

Understanding-based Questions

[1 mark]

Q.1. Name the two major alternative mechanisms through which allocation of funds can be done.

[CBSE 2013]

Ans.

- i. Banks
- ii. Financial markets

Q.2. State any one consequence of a well performed 'allocative function' of financial market.

[CBSE 2013]

Ans. The rate of return offered to households/investors would be higher.

Q.3. Give two examples of Floatation Costs.

Ans.

- i. Brokerage and
- ii. Underwriting Commission.

Q.4. Name any two buyers of Commercial Papers.

Ans.

- i. Banks and
- ii. Insurance Companies.

Q.5. List any two characteristics of secondary market. *[CBSE Sample Paper 2013]*

Ans.

- i. It creates liquidity.
- ii. It has a particular place.

Q.6. Name the form of shares in which they are stored under depository system.

Ans. It is electronic form.

Q.7. State any one Protective Function of SEBI.

[CBSE 2012]

Ans. To check unfair trade practices in connection with security market.

Q.8. State any one Regulatory Function of SEBI.

[CBSE 2012]

Ans. To register brokers, sub-brokers, transfer agents, merchant banks, underwriters, etc.

Q.9. State any one Developmental Function of SEBI.

[CBSE 2012]

Ans. To carry on research work.

Q.10. State any one objective of setting up of Securities and Exchange Board of India (SEBI).

[CBSE 2012]

Ans. To develop and implement the code of conduct relating to security market.

[3 marks]

Q.1. Explain the following money market instruments:

- a. Treasury Bill
- b. Commercial Paper

[CBSE 2010]

Ans. Following is the brief description of money market instruments:

- a. **Treasury Bill:** Treasury Bill means that short term instrument which the Central Government issues to the financial institutions or the general public in order to meet its short-term financial needs. Usually their maturity period is 14 days, 91 days, 182 days and 364 days. Treasury bills are of highly liquid nature because the RBI is ever-ready to buy them on discount. They are issued at less than the face value while the payment is made at the face value.
- b. **Commercial Paper (CP):** Commercial Papers are those unsecured Promissory Notes which are issued by well-reputed companies. The minimum face value of a commercial paper is five lakh rupees. It is used to meet the demand of a short-term seasonal need and the requirement of working capital. They are issued for a period of 15 days to 12 months.

Q.2. How the depository system is parallel to the banking system?

Ans. The depository system is parallel to the banking system. A bank holds cash in accounts whereas a depository holds shares in accounts for its clients. A bank transfers cash between accounts whereas a depository transfers shares between accounts. In both the systems, the transfer of cash and shares takes place without the physical handling of cash or shares. Similarly, both the banks and the depositories are accountable for the safe custody of cash and shares respectively.

Q.3. State any three 'Development functions' of Securities and Exchange Boards of India (SEBI).

[CBSE 2013]

Ans. Developmental Functions: The following are the developmental functions of the SEBI:

- i. To impart training to the intermediaries. (Intermediaries include share brokers, Sub-brokers, Share Transfer Agents, Issue Registrars, Merchant Bankers, Portfolio Managers, etc.)
- ii. To develop the capital market by adapting a flexible approach.
- iii. To carry on research work and publish different kinds of information for the convenience of all the parties operating in the capital market.

Q.4. State any three 'Protective functions' of Securities and Exchange Board of India (SEBI).

[CBSE 2013]

Ans. Protective Functions: Following are the protective functions of SEBI:

- i. To check unfair trade practices (such as, to supply misleading statements to cheat the investors) in connection with security market.
- ii. To check insiders trading in securities. [Insider trading means the buying and selling of securities by those persons (Directors, Promoters, etc.) who have some secret information about the company and who wish to take the advantage of this secret information.]
- iii. To provide education relating to dealing in securities to the investors.

Q.5. 'The Stock Exchange performs many vital functions in today's commercial world.' Explain any three such functions.

[CBSE 2014]

Ans. The main functions performed by a stock exchange are as follows: Refer to Points (i) to (iii) of Q. 5 (Remembering-based Questions—4/5 Marks)

Q.6. *Saqib Ltd. is a large credit worthy company operating in the Kashmir Valley. It is an export oriented unit, dealing in exclusive embroidered shawls. The floods in the Valley have created many problems for the company. Many craftsmen and workers have been dislocated and raw material has been destroyed. The firm is therefore, unable to get an uninterrupted supply of raw material, and the duration of the production cycle has also increased. To add to the problems of the organisation, the suppliers of raw material who were earlier selling on credit are asking the company, for advance payment or cash payment on delivery. The company is facing a liquidity crisis. The CEO of the company feels that taking a bank loan is the only option with the company to meet its short term shortage of cash.*

As a finance manager of the company name and explain the alternative to bank borrowing that the company can use to resolve the crisis.

Ans. Commercial Paper: It is a short term unsecured promissory note, negotiable and transferable by endorsement and delivery with a fixed maturity period. It is issued by large and creditworthy companies to raise short term funds at lower rate of interest than market rates. The issuance of commercial paper is an alternative to bank borrowing for large companies that are generally considered to be financially strong.

[6 marks]

Q1. Differentiate between 'Capital Market' and 'Money Market' on the basis of the following:

- i. Participants
- ii. Instruments
- iii. Duration
- iv. Investment outlay
- v. Liquidity

[CBSE 2014]

Ans. Difference between Capital Market and Money Market:

Basis of Difference	Capital Market	Money Market
(i) Participants	Financial institutions, banks, corporate bodies, foreign investors and ordinary public.	RBI, banks, financial institutions and finance companies are the main participants.
(ii) Instruments Traded	Equity shares, preference shares, debentures, bonds, etc.	Call loans, treasury bill, commercial bills, commercial papers, certificates of deposit, etc.
(iii) Duration	Period of maturity is more than one year.	Period of maturity ranges from one day to one year.
(iv) Investment Outlay	The value of units of securities is generally low, i.e., ₹ 10, ₹ 100, etc.	These instruments are of large amount, e.g., the minimum amount of Call Loan is ₹ 10 crores.
(v) Liquidity	Only actively traded securities have ready market. Hence, there is no guarantee of liquidity in the securities of all companies.	In this market, there is a formal arrangement of creating liquidity. The Discount Finance House of India (DFHI) has been established for this purpose. It is always ready to provide ready market for money market instruments.

		Hence, there is maximum liquidity in this market.
--	--	---

Q.2. Differentiate between ‘Primary Market’ and ‘Secondary Market’ on any five basis.

[CBSE 2014]

Ans. Difference between Primary and Secondary Market:

Basis of Difference	Primary Market	Secondary Market
(i) Issue	Securities (like shares) are issued for the first time.	RBI, banks, financial institutions and finance companies are the main participants.
(ii) Buying and Selling	Investors can only buy securities.	Both buying and selling can take place.
(iii) Specified Place	It has no specified place.	It has a special and fixed place known as stock exchange.
(iv) Price Determination	The prices of securities are determined by the company.	The prices of securities are determined by demand and supply.
(v) Parties	Issuing company and buyers are parties.	Only investors do the trading among themselves.

Q.3. Explain the meaning of ‘Capital Market’, ‘Primary Market’ and ‘Secondary Market’.

Ans.

- i. **Capital Market:** Capital market means that market where transactions in long-term securities are made. This market offers help in meeting the long-term financial needs of various sectors of economy. Transaction of securities in this market include primarily the shares and debentures. This market encourages people to invest their small savings in productive activities. On the one hand, people earn appropriately and on the other hand, the economy develops.
- ii. **Primary Market:** Primary market is that market in which shares, debentures and other securities are sold for the first time for collecting long-term capital. This market is concerned with new issues. Therefore, the primary market is also called New Issue Market (NIM). Through the medium of this market both the newly established companies as well as the existing companies collect capital. In this market, the flow of funds is from savers to borrowers (Industries).
- iii. **Secondary Market:** The secondary market is that market in which the buying and selling of the previously issued securities is done. When a security is sold for the first time, it is the activity of the primary market. However, when the same

security is sold for the second time, it is the activity of the secondary market. The transactions of the secondary market are generally done through the medium of stock exchange. The chief purpose of the secondary market is to create liquidity in securities.

Q.4. Explain the steps in the 'Trading Procedure' of Stock Exchange.

[CBSE Sample Paper

2013]

Ans. Trading Procedure: The trading procedure of securities on a Stock Exchange is as follows:

1. **Selection of a Broker:** For trading of securities on a Stock Exchange, first of all, the selection of a broker registered with SEBI is done. This is necessary because dealing on a Stock Exchange can be done only through a broker. The broker can be an individual, a partnership firm or a company.
2. **The Opening of Demat Account with the Depository:** These days all dealings in securities are done on-line or are paperless. To make such a thing possible, it is obligatory to open a Demat Account. The Demat Account is opened through one of the parties of depository service, a depository participant. The securities are kept by the depository in the electronic form.
3. **Placing an Order:** As soon as the Demat account of the investor is opened, he can order the broker to buy securities. The order may be given personally or telephonically or through e-mail. While placing the order the investor give the detailed description of the securities to be bought or sold out and also conveys the price upto which the transaction may be finalized.
4. **Executing the Order:** In accordance with the order of the investor, the broker does the transaction of buying and selling of the securities. Soon after this, the broker prepares the contract note to be sent to the investor. In the contract note, the name of the securities bought or sold out, along with their quantity and price is written. In this note the information about the brokerage charges is also given. This note is duly signed by the broker and it is preserved by the customer as a proof of the transaction.
5. **Settlement:** This is the final stage of the deal on the Stock Exchange. Settlement implies the transfer of the securities from the Demat Account of the seller to the Demat Account of the buyer. Settlements can be of the following two types:
 - i. **On the Spot Settlement:** It implies immediate settlement of the deal. In such a situation 'T+2' Rolling Settlement is enforced. Here 'T+2' implies that if the transaction is done on a Monday, it will be settled on the following Wednesday. It means delivery and payment both will be done on Wednesday. 'T+2' can be understood in the following manner: T: The day of transaction. T+1: The information about the finalisation of the transaction/preparing the contract note. T+2: Delivery and Payment.
 - ii. **Forward Settlement:** It implies the settlement to be done on some date in the future. Settlement Period may be 'T+5', 'T+7', etc. **Note:** All

transactions on the Stock Exchange are done from 9.15 a.m. to 3.30 p.m.
from Monday to Friday.