THE VILLAGE INTERNATIONAL SCHOOL

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Important Questions For Class 12 Business Studies

Chapter 10 – Financial Markets

Very Short Answer Questions **1 or 2 Marks**

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.

Ans: 'Private Placement' is the process of raising the additional cash.

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.

Ans: The investor was unable to purchase a Treasury Bill because they can only be purchased for a minimum of Rs 25,000 and in multiples of that amount.

3. Name the kind of issue in which shares are offered to existing shareholders.

Ans: Right Issue.

4. **Give an example of any two financial intermediaries. Ans:** Banks and Financial markets.

5. **Give examples of any two money market**

instruments. Ans: Commercial Paper and Treasury bills.

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 the 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)

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

Short Answer Questions 3 or 4 Marks

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)

Ans: 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%) which is greater than the Rate of interest on borrowings (9%), Whereas in option B the cost surpasses the rate of return.

Concept used: Trading on equity

Trading on equity is a financial process in which debt produces gain for shareholders of a company. Trading on equity happens when a company incurs new debt using bonds, loans, bonds or preferred stock. Company usually go this way to boost earning per share

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 the stock exchange for the purpose. Give any 3 reasons in support of your answer.

Ans: The company's stock should be listed on Over-The Counter Exchange of India (OTCEI). The main features of OTCEl are the following-

- **Nation-wide listing:** When you list on one exchange, you can transact with all of the counters in the country.
- **Exclusive list of firms:** On the OTCEI, only companies with an issued capital of $30 million or more are listed.
- **Investor registration:** Every investor who transacts on the OTCEI is required to get himself registered.
- **Transparency in transactions:** The investor is present at all times during the transaction. On the computer screen, the rates of purchasing and selling may be viewed, increasing openness in the activities..

9. **State the protective functions of Securities and Exchange Board of India. Ans:** The Securities and Exchange Board of India's protective functions include:

- **Fraud:** One of SEBI's main goals is to prevent insider trading and other types of fraud. Rules violations and non-compliance with the Companies Act.
- **Information:**SEBI offers investors with the information they need about

companies.

- **Guidelines:**The Securities and Exchange Board of India (SEBI) publishes guidelines for investing in securities. It allows investors to make well- informed judgments in this way.

- **Code of conduct:**SEBI provides a code of conduct for the trade practices of various intermediaries such as brokers and merchant bankers.It monitors these intermediaries' operations and provides them with a competitive environment.

10. "Efficient functioning of the stock exchange creates a conducive climate for an 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)

Ans: The functions of Stock Exchange are:

a. It provides liquidity and marketability to existing securities.

b. The forces of supply and demand determine the price of securities.

c. It ensures transaction security by allowing transactions to take place within an existing legal framework.

d. It contributes to economic growth by promoting capital formation in an indirect manner.

e. It allows for speculation within the confines of the law.

11. Mr. Aditya Gupta was the chairman of 'Bandhan 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 its takeover 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 2.4crores. He gave Rs 1.2 crore to Mr. Aditya Gupta and kept Rs1.2 crore with him. On regular inspection and by conducting enquiries 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.

Ans: SEBI's two functions in this scenario are as follows:

- Regulatory Functions: It monitors and regulates the Indian capital and securities market while ensuring to protect the interests of the investors, formulating regulations and guidelines.
- Protective Functions: SEBI is primarily set up to protect the interests of investors in the securities market.

The following are the lines from the paragraph that show the functions that were done.

- Regulatory Functions: 'On regular inspection and by conducting enquiries of the brokers involved'
- Protective Functions: 'SEBI imposed a heavy penalty on Aditya Gupta'

12. State any four functions of the financial market. (CBSE BOARD 2016)

Ans: A financial market is the place where financial assets like shares and debentures are created and exchanged. The functions of a financial market are as follows.

a. **Transfer of Savings and Investment Alternatives:** A financial market serves as a conduit between savers and investors. It serves as a conduit for household funds to be transferred to investors. It also gives savers a variety of investing options, directing the excess funds to the most profitable choices.

b. **Determines the Price:** A financial asset's price is determined by the dynamics of demand and supply for funds, just like the price of a commodity. The financial market serves as a forum for the interplay of fund demand (represented by commercial firms) and fund supply (represented by individuals and households). As a result, it aids in determining the price of the traded asset.

c. **Facilitates Liquidity:** In a financial market, an asset or a security can be easily bought and sold. The assets gain liquidity as a result of this. That is, assets can be quickly turned into cash or currency equivalents through financial market trading.

d. **Reduced Transaction Costs:** A financial market helps to reduce transaction costs in terms of effort, money, and time by providing information about the assets being exchanged, their price, availability, and so on.

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. (CBSE BOARD 2017)

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

Ans: Allocative function

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

Ans: Functions performed by Financial Markets

a. **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.

b. **Facilitates liquidity:** By trading (sale and purchase of assets) in the financial market, it provides liquidity to the assets, allowing them to be easily changed into cash or cash equivalents.

c. **Reduces the cost of transaction:** It provides useful information about the various securities that are traded.. As a result, it aids in the reduction of transaction costs in terms of time, effort, and money for both buyers and sellers.

14. **State any four functions of "Secondary Market'. (CBSE BOARD 2016)** **Ans:** The four functions of the secondary market are enlisted below.

- **Provide liquidity and marketability:** The secondary market's primary function is to provide liquidity and marketability to existing financial assets and securities. It provides a ready-to-trade platform for existing securities.
- **Valuation of securities:** It allows for consistent valuation of securities and aids in the development of demand and supply. It aids in the determination of the price of securities.
- **Security:** It provides transaction security and fairness. Transactions can be entered into at any time, and the market allows for active trading so that there can be immediate purchase or selling with no fraud.
- **Contributes to economic growth:** It gives a platform for putting funds to the best possible use. It helps the economy's growth and development in this way.

15. State any four functions of "Stock Exchange.'

Ans: The term "stock exchange" refers to a market where existing securities are bought and sold. The major functions of a stock exchange are as follows.

a. **Provides Liquidity and Marketability:** Stock exchange provides a ready platform for trading of existing securities.To put it another way, it acts as a continuous market for the sale and acquisition of securities. Securities can be easily turned into cash at any time through the stock exchange. Long-term securities can also be changed into medium-term and short- term securities via the stock exchange.

b. **Price Determination:** A stock exchange assists in determining the price of monetary assets traded in the market. It provides a platform for buyers and sellers of securities to communicate, assisting in the determination of security prices through the forces of supply and demand.

c. **Aids Economic Growth:** Securities are constantly bought and exchanged on a Stock Exchange. This continual cycle of disinvestment and reinvestment aids in directing savings and investments to the most profitable uses possible. This boosts capital formation and economic growth as well.

d. **Speculation Capacity:** It is widely assumed that some level of speculation is required for improved liquidity and to keep demand and supply of securities in balance. Within the confines of the law, the stock exchange allows for a reasonable and limited amount of speculation.

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. Ans: The Allocative function is the function that the market performs.

(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.

Ans: The Money Market is a market segment other than the capital market in which unsecured and short-term debt instruments are exchanged.

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 the maturity period is more than 1 year.	The money market is concerned with the trading of short-term securities with maturities ranging from one day to one year.
Liquidity	Capital market securities are liquid in nature as they are tradable on the stock exchange, but are less liquid in comparison to the money market.	The securities exchanged are quite liquid.
Returns expected	Expected returns are higher due to the possibility of the capital gains and the long term and regular dividend or bonus.	Due to the shorter term, expected returns are lower.
Instruments	Instruments traded in capital market comprise of equity share, preference share, debenture, bonds and other long-term securities.	Instruments traded in the money market kam price of treasury bills, commercial bills, certificate of deposits and other short term securities.

Long Answer Questions **5 or 6 Marks**

17. Distinguish between money market and capital market on the basis of:
(a) Participants

(b) Instruments (c) Safety and (d) Expected

return. Ans:

Basis	Money market	Capital market
Participants	The participants are RBI, financial institutions, banks, corporate.	The participants are financial institutions, Banks, corporate, foreign investor and retail investor.
Instruments	Instruments traded are treasury bills, commercial paper, certificates of deposit call money and commercial bills.	Instruments traded are share, debenture and bonds.
Safety	Money market securities are comparatively safer.	Money market instruments are less risky than capital market securities.
Expected returns	Money market securities yield comparatively less returns.	Generally yield higher return then money market instruments.

18. The director of a company wants to modernize its plants and machinery by making a public issue of Shares. They wish to approach the stock exchange, while the finance manager prefers to approach a consultant for the new public issue of shares. Advise the directors whether to approach the 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.

Ans: Because the company wishes to undertake a new public issue of shares to upgrade its plants and machinery, the directors should approach the consultant for the new public issue of shares.

The techniques that the corporation may use for the fresh public offering of shares are as follows:

a. **Right Issue:** Because the corporation looks to be an established company seeking to modernise its plant and machinery, it is required by statute to offer these shares first to current shareholders in proportion to their ownership. If existing shareholders do not want to take these shares, the corporation can use the additional procedures listed below.

b. **Public Offer via Prospectus:** After issuing a prospectus, the corporation can directly offer its shares to the general public.

c. **Offer for sale:** In this situation, an intermediary purchases all of the company's shares at a predetermined price and resells them to investors at a higher price.

d. **Private Placement:** in this situation, an intermediary purchases the company's shares but only sells them to a select few.

19. Explain the objectives and functions of the SEBI.

Ans: The Securities and Exchange Board of India (SEBI) was founded in 1988 to promote the orderly and healthy expansion of India's securities market. SEBI was set with an Investor protection as the overarching goal, as well as the development and regulation of securities market functions.

SEBI's objectives are as follows:

SEBI's overall goal is to protect investors' interests while also promoting the development and regulation of the securities industry. This may be elaborated as follows:

a. **Promotion:** To promote the orderly operation of stock exchanges and the securities industry by regulating them.

b. **Security:** Protecting the rights and interests of investors, especially individual investors, as well as guiding and educating them. To prevent trading malpractices and strike a balance between the securities industry's self-regulation and legislative control.

c. **Rules and regulations:** To regulate and develop a code of conduct and fair procedures for intermediaries such as brokers, merchant bankers, and other financial intermediaries in order to make them more competitive and professional.

Functions of SEBI:

SEBI was charged with the dual responsibility of both regulation and growth of the securities market in India, due to the emerging nature of the securities sector.

- **Regulatory Functions**

  SEBI performs the following regulatory functions:

a. All market participants, including brokers, sub brokers, and other market participants, must register.

b. Collective investment plans and mutual funds must be registered.

c. Stock bankers, portfolio exchanges, and merchant bankers are all regulated.

d. Business practises that are dishonest or unfair are prohibited.

e. Regulating insider trading and hostile takeover bids, as well as enforcing penalties for such conduct.

f. Imposing a fee or other charge in order to carry out the Act's purposes.

g. Executing and exercising such powers as the Government of India may designate under the Securities Contracts (Regulation) Act 1956.

- **Development Functions:**

a. Investor education: Investor education is concerned with concerns of the education and information needs of people who participate in, or are considering participating in, the financial markets. Investor education can also assist investors in determining the relevance and acceptability of investing advice.

b. Training of intermediaries: It facilitates the training of intermediaries and attempts to promote stock exchange activity through an adaptable and flexible approach.

c. Fair practises and a code of behaviour for all SROs are promoted: A self-regulatory organisation (SRO), such as a non-governmental organisation, has the authority to develop and implement independent industry and professional regulations and standards.

d. Conducting research and disseminating data that will benefit all market players.

20. What is a Treasury Bill?

Ans: The Reserve Bank of India issues Treasury Bills on behalf of the Central Government of India. They are issued to meet the Government of India's short-term funding needs.

- Treasury Bills have maturities ranging from 14 to 364 days. Commercial banks, LIC, UTI, non-banking financial companies, and others typically issue these bills. They are also called Zero-Coupon Bonds.
- Treasury notes are extremely liquid instruments since the Reserve Bank of India (RBI) is always willing to buy them. Furthermore, because they are issued by the RBI, they are regarded as the safest instrument.
- They can be purchased for a minimum of Rs 25,000 and in multiples of that amount.
- Treasury Bills are issued at a discount i.e. they are issued at a lesser price than the face value and redeemed at the face value.
- The interest received at the time of redemption is the discount (the difference between the issue price and the redemption value).

The purpose of T-Bills is to meet the government's short-term money borrowing needs.

T-bills have a number of advantages over other bills, including:

- No risk weighting. These are issued by the government and have no risk associated with them.

- Because the maturity dates are 91 days and 364 days, there is a lot of liquidity.
- Transparency is there.
- T-Bills have a higher degree of tradability due to their active secondary market.