

**QUICK REVISION MODULE** (UPSC PRELIMS 2021) ECONOMICS

# MONEY MARKET AND CAPITAL MARKET

### **FINANCIAL MARKET**

- 1 refers to a system consisting of Financial Institutions (Bank, NBFC), instruments (shares, bonds), organization (stock exchange), and regulatory bodies (RBI, SEBI) which facilitate financial transactions.
- Objective: Capital flow and savings of household are mobilized for benefit of the market.

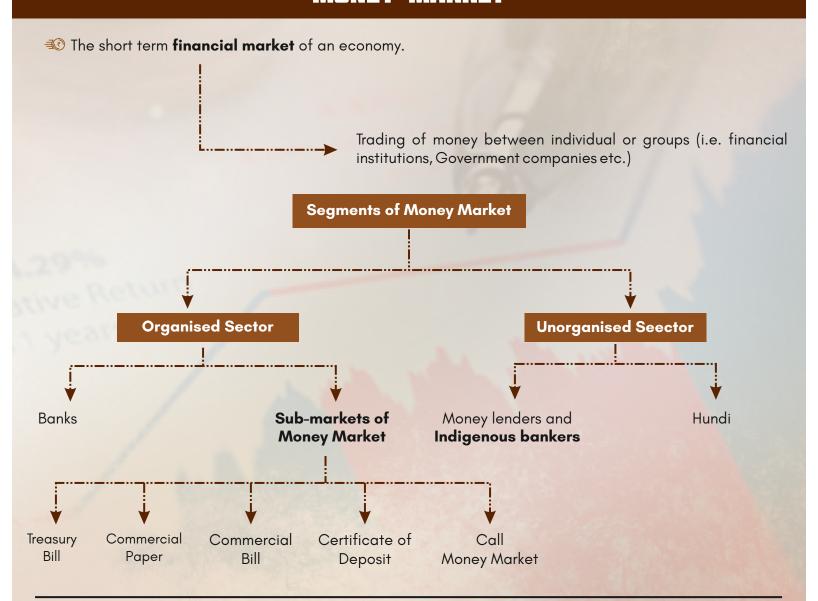








### **MONEY MARKET**







### **MONEY MARKET INSTRUMENTS**

### TREASURY BILL (TB)

- Used by Central Government to fulfil its short term (upto 364 day) liquidity requirement.
- Variants of Tbs
  - a) 14-day (Intermediate Tbs) ' b) 14-day (Auctionable TBs)
- discontinued in 2001.

- c) 91-day Tbs
- d) 182-dayTbs
- e) 364-dayTbs

### 2) COMMERCIAL PAPER (CP)

- Unsecured security.
- Issued by **a high net worth company** to a Bank against short term loan.
- **Solution** Issued at discount to their face value.
- Issued in multiple of Rs1 Lakh subject to minimum value of Rs 25Lakhs.
- Maturity: from 14 days to 1 year.
- Most important source of working capital finance of large firms.

### **COMMERCIAL BILL**

- Unsecured security.
- lssued by one merchant firm to another against a credit transaction.
- Source of working capital for small companies.

### CERTIFICATE OF DEPOSIT

- A Security/Bond which is issued by Bank to depositors of funds.
- Issued in multiple of Rs1Lakh subject to a minimum value of Rs 25Lakhs.
- Issued at discount.
- Similar to FDs but these are negotiable and tradable in money market.

#### 51 INTER BANK CALL MONEY MARKET

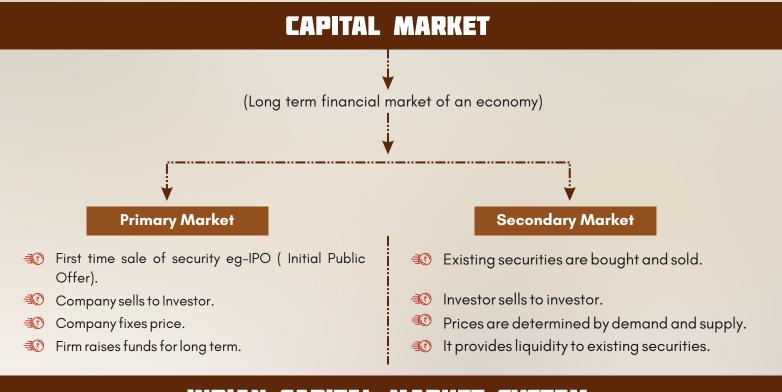
- Deals in day to day lending and borrowing transaction of Banks against themselves.
- Very Short term Loan- Usually for 1 or 2 days or maximum can be for 14 days.
- Interest charged on such loans is called the **Call Money Rate** (CMR) which is market-determined.
- MR serves as a benchmark for monetary policy operations. Eg- if the interest rate is high, RBI will buy securities.
- It helps in the optimum use of liquidity.

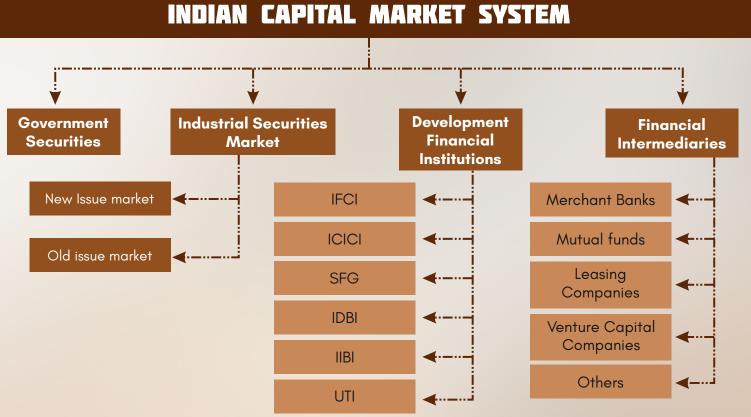




- A Commercial Bill of unorganised sector/market. It is issued by one firm to another against credit
- These are **not** discounted/accepted by banks.
- They are mostly on a trust basis.

Note: Discount and Finance House of India (DFHI), serves as a secondary market for the money market instruments eg-CD, CP etc.









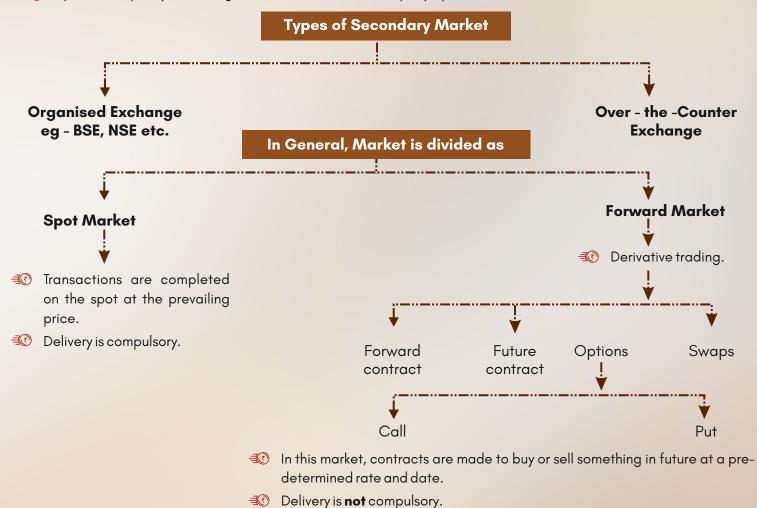
### PRIMARY CAPITAL MARKET

- Securities are issued to the public/investor for the first time.
- Here, a transaction takes place between the company and investors.

- (I) Initial Public Offering (IPO): It is a process when an unlisted company raises funds by offering its shares to the public and consequently gets listed on a stock exchange.
- (ii) Follow on Public Offer (FPO): When a listed company comes out with a fresh issue of shares or makes an offer for sale to the public to raise funds it is known as FPO.
  - Note: It is an issuance of additional shares made by a company after an initial public offering (IPO).
- (iii) Preferential issue: It refers to the procedure of bulk allotment of fresh shares to a specific group of individuals, venture capitalists, companies, or any other person by any particular company for fund raising. **Note:** The preferential issue is neither a public issue nor a rights issue.
- (iv) Rights Issue: Issue of shares to existing Equity shareholder in proportion to their existing shareholding.
- (v) Private Placement: When a company offers its securities to a small group of investors, it is called private placement. Such securities may be bonds, stocks or other securities, and the investors can be both individual and institutional.

### SECONDARY CAPITAL MARKET

- Existing securities are traded i.e bought and sold. Here, transactions take place between various investors.
- It provides liquidity to existing securities; reflects the company's performance.







### PES OF DERIVATIVES

- (I) **Forward** It is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.
- A futures contract is an agreement between two parties to buy or sell an asset at a certain (ii) Future time in the future at a certain price.
- (iii) Option An Option is a contract which gives the right, but not an obligation, to buy or sell the underlying at a stated date and at a stated price. Options are of two types - Calls and Puts options:
  - O 'Calls' give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future dates.
  - O 'Puts' give the buyer the right, but not the obligation to sell a given quantity of underlying asset; at a given price on or before a given future date.
- (iv) **Swap** These are contracts of forward markets to exchange a commodity or security with another at a pre-determined ratio & date.

### **EXCHANGES IN INDIA**

### I) BOMBAY STOCK EXCHANGE (BSE)

- 1 It is the oldest stock exchange of Asia.
- stablished in 1875 as the Native share and stock Broker's Association.
- > 5000 companies listed.
- Indices BSE Sensitive Index (Sensex)
  - BSE 100
  - BSE 200
  - Bankex etc.

### NATIONAL STOCK EXCHANGE

- 🕯 Established in 1992 on the recommendation of **Pherwani committee** as the most modern stock exchange of the country.
- It was promoted by IDBI & other public sector Fls.
- About 1500 Companies are listed.
- Indices Nifty (50 companies)
  - Nifty Junior.
  - S & P 100 etc.

### MULTI COMMODITY EXCHANGE OF INDIA (MCX-SX)

- Established in 2003.
- It was granted license by SEBI in 2012 to operate as stock exchange.
- Deals in currency future.
- Indices SX-40.

### OVER THE COUNTER EXCHANGE OF INDIA LTD. (OTCE)

- Established in 1990 & became operational in 1992.
- 🖚 Facilitate trade in securities of those companies whose paid up capital is 30 lakhs & above.
- It is OTC (Over the Counter) of the country.





### REGIONAL STOCK EXCHANGES

- 10 They serve as a link between the local companies and local investors.
- Teach regional stock exchange follows its own practice and procedures in respect of listing and trading of securities, clearing and settlement of transaction, and risk containment measures.
- Some examples of Regional Stock Exchanges are -Bombay Stock Exchange; Kolkata Stock Exchanges; Pune Stock Exchange etc.

# SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

- Established in 1988 as a Non-Statutory body.
- Granted statutory status on the recommendation of Narasimhan Committee in 1992 through SEBI Act, 1992.

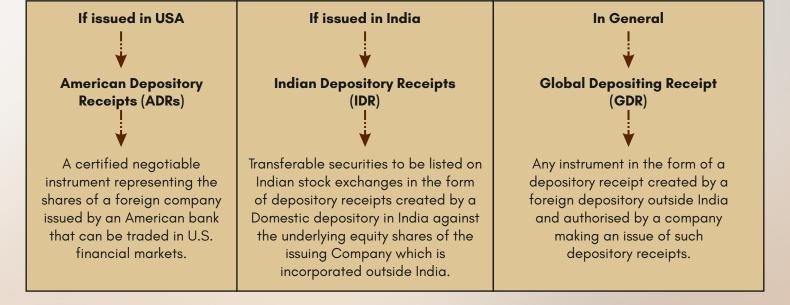
### FUNCTIONS OF SEBI

- (i) Regulation of capital market (Primary as well as secondary market).
- (ii) To register and regulate all intermediaries in stock exchanges like share brokers, underwriters, Mutual Fund etc.
- (iii) To check malpractices in stock exchanges.
- (iv) To protect investor's interest and to promote investors education and awareness.

## DEPOSITORY RECEIPT (DR)

- A type of negotiable (transferable) financial security traded on a local stock exchange usually in the form of equity, issued by a foreign publicly listed company.
- The DR, which is a physical certificate, allows investors to hold shares in equity of other countries.

### THE LOCATION IN WHICH THESE RECEIPTS ARE ISSUED







## MUTUAL FUNDS (MFS)

- 📧 It refers to a pool of money accumulated by several investors who aim at saving and making money through their
- The corpus of money so created is invested in various asset class eg-Debt funds, Equity etc.
- 🚳 Gains and losses are shared by all the investors in accordance with their proportion of contribution to the corpus.
- Registered with SEBI.

### **EXCHANGE TRADED FUND (ETF)**

- These are mutual funds listed and traded on stock exchange like shares.
- 🎫 ETFs are created by Institutional investors swapping shares in an index basket, for units in the fund.
- The Government has latched upon the ETFs route to disinvest its holding in public sector undertaking. Eg– Bharat 22 ETF, a fund which houses 22 public sector companies.

### CORPORATE BOND

- Corporate bonds are **debt securities** issued by private and public corporations to raise funds for various purposes like building new plant, purchasing equipment's etc.
- Investor in the corporate bond gets pre-determined rate of interest until company return, the principal amount.
- Investing in corporate bond does not provide ownership in the company unlike investing in equity shares.

### PARTICIPATORY NOTES (P-NOTES)

- 🖚 Participatory notes or P- Notes are financial instruments issued by foreign institutional investors to investors and hedge funds who wish to Invest in Indian stock markets. These are also called as Offshore Derivative Instruments.
- 💨 P-Notes, mostly used by overseas High Net Worth Individual (HNI), hedge funds and other foreign institutions, allow such investors to invest in Indian market through registered foreign Institutional investors (Flls).







### **IMPORTANT ASSOCIATED TERMS**

### Arbitrage

Olt refers to buying some asset and immediately selling it in another market to take advantage of price differentials.

### Angel Investors

- O They are High Net-Worth Individuals (HNIs), who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.
- O Angel investors usually give support to start-ups at the initial moments and when most investors are not prepared to back them.

#### Bear Market

- O Refers to the market where share prices are **continuously declining**.
- O Its downward trend makes investors believe that the trend will continue, which, in turn, perpetuates the downward spiral.
- O During a bear market, the economy slows down and unemployment rises as companies begin laying off workers.

#### Bull Market

- O Refers to a market that experiences a sustained increase in market share prices.
- O It ensures investors that the uptrend will continue over the long term.
- O It signifies that the country's economy is strong and employment levels are high.

#### **Bonds**

- O It refers to high-security debt instruments that enable an entity to raise funds and fulfil capital requirements.
- O Bonds are classified into different categories as per the model of return and validities of legal obligations.

#### Buy- Back of Shares

- O Under this, the company can buy back a certain percentage of its shares from the market directly.
- O SEBI has imposed certain restrictions on buy-back.

#### Derivatives

- O A derivative is a contract between two parties which derives its value/price from an underlying asset.
- O The most common types of derivatives are futures, options, forwards and swaps.

### Demat/ Dematerialised trading

O It is a form of trading in which computer records of transactions are maintained instead of issuing documents like share certificates etc.

#### Demutualization

O Separation of ownership, management, and brokerage rights in the stock exchange.

#### Hedge Funds

- O It is a private portfolio of investments that uses investment and risk management strategies to generate returns.
- O It is a relatively aggressive type of fund that is used by high net worth investors.

### Insider Trading

O It refers to buying/selling of a company shares on the basis of price-sensitive unpublished information.





#### Index

O A benchmark that is used by investors and portfolio managers to measure market performance. Nifty and Sensex are such benchmarks.

### **Liquidity**

O It refers to how easily a stock can be sold off. A share that can be sold off quickly i.e. has high trade volumes is said to be highly liquid.

### Over- the-counter market

Olt is a **decentralized market** in which market participants trade stocks, commodities, currencies, or other instruments directly between two parties and without a central exchange or broker.

#### Net Asset Value

- O It is the cumulative market value of the assets of the fund net of its liabilities.
- O NAV per unit is simply the net value of assets divided by the number of units outstanding.

### **Shares**

O Shares are the smallest denomination of a company's stocks, indicating a portion of ownership of the company.

### Equity Shares

- O They are long-term financing sources for any company and are issued to the general public and are nonredeemable in nature.
- O Investors in such shares hold the right to vote, share profits and claim assets of a company.

#### Preference Shares

- O They are generally issued to an investor as a guarantee of the payment of cumulative dividend before returns are distributed among ordinary shareholders.
- O However, preference shares do not have any associated voting and membership rights which are provided on common shares.

#### Sweat share

O A share given to the employees of the company without any charge.

#### Speculation

O It refers to buying and selling of some asset with some time lag in order to make a profit by changes in market prices in the future.

### **Underwriting**

- O It involves determining the risk and price of a particular security.
- Olt is a process seen most commonly during initial public offerings, wherein investment banks first buy or underwrite the securities of the issuing entity and then sell them in the market.

#### Venture Capitalists

Olt is a form of private equity financing that is provided by venture capital firms or funds to startups, early-stage, and emerging companies that have been deemed to have high growth potential or which have demonstrated high growth.

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