

## **MODEL ANSWERS to PYQs on Financial Markets and Institutions**

### CAPITAL MARKET

Basic concepts:

2007: Distinguish between Money Market and Capital Market.

2017: Distinguish between Money Market and Capital Market.

Money market is type of market where **short-term securities** are traded. Capital market is type of market where **long-term securities** are traded.

Differences:

Sl.No	BASIS	MONEY MARKET	CAPITAL MARKET
1.	Risk	Low credit and market risk	High credit and market risk
2.	Liquidity	High	Low
3.	Duration	Up to one year	More than one year
4.	Instruments	Commercial bills, certificate of deposits etc.	Shares, debentures etc.
5.	Role	Liquidity adjustment	Putting capital to work
6.	Return on investment	Relatively low	Relatively high
7.	Participants	Bankers, RBI and Government	Investors, authorized dealers, and SEBI
8.	Regulator	RBI	SEBI
9.	Frequency of transactions	Very high	Relatively very low
10.	Merit	Increase liquidity in the economy	Mobilization of savings in economy
11.	Nature of market	Both formal and informal	Formal market
12.	Intermediaries	Between depositors and borrowers.	Between investor and entrepreneur.

Similarities:

- Both are **important components** of financial market.

- Both are **interrelated** as healthy capital market helps in development of money market and vice versa.

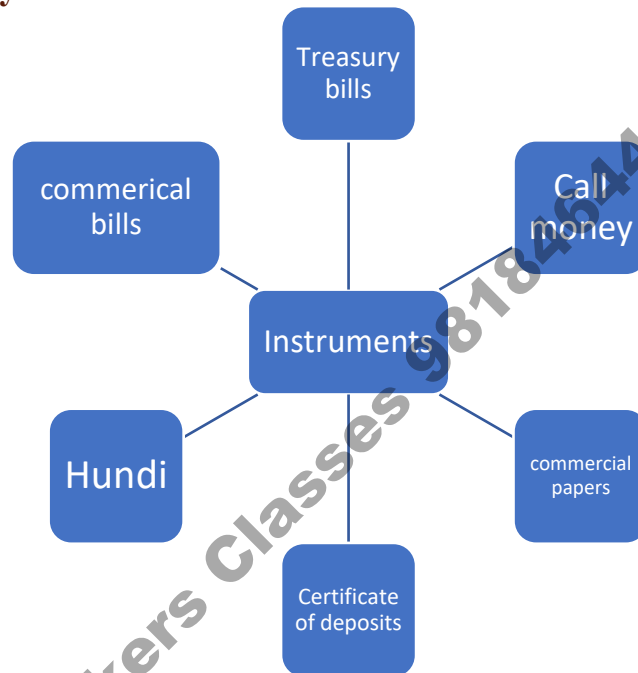
**2009: Write a short note on Money Market and Capital Market in India.**

**Money market in India:**

The **India money market** is a monetary system that involves the lending and borrowing of short-term funds of duration not exceeding one year.

India money market has seen exponential growth just after the globalization initiative in 1992.

**Types of Money Market instruments in India**



**Role of money market in India**

- **Access to money** for short term borrowers.
- **Liquidity** for economic growth.
- **Portfolio management**
- **Economization of use of cash**
- Demand and **supply equilibrium**.

**Shortcomings in Indian money market**

- **Lack of banking habits** and poor financial literacy
- Vast unorganized market dominated by money lenders.
- **Seasonal fluctuations**
- Lack of **technological upgradation**
- **Lack of developed** commercial bill market
- **Higher regulatory requirement** and lack of involvement of small investors.

**Steps taken**

- Introduction of **new money market instruments** such as certificate of deposits.
- **Ease in government regulations** such as retail participation in treasury bill market
- **Liquidity adjustment facilities**
- **Regulations of NBFCs.**

Despite various efforts more steps need to be taken to develop Indian money market to become global hub of financial market on line of London, Singapore etc.

**Capital market in India**

**The India capital market** is a market place where trading of long term securities happened which is of duration exceeding one year.

India has a fair share of the world economy and hence the capital markets or the share markets of India form a considerable portion of the world economy. The capital market is vital to the financial system.

**Constituents of India capital market**

- **Fund Raisers:** companies, governments etc.
- **Fund Providers:** venture capitalist, mutual funds etc.
- **Intermediaries:** Merchant bankers, underwriters etc.
- **Organizations:** NSDL, CSDL etc.
- **Market regulators:** SEBI, RBI etc.

**Role and importance of capital market in India**

- **Mobilization of Savings and Acceleration of Capital Formation**
- **Raising Long-Term Capital**
- **Promotion of Industrial Growth**
- **Ready and Continuous Market**
- **Technical Assistance**
- **Proper Channelization of Funds**
- **Foreign Capital**

**Shortcomings in Indian money market**

- **Governance issues:** Satyam fiasco and recent routing of Adani shares etc.
- **Regulatory issues:** lack of autonomy, poor staffing etc.
- **Systemic issues:** restricted timing and high stamp duty.
- **High volatility:** considering disproportionate impact of FPIs,etc

**Steps taken**

- **Introduction of new norms:** ESG parameters, ISO 26000 etc.

- **SEBI guidelines:** to restrict unfair trade practices etc.
- Allowing **social enterprises** to list in social stock exchanges.
- **Rationalization of stamp duty** to make it more competitive.

Further with **GIFT city and IFSCA** India capital market is going to take a leap forward to make India a **\$10 trillion economy**.

**2019: Distinguish between Primary Market and Secondary Market.**

**2003: What is a new issue market?**

The **primary market** refers to a place where **securities are created** whereas the **secondary market** refers to a place where these **securities are traded**.

Sl. No	BASIS	PRIMARY MARKET	SECONDARY MARKET
1.	<b>Types of Securities</b>	In the primary market, the sale of new securities takes place.	In the secondary market, the sale and purchase of existing or second-hand securities take place.
2.	<b>Issued by</b>	Securities are directly issued by companies.	Securities are transferred between the investors only.
3.	<b>Capital Formation</b>	It directly contributes to the capital of a company as it involves the transfer of funds from surplus units to deficit units.	It indirectly contributes to the capital of a company as it involves an exchange of funds between surplus units only.
4.	<b>Frequency of selling</b>	Once	As many as possible
5.	<b>Parties involved</b>	Company and the investors are involved in buying and selling the security.	Here investors buy and sell the securities among themselves.
6.	<b>Beneficiary</b>	Company	Investor

7.	<b>Purpose</b>	Help new and existing companies to raise capital for expansion and diversification.	It does not provide funding to companies; instead, it helps investors to make money.
8.	<b>Price</b>	The company sells the shares to the investors at a fixed price.	Both buy and sell-side investors work toward finding the best price for the trade.
9.	<b>Type of product</b>	Products are limited and mainly include IPO and FPO.	Many products, such as shares, warrants, derivatives, and more, are available.
10.	<b>Purchase type</b>	Direct purchase from company	Trading between investors.

**Similarities**

While the **primary market directly** contributes to capital formation, the secondary market indirectly contributes to capital formation by providing liquidity for primary market securities.

**SEBI:**

**Q1 Discuss the powers and role of SEBI.**

**2017: Discuss the role of SEBI in regulating the Capital Market. 15**

**SEBI** was setup with an **aim to protect the interests of investors** in securities and to promote the development of, and regulate the securities market.

**Power and role of SEBI**

- It is a **quasi-legislative and quasi-judicial body** which can draft regulations, conduct inquiries, pass rulings and impose penalties.
- To protect the **interests of Indian investors** in the securities market.
- To promote the development and hassle-free functioning of the securities market.
- To **regulate the business operations** of the securities market.

- To **regulate the tasks entrusted to depositors**, credit rating agencies, custodians of securities, foreign portfolio investors and other participants.
- To **educate investors** about securities markets and their intermediaries.
- To **prohibit fraudulent and unfair trade practices** within the securities market and related to it.
- By **Securities Laws (Amendment) Act, 2014**, SEBI is now able to regulate any money pooling scheme worth Rs. 100 cr. or more and attach assets in cases of non-compliance.

#### Shortcoming in its power and role

- **Overlapping of jurisdiction** with other regulatory bodies such as CCI, RBI etc.
- **Lack of autonomy** with respective ministry leading to delayed response to frauds and scams.
- **Poor staffing as SEBI** is invariably is short on human resources as compared to its counter parts in developed countries.
- **Bureaucratic control** especially when its chairperson is mostly IAS officers.
- **Lack of parliamentary oversight** on its functioning leading to lack of proper accountability of SEBI.

Looking it all second generations reforms need to be made such as proper autonomy along with predefined jurisdiction. Further parliamentary oversight would help in ushering transparency and accountability in SEBI.

**2011: “SEBI has failed to effectively control the capital market in India.” Critically examine this statement.** **20**

**SEBI is the regulatory body** that oversees the functioning of the capital market in India. Its primary mandate is to protect the interests of investors and ensure that the market operates in a fair and transparent manner.

#### SEBI's efforts in regulating capital market

- The introduction of **insider trading regulations**,
- The implementation of the **electronic trading system**, and
- The establishment of a **robust surveillance mechanism** to monitor market activity.

These measures have helped in improving the overall efficiency and transparency of the capital market in India.

#### SEBI's criticism

- SEBI's inability to detect and prevent **insider trading**.

- SEBI's inability to **effectively regulate certain** aspects of the market, particularly with regard to the prevention of fraudulent activities such as: **PNB scam, NSEL scam etc.**
- SEBI has failed is in **regulating the activities of market intermediaries.**
- SEBI has also been criticized for its inability to take timely action against companies that violate regulations. Such as **IL&FS fiasco.**
- **IPO overpricing is yet** another area where SEBI has completely failed to protect the interests of the common retail investors such as PAY TM IPO etc.

#### **Steps need to be taken**

- SEBI to strengthen its **regulatory framework and enhance its enforcement capabilities.**
- More autonomy and professionalism in **SEBI functioning.**
- **Parliamentary oversight** on SEBI considering debilitating impact on failure of capital market on Indian economy.
- Adoption of international best practices.

It is essential for SEBI to take a more proactive approach in detecting and preventing market manipulation, and to ensure that market intermediaries operate in a transparent and ethical manner.