order:** After selecting a broker, the investors specify the type and number of securities they want to buy or sell.
3. **Executing the order:** The broker will buy or sell the securities as per the instructions of the investor.
4. **Settlement:** Transactions on a stock exchange may be carried out on either cash basis or carry over basis (i.e. badla). The time period for which the transactions are carried forward is referred to as accounts which vary from a fortnight to a month. All transactions made during one account are to be settled by payment for purchases and by delivery of share certificates, which is a proof of ownership of securities by an individual. Earlier trading on a stock exchange took place through a public outcry or auction system which is now replaced by an online screen based electronic trading system. Moreover, to eliminate, the problems of theft, forgery, transfer, delays etc. an electronic book entry from a holding and transferring securities has been introduced, which is called process of de materialization of securities.

Difference between Capital and Money Market

Basis	**Capital Market**	**Money Market**
Participants	Financial Institutions, Banks, Corporate Entities, foreign investors and individuals.	RBI, Banks Institutions and finance companies.
Instruments traded	Equity shares, bonds preferences and debentures, call money etc.	Treasury Bills, Trade Bills commercial paper
Investment Outlay	Does not necessarily require a huge financial outlay.	Entails huge sum of money as the instruments are quite expensive.
Duration	Deals in medium and long term securities having a maturity period of one year.	Deals in short term funds having a maturity period upto one year.
Liquidity	Securities are less liquid as money market securities.	Money markets instruments are highly liquid
Expected	High return	Low return

Safety	Capital Market Instruments are riskier both with respect to return and repayment.	Money market instruments are generally much safer with a minimum risk of default.

- **Depository Services and DEMAT Accounts**: Keeping in the mind the difficulties to transfer of shares in physical form, SEBI has developed a new system in which trading in shares is made compulsory in electronic form Depository services system and D-Mat Account are very basis of this system.
- **Depository Services:** 'Depository is an institution/organization which holds securities (e.g. shares, debentures, bonds, mutual funds etc.) in electronic form, in which trading is done. The services provided by a Depository are termed as 'Depository Services'. At present there are two depositories in India: NSDL. (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.). which are known as "Depository Participants". (DPs)
- **Services provided by Depository:** Dematerialization (usually known as demat) is converting physical certificates to electronic form. Rematerialisation, known as remat, is reverse of demat, i.e. getting physical certificates from the electronic securities.
  Transfer of securities, change of beneficial ownership.
  Settlement of trades done on exchange connected to the Depository. Now a day's on-line paper-less trading in shares of the company is compulsory in India. Depository services is the name of that mechanism. In this system transfer of ownership in shares take place by means of book entry without the physical delivery of shares. When an investor wants to deal in shares of any company he has to open a Demat account. There are four players who participate in this system.
  1. **The Depository:** A depository is an institution which holds the shares of an investor in electronic form. There are two depository institutions in India these are NSDL and CDSL.
  2. **The Depository Participant:** He opens the account of Investor and maintains securities records.
  3. **The Investor:** He is a person who wants to deal in shares whose name is recorded
  4. **The Issuing Company:** That organization which issues the securities. This issuing company sends a list of the shareholders to the depositories.
- **Benefits of Depository Services:**
  Sale and Purchase of shares and stocks of any company on any stock Exchange.
  Saves time.
  Lower transaction costs
  Ease in trading.
  Transparency in transactions.
  No counterfeiting of security certificate
  Physical presence of investor is not required in stock exchange.
  Risk of mutilation and loss of security certificate is eliminated.
- **Demat Account:** Demat account is the abbreviation of 'Dematerialized Account'. (Dematerialized account refers to an account which an Indian citizen must open with the

depository) participant (banks, stockbrokers) to trade in listed securities in electronic form wherein one can hold shares of various companies in the Dematerialized{electronic} form. Access to De-mat account requires an internet password and a transaction password. Transfer and purchase of securities can then be initiated. Purchase and sale of securities on the De-mat account are automatically made once transaction is confirmed and completed.

- **Benefits of Demat Account**
  1. Reduces paper work.
  2. Elimination of problems on transfer of shares such as loss, theft and delay.
  3. Exemption of stamp duty when transfer of shares.
  4. The concept of odd lot stand abolished.
  5. Increase liquidity through speedy settlement.
  6. Attract foreign investors and promoting foreign investment.
  7. A single demat account can hold investments in both equity and debt instruments.
  8. Traders can work from anywhere.
  9. Automatic credit into demat account for shares arising out of bonus/split/consolidation % merger.
  10. Immediate transfers of securities.
  11. Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them.
- **Opening of Demat Account:** A Demat account is opened on the same lines as that of a bank account. Prescribed account opening forms available with the DP, need to be filled in. Standard agreement is to be signed by the client and the DP, which details the rights and obligation of both parties. Along with the form, the client is required to attach photograph, attested copies of residence proof and proof of identity need to be submitted.
- **Securities and Exchange Board of India (SEBI):** SEBI was established by Government of India on 12 April 1988 as an interim administrative body to promote orderly and healthy growth of securities market and for investor protection. It was given a statutory status on 30 January1992 through an ordinance which was later replaced by an Act of Parliament known as the SEBI Act, 1992. It seeks to protect the interest of investors in new and second hand securities.
- **Objectives of SEBI**
  1. To regulate stock exchange and the securities market to promote their orderly functioning.
  2. To protect the rights and interests of investors and to guide & educate them.
  3. To prevent trade mal practices such as internal trading.
  4. To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers etc.
- **Functions of SEBI:**

FUNCTIONS OF SEBI

Regulatory Functions

1. Framing Rule & Regulations
2. Registration of brokers & sub-brokers.
3. Registration of collective investment schemes & mutual funds.
4. Regulation of stock broker, port folio exchanges, under writers & merchant bankers
5. Regulation of task over bids by companies.
6. Levying fee or other charges as per act.

Development Functions

1. Training of intermediaries
2. Conducing Research & Publishing useful information.
3. Undertaking measures to develop capital market by adopting flexible approach
4. Educating Investors to broaden their unders-tanding
5. Permitting Internet trading through regi-stered stock brokers

Protective Functions

1. Prohibiting of fraudulent & unfair trade practices.
2. Check on insider trading.
3. ensure investors protection.
4. Promote fair practices & code of conduct in securities market.
5. Check on price rigging.
6. Check on preferential allotment.