QUICK REVISION MODULE
(UPSC PRELIMS 2021) ECONOMICS

MONEY MARKET AND CAPITAL MARKET

FINANCIAL MARKET

- It 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.

Financial Market

Money Market

- Deals in **short term** financial transactions (i.e. upto 1 yr.)
- A source of working capital finance of firms.
- Deals only in bonds:
  - Commercial Bill
  - Commercial paper etc.
- General public participation is limited.
- Organised and unorganised sector.
- RBI is the prime regulator.

Capital Market

- Deals in **medium (1 to 5 yrs.)** and **long term (>5 yrs.)** financial transactions.
- A source of financing capital assets.
- Deals in **bonds** as well as **Equity**.
- Public participation is significant.
- Mainly confined to organised sector.
- SEBI is the prime regulator.

MONEY MARKET

- The short term **financial market** of an economy.

→ Trading of money between individual or groups (i.e. financial institutions, Government companies etc.)

Segments of Money Market

Organised Sector

- Banks
- **Sub-markets of Money Market**
  - Treasury Bill
  - Commercial Paper
  - Commercial Bill
  - Certificate of Deposit
  - Call Money Market

Unorganised Seector

- Money lenders and **Indigenous bankers**
- Hundi

MONEY MARKET INSTRUMENTS

1) 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) } discontinued in 2001.
  - b) 14-day (Auctionable TBs) } discontinued in 2001.
  - c) 91-day Tbs
  - d) 182-day Tbs
  - e) 364-day Tbs

2) COMMERCIAL PAPER (CP)

- **Unsecured security.**
- Issued by **a high net worth company** to a Bank against short term loan.
- **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**.

3) COMMERCIAL BILL

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

4) 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.**

5) 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.
- CMR 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.

6) HUNDI

- A Commercial Bill of unorganised sector/market. It is issued by one firm to another against credit transactions.
- 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.

CAPITAL MARKET

(Long term financial market of an economy)

Primary Market

- First time sale of security eg-IPO (Initial Public Offer).
- Company sells to Investor.
- Company fixes price.
- Firm raises funds for long term.

Secondary Market

- Existing securities are bought and sold.
- Investor sells to investor.
- Prices are determined by demand and supply.
- It provides liquidity to existing securities.

INDIAN CAPITAL MARKET SYSTEM

- **Government Securities**
- **Industrial Securities Market**
  - New Issue market
  - Old issue market
- **Development Financial Institutions**
  - IFCI
  - ICICI
  - SFG
  - IDBI
  - IIBI
  - UTI
- **Financial Intermediaries**
  - Merchant Banks
  - Mutual funds
  - Leasing Companies
  - Venture Capital Companies
  - Others

PRIMARY CAPITAL MARKET

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

MEANS OF RAISING FUNDS AT PRIMARY MARKET

(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.

Types of Secondary Market

- **Organised Exchange eg - BSE, NSE etc.**
- **Over - the -Counter Exchange**

In General, Market is divided as

- **Spot Market**
  - Transactions are completed on the spot at the prevailing price.
  - Delivery is compulsory.
- **Forward Market**
  - Derivative trading.
    - Forward contract
    - Future contract
    - Options
      - Call
      - Put
    - Swaps
  - In this market, contracts are made to buy or sell something in future at a pre-determined rate and date.
  - Delivery is **not** compulsory.

TYPES 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.

(ii) **Future** - A futures contract is an agreement between two parties to buy or sell an asset at a certain 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:

- '**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.
- '**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)

- It is the oldest stock exchange of Asia.
- Established 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.

II) 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 **FIs.**
- About 1500 Companies are listed.
- Indices - Nifty (50 companies)
  - Nifty Junior.
  - S & P 100 etc.

III) 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.

IV) OVER THE COUNTER EXCHANGE OF INDIA LTD. (OTCEI)

- 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.

(V) REGIONAL STOCK EXCHANGES

- They serve as a link between the local companies and local investors.
- Each 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.

TYPES (DEPENDING ON THE LOCATION IN WHICH THESE RECEIPTS ARE ISSUED)

If issued in USA	If issued in India	In General
↓	↓	↓
American Depository Receipts (ADRs)	**Indian Depository Receipts (IDR)**	**Global Depositing Receipt (GDR)**
↓	↓	↓
A certified negotiable instrument representing the shares of a foreign company issued by an American bank that can be traded in U.S. financial markets.	Transferable securities to be listed on Indian stock exchanges in the form of depository receipts created by a Domestic depository in India against the underlying equity shares of the issuing Company which is incorporated outside India.	Any instrument in the form of a depository receipt created by a foreign depository outside India and authorised by a company making an issue of such depository receipts.

MUTUAL FUNDS (MFS)

- It refers to a pool of money accumulated by several investors who aim at saving and making money through their investments.
- 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 (FIIs).

IMPORTANT ASSOCIATED TERMS

Arbitrage

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

Angel Investors

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

Bear Market

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

Bull Market

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

Bonds

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

Buy- Back of Shares

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

Derivatives

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

Demat/ Dematerialised trading

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

Demutualization

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

Hedge Funds

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

Insider Trading

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

Index

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

Liquidity

- 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

- It 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

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

Shares

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

Equity Shares

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

Preference Shares

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

Sweat share

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

Speculation

- 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

- It involves determining the risk and price of a particular security.
- It 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

- It 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.