

Chapter – X

Capital Market

(4+ 4 = 8 Marks) 60-80 words

What is meant by capital market? Describe its nature. – 4 marks

- It is a market where all organizations, financial institutions and instruments provide long and medium term funds to the business sector.
- The two major components of capital market are
 - Primary (new issue market)
 - Secondary market (stock exchange).

The nature of capital market can be understood from the following points:

- It acts a link between savers and borrowers who need funds to invest profitably and efficiently.
- It helps firms to procure finances for long-term investments such as buying plant & machinery, building, etc.
- It obtains its funds through issue of various securities such as equity shares, bonds, debentures and innovative securities like zero interest bonds and deep discount bonds.
- It functions thru' various intermediaries such as underwriters, bankers, stock brokers, etc.
- It includes both individual investors and institutional investors such as UTI, LIC, IDBI, etc

State any four PROTECTIVE functions of SEBI? (What is insider trading)?

- It prohibits *insider trading*. It prevents insiders such as directors, promoters who have access to price sensitive information regarding securities of the company (which is not available to the public) to make individual profits through trading of securities.
- It prohibits *fraudulent and unfair trade practices* in the security market like making misleading statements and price rigging. (Manipulating with the sole intention of inflating or deflating the market price of securities is termed as “price rigging)
- It promotes *fair practices and code of conduct* in the securities market.
Example: Looks after the interest of the debenture holders in terms of any mid term revision of interest rate, etc.
- It takes steps to *educate investors*.

SEBI is a REGULATORY authority of the securities market. Do you agree? Explain

in brief any four reasons in support of your answer. 4 marks - CBSE-2005 Set 1, 2.

OR V. Imp

- It carries out audit of the share markets
- It regulates takeover of companies
- It regulates the business being conducted in the share market.
- It registers and regulates the working of brokers, sub brokers, transfer agents, merchant banks, underwriters, etc.
- It registers and regulate the credit rating agency, venture capital funds and mutual funds

State any two developmental functions of SEBI – 4 marks CBSE-2004 Set 1 V. Imp

- It promotes trading of intermediaries of the securities market.
- It adopts a flexible approach to develop the capital market.

You are a finance expert. One of your friends comes to you and tells you that the capital market and money market are one and the same, whereas you differ with him. How would you convince him? Give any 4 reasons. – 4 marks CBSE-2004 Set 1,2,3

Or

Dist between: Capital Market and Money Market on the basis of: participants, instruments traded, investment outlay and safety 4 will be asked (4 marks CBSE 2005 Set 2) V. Imp

<i>Basis</i>	CAPITAL MARKET	MONEY MARKET
<i>Participants</i>	Participants are financial institutions, banks, corporate entities, foreign investors and ordinary retail investors from the public	Participants are institutions such as RBI, Banks, Financial Institutions and finance companies
<i>Instruments Traded</i>	Equity shares, debentures, bonds, preference shares, etc	Treasury bills, trade bills, commercial papers, certificates of deposit
<i>Investment outlay</i>	Does not require huge investment outlay as value of units of securities is low	Requires huge investment outlay as instruments are quite expensive
<i>Safety</i>	Risky both in terms of returns and principal repayment	Safer with minimum risk of default
<i>Duration</i>	Deals in medium and long term securities	Deals in short term securities from 1 day up to 1 year
<i>Liquidity</i>	Low liquidity	High degree of liquidity
<i>Expected returns</i>	Generally yields high returns	Generally yields low returns

Dist between: 4 marks

NSEI and OTCEI on the basis of: size of company, securities traded, settlement, objective.

<i>Basis</i>	NSE(I)	OTCE(I)
<i>Size of company</i>	Paid up capital 3 crores & above	Paid up capital 30 lakhs and above
<i>Securities traded</i>	Trades in Equity, debentures, treasury bills, PSU, bonds, etc	Equity, debentures, etc
<i>Settlement</i>	Payment within 15 days of transaction	Payment within 7 days of the transaction
<i>Objective</i>	Nationwide, ringless transparent trading facility for both capital and money market	Serves as an exchange for securities of small companies

Dist between: Primary and Secondary Market on any 4 basis		
Basis	Primary Market(<i>New Issue Market</i>)	Secondary Market(<i>Stock Exchange</i>)
<i>Securities trading</i>	It is a market for new securities	It is a market for existing securities
<i>Sale of securities</i>	Securities are sold to investors directly by the company or through their intermediary	Securities are exchanged between investors without involvement of the company
<i>Flow of funds</i>	It directly promotes capital formation as flow of funds is from savers to investors	It indirectly promotes capital formation as it enhances liquidity of shares
<i>Location</i>	It has no fixed geographical location. Shares can be traded from anywhere	It has a fixed location and fixed working hours
<i>Prices</i>	Prices are determined by management of the company	Prices are determined by demand and supply of the securities

The directors of a company want to modernize its plants and machinery by making a public issue of shares. They wish to approach stock exchange, while the finance manager prefers to approach a consultant for the new public issue of shares. Advise the directors whether to approach stock exchange or a consultant for new public issue of shares and why? Also advise about the different methods that the company may adopt for the new public issue of shares.

The directors should approach the consultant for the new public issue of shares. The reason being that as stock exchange is a secondary market, which deals in existing securities while the company wants to make a public issue of shares.

The following are the methods for the new public issue of shares.

Public issue through prospectus:

- Under this method, the company issues a prospectus to invite the public to invest in its securities.
- The prospectus provides the following details

- purpose for which funds are being raised
- past financial performance of the company
- background and experience of promoters
- This information helps the investing public to evaluate the earning potential and risk of the proposed investment.

Offer for sale:

- The sale of securities takes place in two steps:
 - In the first step the company sells all the shares to intermediaries at an agreed price.
 - In the second step the intermediaries resell these securities to investors at a higher price.
- The advantage of this method is that the company is saved from the tedious process involved in making a public issue.

(1 mark for correct advice + 1 mark for reason + 1 mark for each correct method = 1+1+2=4 marks)

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