B.Com. (Hons.) V Semester
Paper Title: Financial Market Operations
Paper Code: AS-2640

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Note: These model answers are a depiction of important points which, an examinee must have to mention, to secure high marks in particular question. The length of the answer may vary as per the examinee's understanding, interpretation, and his/her ability to comprehend the content.

Section – A (Short Answer Type Questions)

1. (i) Role of Financial Market in Capital Formation:

All the countries, irrespective of their stage of development, need funds for their economic development and growth. In the economy these funds are obtained from savers or surplus units. There are certain investors or deficit units. Therefore, financial markets play a significant role in transferring these surplus from savers (lenders) to borrowers (users). This process is known as 'Transmission Mechanism.'

(ii) General features of Money Market:

Some important features of Money market are:

(a) It is basically over the phone market. Written communication and exchange of relevant documents may follow subsequently.

(b) Dealings in money market may be conducted with or without the help of brokers.

(c) It is a short-term market for financial assets that are close substitute for money.

(d) Short-term for this purpose is generally taken as a period up to one year.

(iii) Certificate of Deposits:

Certificates of Deposit (CDs) are unsecured, negotiable, short-term instruments in bearer form, issued by commercial banks and development financial institutions. These attract stamp duty as applicable to negotiable instruments. They can be issued to individuals, corporations, companies, trusts, funds, associates, and others.

(iv) Discount Houses:

Discount houses discount trade bills of traders so as to provide adequate liquidity in the market. They sell these bills to commercial banks to raise funds so that they can provide this service further to traders.

(v) ASBA (Applications supported by Blocked Amount):

ASBA is an application by retail investors for subscribing to an issue, containing an authorisation to block the application money in a bank account. This system does away with the refund process and thereby reduces the time between an issue and its listing. All investors including retail, high net worth individuals (HNIs), corporate investors, and qualified institutional buyers are eligible to apply through ASBA in public issues.

(vi) Central Listing Authority (CLA):

CLA is being setup by representations of regional exchanges. It would regulate prelisting procedures including clearing of prospectus. It would also apply post-listing measures to monitor the purpose for which funds are used. The CLA will have two primary roles:

(a) Laying down standard listing process, and

(b) Carrying out the due diligence of a company to be listed.

(vii) Marketing of Public Issue:

Marketing of public issue include the services and activities of all the intermediaries who make the issue a success. Following intermediaries are involved in public issue: Merchant bankers (or, lead managers), underwriters, bankers to the issue, Registrar to the issue etc.

(viii) Jobbers:

Jobber is a person who is ever willing to buy or sell securities and who thus makes a market of such securities. Like any other dealer, Jobber's intelligence lies in purchasing the shares or the securities at a lower price and selling them at a higher price.

(ix) Factors inhibiting the growth of Certificate of Deposits:

(a) Transactions in the secondary market have not developed because the numbers of participants are limited, interest rates are quite high, and CDs are not listed.

(b) The reliance of financial institutions on CDs has decreased. It can be increased if the tenor of the CDs of the financial institutions is rationalised.

(c) The market is limited to few investors as the minimum level of investment is still high.

(d) The stamp duty on the CDs has also affected their growth.

(x) Major institutions offering Merchant banking services in India:

(a) ICICI Securities,

(b) Kotak Mahindra Capital Company,

(c) SBI Capital Markets,

(d) Karvy Investor Services, etc.

Section – B (Long Answer Type Questions)

2. Financial Market – its role, functions, and components:

The examinee has to explain about financial market as the market which facilitates the exchange of financial assets among dealers. Afterwards, the examinee should emphasise upon the role of financial market as facilitator of converting savings into investments and hence, developing capital formation in the country.

About its functions, the examinee has to explain about the various economic and financial functions of the financial market. At last, examinee should give a detail chart of different components of financial market viz. Capital and Money Market and then, its different sub-units like, T-bills market, call money market, primary capital market etc.

Examinees are expected to give a crisp but concise explanation of these concepts. Proper examples will be added advantages for securing better marks.

3. T-bills Market and Size of the 182-day T-bills market:

Treasury bills are short-term instruments issued by the Reserve Bank on behalf of the government to tide over short-term liquidity shortfalls. This instrument is used by the government to raise short-term funds to remove the gaps between receipts and expenditure.

Thereafter, the examinee should explore some features and types of T-bills along with their importance. In importance, it is required that examinee should mention that T-bills market is one of the largest market in all the segments available in the money market of India. It helps in the cash management of the government, helpful in high yields with zero-risk to the investors and provides a minimum required rate for other money market instruments.

Lastly, the examinee should explain about the 182-day T-bills market and its size with a proper table.

4. Bidding Process and Determination of Price in the Book-building Process:

The examinee should first write some words about the book-building process of the capital market and its need in the present era.

Thereafter, the examinee should explain the bidding process and determination of price in the book-building process. Some important points, which are given below, must be mentioned in the answer:

Bidding Process:

(i) Bidding process shall be only through an electronically linked transparent bidding facility provided by recognised stock exchange(s).

(ii) The lead book runner shall ensure the availability of adequate infrastructure with syndicate members for data entry of the bids in a timely manner.

(iii) At least one computer system should be available by the syndicate member at all bidding places to facilitate bidding by the prospective investors.

(iv) There should be an online graphic system on the bidding terminals which updates / refreshes at least every 30 minutes.

(v) Investors, except ASBA investors, can revise their bids.

(vi) QIBs cannot withdraw their bids after the closure of bidding process.

Determination of Price:

(i) The issuer shall, in consultation with lead book runner, determine the issue price based on the bids received.

(ii) On determination of the price, the number of specified securities to be offered shall be determined (i.e., issue size divided by the price to be determined).

(iii) Once the final price (cut-off price) is determined, all those bidders whose bids have been found to be successful (i.e., at and above the final price or cut-off price) shall be entitled for allotment of specified securities.

(iv) Retail individual investors may bid at ‘cut off’ price instead of their writing the specific bid price in the bid forms.

(v) The lead book runner may reject a bid placed by a QIB for reasons to be recorded in writing provided that such rejection shall be made at the time of acceptance of the bid and the reasons therefore shall be disclosed to the bidders.

5. Secondary Market and its inter-relation with Primary market:

Secondary market is a market for outstanding securities. It facilitates liquidity and marketability of securities; provides valuation of securities; reduces cost of capital; enables price discovery; and creates a wealth effect. The examinee can explore these or more features of secondary market hereafter.

The examinee also needs to give a brief inter-relation between primary and secondary market like, where the primary market is the first introduction of financial securities with the investors from the company, it can move from one stakeholder to other stakeholder with the help of secondary market only. The examinee can also explain the role of computer terminals and on-screen bidding process of IPOs facilitated through stock exchanges.

While the capital is formed through the primary market, the flow of such capital from surplus side to deficit side (or, simply flow of funds) is promoted by the activities of secondary market. Finally, secondary market and primary market are inter-related in such a manner that without the feasibility or accessibility of both, savings cannot be converted into investments.

6. Listing – Its advantages and disadvantages:

The examinee should answer this question by first defining the listing of security and then providing advantages and disadvantages of listing. Some main points shall be:

Listing denotes registration of a security as officially approved for dealing on a stock exchange. It is not a compulsory exercise under the Companies Act but is Section 73 requires that company desires to issue shares or debentures to the public through prospectus, listing is necessary.

Advantages of Listing can be broadly divided as:

(i) Advantages to the companies, like:

- **(a)** Distinct advertising value of the company,
- **(b)** Diversification of shareholding,
- **(c)** Company can gain national importance,
- **(d)** Psychological motivation to investors, and
- **(e)** Helpful in merger, acquisition, demerger and other business operations

(ii) Advantages to investors, like:

- **(a)** Provide liquidity to their securities
- **(b)** Fair price in case of disposal of holding or a part thereof through stock-exchange
- **(c)** Not a problem in finding the buyers
- **(d)** Listing securities are easily taken as collateral by banks over loans
- **(e)** Maximum protection to investors due to listing of their holdings, etc.

7. Main objectives of setting up the NSE and overview of its activities:

The examinee should explain the main objectives of the establishment of NSE. Following points are suggested:

- **(i)** To establish a nationwide trading facility for equities, debt instruments, and hybrids

(ii) To ensure all investors all over the country equal access through an appropriate communication network

(iii) To provide fair, efficient, and transparent securities market to investors through an electronic trading system

(iv) To enable shorter settlement cycles and book-entry settlement system

(v) To meet the current international standards of securities market

Apart from this, the examinee can also explain the concept of **demutualisation** which came into existence of Indian Financial Markets with the establishment of National Stock Exchange (NSE).

In the segment of major activities of NSE, the details of its indices, its market segments, and activities of its subsidiary – the NSCCL can be explained by the examinee.

8. Functions of Merchant bankers:

The examinee should first explain the definition of Merchant banker as given by the SEBI. After that, the examinee should mention that as per the definition, the major function of merchant banking is Issue management. From here, the examinee should detail about the issue management process. The answer should flow in this order:

As per SEBI, "Merchant banker is a person who is engaged in the business of issue management, either by making arrangements regarding selling, buying or subscribing to securities, or acting as a manager, consultant or advisor or rendering corporate services in relation to such issue management."

Issue management can be broadly classified as follows:

1. **Pre-issue obligations:**

(i) Submitting offer document,

(ii) Submitting an undertaking,

(iii) Submitting, list of promoters group,

(iv) Appointment of intermediaries,

(v) Appointment of underwriter,

(vi) Making offer document public,

(vii) Filing a No-complaint certificate,

(viii) Appointing authorised collection agents, and

(ix) Entering into an agreement with Depository(ies)

2. **Post-issue obligations:**

(i) Submitting post-issue monitoring reports,

(ii) Redressal of investor grievances,

(iii) Maintaining a close coordination with intermediaries,

(iv) Ensuring full subscription of the issue,

(v) Verifying post-issue advertisements details, and

(vi) Finalising basis of allotment and allotment procedure

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