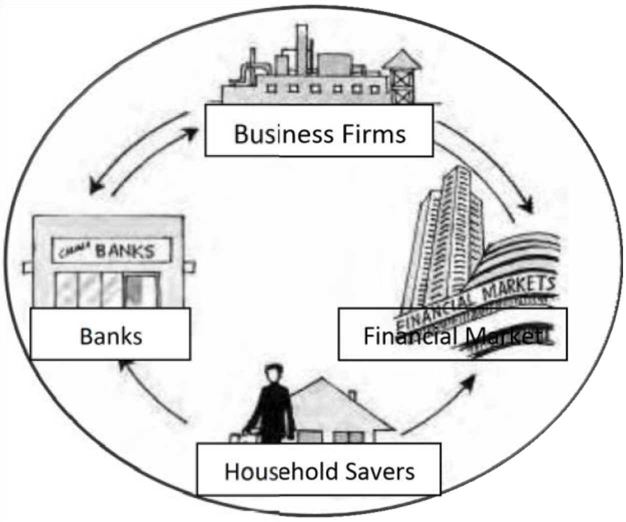
FINANCIAL MARKET

Meaning – Financial market is a market for the creation and exchange of financial assets such as shares, debentures, bonds and government securities. It is a network of institutions which provide short, medium and long term funds.

Financial markets make possible the transfer of money from the investors to the entrepreneurial borrowers. Actually they bring together the lenders of funds and borrowers of funds.



Allocation of funds – There are two alternatives through which allocation of funds can be done – banks and financial markets. Household savers can deposit their surplus funds with banks. Banks then lend these funds to business firms.

Household savers can also invest their savings in financial market directly by purchasing shares and debentures offered by business firms.

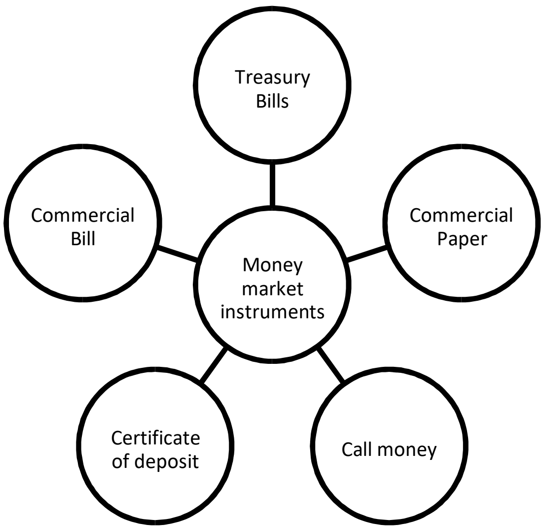
Both banks and financial markets are competing financial intermediaries.

Money Market – Meaning

Money market is the market for short term funds. Short term funds are meant for a period of up to one year. Money market is not usually located at a particular place. It is a term used to describe all organizations and institutions that deal in short term debt instruments.

It makes possible the raising of short term funds for meeting the working capital needs and temporary deployment of excess funds to get returns.

Money market instruments



1. **Treasury Bills (T-Bills / Zero Coupon Bonds) –** These are issued by RBI on behalf of Central Government. Maturity less than one year. It is an instrument for short term borrowings by Government of India.

   They are issued in the form of promissory notes and freely transferable as it comes under Negotiable Instrument Act

   They are issued at a price which is lower than their face value and repaid at par, the difference between issue price and redemption value is called **discount.** It is available for a minimum amount of Rs. 25,000 and in the multiples thereof.

2. **Commercial Paper (CP) –** Issuing commercial paper in India as a money market instrument took place in 1989-90. It is an unsecured promissory note issued to the public with a fixed maturity period ranging from 15 days to 1 year. Since being unsecured, this is issued by highly reputed corporate entities.

   This serves as an important source of working capital and for bridge financing for raising long term funds from capital market in order to meet flotation cost, brokerage, advertising, printing share applications etc. Commercial banks and mutual funds contribute towards this kind of instruments.
3. **Call Money –** This is an important part of money market where day-to-day surplus funds of banks and other financial institutions are dealt with. The banks with surplus funds lend other banks that are facing deficiency. The duration of call money caries from one day to 15 days and is repayable on demand, either by the lender or by the buyer. Interest paid on call money is called <u>Call rate.</u>

   Call money is a method by which banks borrow mutually to maintain CRR (Cash Reserve Ratio), CRR is the minimum balance a commercial bank should maintain with RBI.

4. **Certificate of Deposit (CD) –** It is an unsecured, negotiable, short term instrument in bearer form, issued by commercial banks and financial institutions to individuals, corporations and companies. Maturity period 3 months to 12 months. These are issued at a discount and redeemed at par.
5. **Commercial Bill (Trade Bill) –** This is a bill of exchange used to finance working capital requirements of a business. It is a short period, negotiable and self-liquidating instrument used to finance credit sales.

   On credit sales, the seller (drawer) draws the bill and the buyer (drawee) accepts it, by putting his signature on it. On acceptance, the bill becomes a marketable instrument and is called a <u>trade bill</u>. This bill can be discounted with a bank if the seller requires funds before maturity. When a trade bill is accepted (discounting of bills) by a commercial bank, it is known as <u>commercial bill.</u>

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Capital Market – Meaning

1. Capital market is an institutional arrangement by which savings are channelized into investment avenues. It enables the borrowers to raise funds for their purpose. Similarly,

it gives opportunities to the lenders to wisely invest their funds. The borrowers raise required funds through issue of securities like shares, debentures, bonds etc. A security means a certificate of title evidencing investment made in the capital or debt of any entity.

Primary Market (New issue market)

This is the market which deals in new securities issued by new companies or existing companies. Therefore, it is also called New Issue Market (NIM). If it is issued by new companies it is called Initial Public Offerings (**IPO**s) and if it is issued by existing companies it is called Seasoned Equity Offerings (**SEO**s). The securities offered are equity shares, preference shares, debentures, bonds, innovative types of securities like deep discount bonds, zero interest bonds etc.

Secondary Market (Stock Exchange)

Secondary market is the market for the purchase and sale of second hand or listed securities. Shares, debentures, bonds etc. which have already been issued by companies or government are traded in this market. It consists of buyers and sellers of securities and brokers as intermediaries. The investors can buy and sell securities only through brokers. Secondary markets are also known as stock exchanges.

Comparison between Primary market and secondary market

Primary market	Secondary market
1. It deals with new securities.	1. It deals with existing securities.
2. Securities are sold only once.	2. It provides regular and continuous market.
3. It links the issuing company and investors.	3. Transactions are made between investors.
4. Investors can only purchase securities.	4. Investors can purchase and sell securities.
5. It provides capital to the companies.	5. Issuing company has no direct role.
6. It does not have any physical existence.	6. It has physical existence.
7. Prices of securities are determined by the Co.	7. Price is based on demand and supply of securities.
8. Securities can be sold without listing.	8. Only listed securities can be traded.

Securities and Exchange Board of India (SEBI)

SEBI is the regulatory and developmental agency of Indian Capital Market, established in 1988 based on the recommendations of G S Patel Committee. It was made a statutory body under Securities and Exchange Board of India Act 1992.

Reasons for establishment of SEBI

During 1980's the capital market witnessed a tremendous growth due to increase in investor population. This hike in market capitalization led to various malpractices by companies, brokers, merchant bankers, investment consultants, etc. All these made huge losses to the ordinary investors and they have lost their confidence in this segment. This made Government of India to constitute a regulatory body known as SEBI.

Common Malpractices in stock market:

a. Self-styled merchant bankers
b. Unofficial private placement
c. Price rigging (artificially inflating prices of certain shares by a group)

d. Unofficial premium on new issue
e. Non-adherence of provision to Companies Act
f. Violation of rules and regulations of stock exchanges and listing formalities.

Purpose and Role of SEBI

SEBI was constituted by the Govt. of India with a view to create a favorable environment for efficient mobilization and allocation of resources through securities market. This environment aims at fulfilling the needs of three groups:

a. **Issuers –** SEBI ensures a market place where the companies can confidently raise finance in easy, fair and efficient manner.
b. **Investors –** Provides protection of their rights and interest by providing authentic information.
c. **Intermediaries –** Offers a competitive professional market by equipping intermediaries to render better services to the investors and issuers.

Objectives of SEBI

1. **Regulatory functions -** To regulate the securities market and ensure fair practices.
2. **Protection of rights -** To protect the interest of investors and thereby attract a steady flow of savings into capital market.
3. **Prevention of malpractices –** To prevent trading malpractices.
4. **Develop a code of conduct -** To promote efficient services by brokers, merchant bankers etc. so as to make them competitive and professional.

Functions of SEBI

A. Regulatory functions:

1.Registration of brokers and sub brokers in the market.
2.Registration of investment schemes and Mutual Funds.
3.Regulates the functioning of share brokers, underwriters etc.
4.Regulation of takeover bids by companies.
5.Conducting enquiries and audits of stock exchanges.
6.Levying fee or other charges as specified by the Act.

B. Developmental functions:

1.Promoting investor education and training of intermediaries.
2.Conduct of research and publication of useful information.
3.Undertaking measures to develop the capital market.

C. Protective functions:

1. Prohibition of fraudulent and unfair trade practices like misleading statements, manipulations, price rigging etc.
2. Controlling insider trading in securities to protect the interest of individual investors. Insider means the top officials of the company, who can make bulk purchase or sale for making huge profit on the basis of vital information such as declaration of dividend on a future date etc.
3. Undertaking steps for investor protection.
4. Promotion of fair practices and code of conduct in securities market.

Stock Market Indices

Stock market index is a device, which reflects the relative change in prices of securities in a stock exchange. The general trend of the market can be measured by studying stock market index. Eg: BSE Sensex (Sensitive Index), BSE 100, S&P CNX Nifty, S&P CNX500, CRISIL 500 etc.

BSE Sensex is calculated on weighted average basis of 30 shares, and Nifty applied in NSE is based on 50 shares.

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