

CBSE Test Paper - 03
Chapter - 10 Financial Markets

1. Capital market deals in _____ (1)
 - a. Very short term securities
 - b. None of these
 - c. Medium and long term securities
 - d. Short term securities
2. OTCEI was started on the lines of: (1)
 - a. NSE
 - b. NYSE
 - c. NASAQ
 - d. NASDAQ
3. What is meant by Demat Account? (1)
 - a. Demand Depository Account
 - b. Depository Participant Account
 - c. Dematerialisation of of Securities
 - d. Development Market Account
4. Only institutional investors can participate in _____. (1)
 - a. Money Market
 - b. Capital Market
 - c. Foreign Market
 - d. Loan Market
5. State the consequences of well performed well function of financial market. (1)
6. As a financial advisor, advise whose method is appropriate in the given situation. Mr. Rohit and Mr. Mohit are promoting a new company. They are totally confused about how to raise funds from the market. Rohit is interested in new issue of shares through issue of prospectus. However, Mohit is interested in Rights issue. (1)
7. State any one consequence of a well performed 'allocative function of financial market'. (1)
8. State the instrument by which unsecured, negotiable, short-term instrument in bearer form, issued by commercial banks and development financial institutions. (1)

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9. Give the meaning of the following money market instruments
- Commercial bill; and
 - Certificate of deposit. **(3)**
10. Mission Coach Ltd. is a large creditworthy company that manufactures coaches for the Indian Railways. It now wants to export these coaches to other countries and decides to invest in new hi-tech machines. Since the investment is large, it requires long-term finance. It decides to raise funds by issuing equity shares. The issue of equity shares involves huge floatation cost. To meet the expenses of floatation cost, the company decides to tap the money market.
- Name and explain the money-market instrument the company can use for the above purpose.
 - What is the duration for which the company can get funds through this instrument?
 - State any other purpose for which this instrument can be used. **(3)**
11. State any one function of Stock Exchange. **(4)**
12. SEBI is the watch dog of security market. Do you agree? Give reason. **(4)**
13. Explain any five functions of stock exchange. **(5)**
14. Dev opened a D-mat account with a reputed stock broker. As per the advice of his brother who actively trades in securities he placed an order to buy 100 shares of Mega Ltd. at the current price of Rs. 430 per share. Later on, he has issued two documents first one on placing the order and second one after execution of his order online. Also, the broker forwarded a legally enforceable document to Dev within 24 hours of the execution of the order. There after he was asked to make a payment of Rs. 43,000 plus commission. He was told that the broker will first make the payment to the exchange and thereafter the exchange will make payment to the other broker who will further forward it to the investor who has sold these securities.
- In the context of the above case:
- Identify and explain the various documents mentioned above which were issued to Dev during the process of screen based trading.
 - Name the two phases involved in the settlement process of screen based trading described above wherein one of them is to be carried out before T+2 day and the other one on the T+2 day by quoting lines from the paragraph. **(5)**
15. What are the methods of floatation in Primary Market? **(6)**

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Answer

1. c. Medium and long term securities

Explanation:

Capital Market is a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities.

2. d. NASDAQ

Explanation:

OTCEI (Over the Counter Exchange of India) was incorporated in the year 1990 on the lines of NASDAQ which is the OTC in USA. OTCEI is a fully computerized and transparent stock exchange.

3. c. Dematerialisation of Securities

Explanation:

In India, shares and securities are held electronically in a dematerialized (Demat) account, instead of the investor taking physical possession of certificates. A Demat account is opened by the investor while registering with an investment broker (or sub-broker).

4. a. Money Market

Explanation:

Only institutional investors can participate in money market. The money market consists of financial institutions and dealers in money or credit who wish to either borrow or lend. Participants borrow and lend for short periods, typically up to thirteen months.

5. The consequences of well performed well function are :

- i. The rate of return offered to households would be higher.
- ii. Scarce resources are allocated to those firms which have the highest productivity for the economy.

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6. The method of issue suggested by Rohit (Offer Through Prospectus) is appropriate as 'Rights Issue' can be used only by existing companies.
 7. One of the consequences of a well performed 'allocative function of financial market' is to provide liquidity to financial assets.
 8. " Certificate of deposit " is the instrument by which unsecured, negotiable, short-term instrument in bearer form.
 9.
 - i. **Commercial bill:** A commercial bill is a bill of exchange used to finance the working capital requirements of business firms. It is a short-term negotiable, self liquidating instrument, which is used to finance the credit sale of the firms When goods are sold on credit, seller draws the bill of exchange on the buyer On being accepted by the buyer, it becomes a trade bill, which is a marketable instrument On being discounted from the bank, the trade bill becomes the commercial bill.
 - ii. **Certificate of deposit:** A certificate of deposit (CD) is a savings certificate with a fixed maturity date and specified fixed interest rate that can be issued in any denomination aside from minimum investment requirements. A CD restricts access to the funds until the maturity date of the investment.
 10.
 - a. Commercial Papers can be used for Bridge financing by Mission Coach Ltd. as it is issued by large and credit worthy companies. The instrument is in the form of an unsecured promissory note and is freely transferable by endorsement. It is sold at discount and redeemed at par.
 - b. Its maturity period may range from a fortnight to a year.
 - c. Working capital, also known as net working capital (NWC), is the difference between a company's current assets such as cash, accounts receivable (customers' unpaid bills) and inventories of raw materials and finished goods, and its current liabilities, such as accounts payable. It is also used to meet the short term seasonal and working capital requirements of a business enterprise.
 11. **Safety of Transactions:**

In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.
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12. Yes, I agree as SEBI regulates and protects the interest of investors. SEBI was established in 1988 and given a statutory status in 1992, to protect the investors from the fraudulent malpractices, rampant in securities market before 1988. As a watch dog, it regulates the market and protects the investors by keeping a check on various manipulative activities by performing the following functions:
- i. Regulates takeover bids by companies.
 - ii. Prohibits fraudulent and unfair trade practices.
 - iii. Undertakes several steps to protect the investors, for example calls for information by conducting inspections, enquiries and audits of the companies.
13. Stock exchange is a marketplace where securities, commodities, derivatives and other financial instruments are traded. The core function of an exchange is to ensure fair and orderly trading and the efficient dissemination of price information for any securities trading on that exchange. Exchanges give companies, governments, and other groups a platform from which to sell securities to the investing public.

Main functions of stock exchange are as follows

- i. **Pricing of securities:** The stock market helps to value the securities on the basis of demand and supply factors. Higher the demand for such securities, higher is their value. The valuation of securities is useful for investors, government and creditors.
- ii. **Contributes to economic growth:** In stock exchange, securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.
- iii. **Spreading of equity cult:** Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating people about investment.
- iv. **Liquidity:** The main function of stock market is to provide ready market for sale and purchase of securities which assures the investors that their investment can be converted into cash whenever they want.
- v. **Safety of transaction:** The stock exchange is well regulated and its dealings are well defined according to the existing legal framework. This ensures that the

investing public gets a safe and fair deal in the market.

14. a. The stock exchanges now provide an on-line fully automated 'screen based trading system (SBTS)' A member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching order from a counter party. It allows faster incorporation of price sensitive information into prevailing prices, and enables increasing the informational efficiency of markets. It enables market participants to see the full market on real time, making the market transparent. The various documents mentioned above which were issued to Dev during the process of screen based trading are described below:
- i. Order confirmation slip: It's through an order confirmation slip that a broker certifies to the investor that the said order as placed by a buyer to a broker has been transmitted to and confirmed by the computer system at stock exchange. This slip is issued the stock exchange, to the broker who then forwards it to the buyer/investor.
 - ii. Trade confirmation slip: A trade confirmation slip is a document issued by the stock broker showing the details of the securities bought or sold after the order has been executed electronically.
 - iii. Contract note: A contract note contains details about the deal i.e. the number of securities bought/sold, price, date and time of transaction etc. and also includes a unique order code generated by the stock exchange for that particular transaction. It is a legal document, which may be used to settle the claims between the investor and the broker.
- b. The two phases involved in the settlement process of screen-based trading described above are:
- i. Pay-in day which refers to the steps to be carried out before T+2 day.
"He has been told that the broker will first make the payment to the exchange."
 - ii. Pay-out day which refers to the steps to be carried out on the T+2 day.
"The exchange will make payment to the other broker who will further forward it to the investor who has sold these securities."
15. The methods of floatation in primary market are:
- i. **Offer for Sale:** Under this method, securities are not issued directly to the public.

Securities are offered for sale to the public by the intermediaries like issue houses and stockbrokers for example, Sharekhan, Motilal Oswal, Karvi stock broking, ICICI Direct, and HDFC Security etc. The company sells its shares to the brokers at an agreed price and brokers resell these shares to the investors.

- ii. **Offer Through prospectus:** Offer through prospectus is the most popular method of raising funds by public companies in the primary market. This involves inviting subscription from the public through issue of the prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines.
- iii. **Private Placement:** A private placement is concerned with issuing securities to a selected group of persons or institutional investors under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital. Private placement of securities by a listed company is generally known as a preferential allotment. The main purpose of private allotment is to avoid the cost of an issue (expenses) which a company cannot afford.
- iv. **Rights Issue:** Under this method, a company offers new shares to its existing shareholders according to the terms and conditions of the company. Existing shareholders get shares in proportion of shares already held by them. This method is useful for closed-end companies, which cannot retain earnings because they distribute essentially all of their realized income and capital gains each year; therefore, they raise additional capital through rights offerings. When a company is unable to raise equity capital from the general public, it may ask the existing shareholders to buy more shares.
- v. **E-IPOs:** Under this method, a company offers and issue its securities to the public through the online system of the stock exchange. This is called the Initial Public Offer (IPO). Only those brokers can accept applications and place orders with the company who are registered with the SEBI. The company who is issuing shares through the online system should appoint a registrar for having electronic connectivity with the exchange. The issuer company can apply for listing of its securities on any exchange except the exchange through which it has offered its securities. The lead manager plays important role in coordinating all the activities amongst the intermediaries concerned with the issue.