



# Collegedunia NCERT Notes

*NCERT Revision Guide for Class 12 Business Studies*

## Chapter 10: Financial Markets

**What this chapter covers (class 12 business studies notes chapter 10 Financial Markets):** the meaning and four functions of financial markets, money market vs capital market, five money-market instruments (T-Bill, Commercial Paper, Call Money, Certificate of Deposit, Commercial Bill), primary vs secondary market, five methods of floatation, stock exchange functions, the National Stock Exchange (NSE), the Over the Counter Exchange of India (OTCEI), SEBI (objectives + protective, regulatory, developmental functions), the six-step trading procedure and dematerialisation. Session 2026-27.

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## 9. Quick Reference Summary

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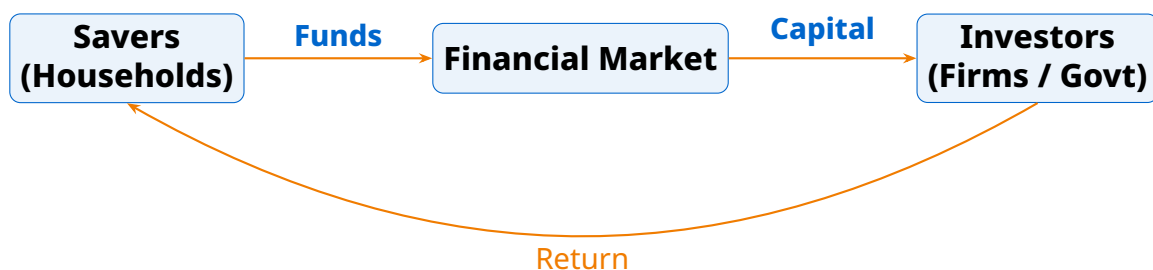
Also see for this chapter: [NCERT Solutions](#)

## 1. Concept of Financial Market

A **financial market** is the market for the creation and exchange of financial assets such as shares, debentures, bonds, Treasury Bills and commercial paper. It is the mechanism through which savings of households are channelised into productive use by business firms and the government. Without a financial market, household savings would sit idle and firms with profitable investment opportunities would not get the capital they need.

### 1.1 Allocation of Savings

In an economy, savers (mostly households) supply funds; investors (mostly firms and the government) demand them. Allocation of savings can be *direct* (an investor lends directly to a firm) or *indirect* (through a financial intermediary like a bank or mutual fund). Both paths flow through the financial market.



### 1.2 Functions of a Financial Market

#### Four Functions

1. **Mobilisation of savings and channelising them to productive uses.**
2. **Facilitating price discovery** of financial assets through demand–supply forces.
3. **Providing liquidity** so investors can convert securities to cash whenever needed.
4. **Reducing transaction costs** by providing ready information.

#### Memory Aid: M-P-L-R

**M**obilise savings, **P**rice discovery, **L**iquidity, **R**educe transaction costs. Four

functions, four letters.

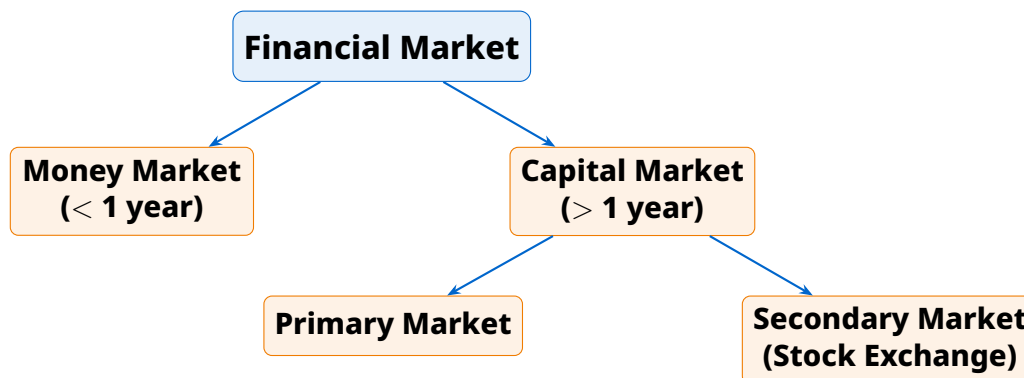
### 1.3 Allocative vs Liquidity Functions in Detail

The four functions split into two camps. **Mobilisation** and **price discovery** are *allocative* functions: they decide *where* the savings go. **Liquidity** and **lower transaction cost** are *service* functions: they make it cheaper and easier for participants to use the market.

- **Allocative efficiency:** the market routes capital to firms with the highest return potential. Firms with better prospects pay lower borrowing rates and attract more investment.
- **Liquidity premium:** the price an investor is willing to pay for a security depends on how easily it can be sold back. A liquid market shrinks this premium and raises prices.
- **Information role:** prices in the financial market are a public signal of how investors view a firm's prospects.

### 1.4 Classification of Financial Markets

The financial market is split by tenure into *money market* (short term, less than 1 year) and *capital market* (medium and long term, more than 1 year).



#### Real-World Application

When the RBI announces a 14-day variable rate repo or you read that “commercial paper yields spiked”, you are watching the money market in action. When the BSE Sensex moves on the strength of a Reliance result, you are watching the secondary capital market.

## 2. Money Market

The **money market** is the market for short-term funds with maturities of less than one year. It deals in monetary assets that are close substitutes for money and are highly liquid. Major participants are the Reserve Bank of India, commercial banks, NBFCs, mutual funds and large corporate houses. Individual investors are largely excluded because the ticket size is high.

### 2.1 Five Money Market Instruments

#### Money Market Instruments at a Glance

T-Bill

Commercial  
Paper

Call Money

Certificate  
of DepositCommercial  
Bill

### 2.2 Treasury Bill (T-Bill)

#### Definition

A **Treasury Bill** is a short-term promissory note issued by the RBI on behalf of the Government of India to meet the government's short-term funding needs. Also called a *Zero Coupon Bond*.

#### Features:

- **Issuer:** RBI on behalf of Government of India.
- **Maturity:** 14 days, 91 days, 182 days, 364 days (always less than 1 year).
- **Return:** Issued at a *discount* on face value and redeemed at *par*; the difference is the holder's return. No coupon (interest) is paid in between.
- **Minimum amount:** Rs. 25,000 and multiples thereof.
- **Investors:** Banks, FIs, corporates, individuals.
- **Safety:** Sovereign-backed, virtually risk-free.

#### Quick Tip

For a numerical: T-Bill of face value Rs. 1,00,000 sold for Rs. 97,000 with 91 days to maturity returns Rs. 3,000 to the holder. Annualised yield  $\approx (3000/97000) \times (365/91) \approx 12.4\%$ .

## 2.3 Commercial Paper (CP)

### Definition

**Commercial Paper** is a short-term *unsecured* promissory note issued by large creditworthy companies to raise short-term funds at rates lower than the bank rate.

### Features:

- **Maturity:** 15 days to 1 year.
- **Issuer:** Large, creditworthy corporates.
- **Form:** Negotiable, unsecured, issued at a discount.
- **Minimum:** Rs. 5 lakh and multiples thereof.
- **Uses:** Working capital, seasonal financing, *bridge financing* for a new public issue.

## 2.4 Call Money

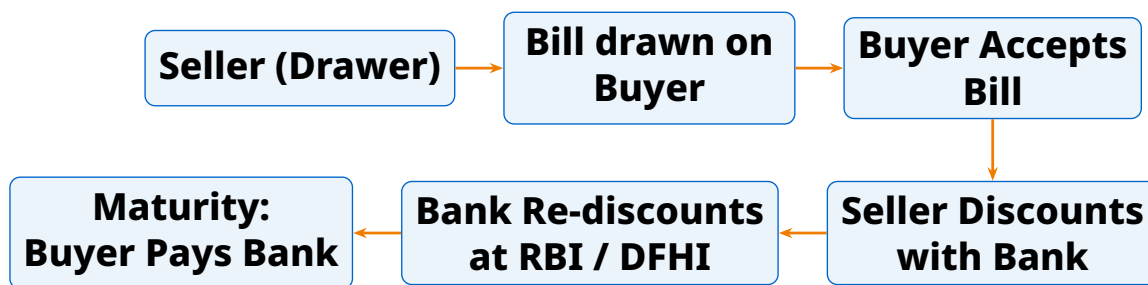
**Call Money** is a short-term finance instrument repayable on demand, used among commercial banks to meet their temporary cash shortages and the Cash Reserve Ratio (CRR) requirements of the RBI. Maturity: 1 day to 15 days. The interest rate is the **call rate**, which is highly volatile.

## 2.5 Certificate of Deposit (CD)

**Certificate of Deposit** is an unsecured, negotiable, bearer-form short-term instrument issued by commercial banks and development financial institutions. Maturity is 91 days to 1 year. CDs are issued by banks during periods of *tight liquidity*: when deposit growth is slow but credit demand is high.

## 2.6 Commercial Bill

A **Commercial Bill** is a bill of exchange used to finance the working capital requirements of business firms. When goods are sold on credit, the seller (drawer) draws a bill of exchange on the buyer (drawee). The buyer accepts the bill and returns it. The seller can either keep the bill till maturity or get it *discounted* from a bank to get cash immediately. The bank can then *re-discount* the bill with the RBI or the DFHI.



## 2.7 Money Market Instruments: Comparison Table

Basis	T-Bill	CP	Call Money	CD	Commercial Bill
Issuer	RBI / Govt of India	Large corporates	Commercial banks	Banks / DFIs	Seller of goods
Maturity	14 – 364 days	15 days – 1 yr	1 – 15 days	91 days – 1 yr	Short term (trade credit)
Return type	Discount to par	Discount to par	Call rate	Interest	Discount on bill
Security	Sovereign	Unsecured	Inter-bank	Unsecured	Trade-backed
Min amount	Rs. 25,000	Rs. 5 lakh	Bulk	High	Trade-based

### Common Mistake

Students often write that CDs are issued by NBFCs. Only *commercial banks* and *development financial institutions* can issue CDs. NBFCs cannot.

## 3. Capital Market

The **capital market** is the market for medium- and long-term funds (above one year). It mobilises savings from a wide pool of investors (institutions plus retail) and routes them to firms and the government for productive long-term investment.

### 3.1 Primary Market vs Secondary Market

The capital market has two segments: the **primary market** (new issues) and the **secondary market** (stock exchange / stock market).

Basis	Primary Market	Secondary Market
What is traded	New / fresh securities issued for the first time	Existing securities already issued earlier
Parties	Company sells; investor buys	Investor sells to another investor through brokers
Capital formation	Direct: money flows to the company	Indirect: only ownership changes hands
Location	No fixed venue	Stock exchange (NSE, BSE)
Pricing	Set by the company (with merchant banker / SEBI guidance)	Set by demand-supply forces in the market
Times traded	One sale per new security	Repeated trading possible
Intermediaries	Merchant bankers, underwriters	Brokers, sub-brokers, DPs

### 3.2 Functions of Capital Market

1. Links savers with investors.
2. Encourages saving by giving households a range of return options.
3. Encourages investment by providing firms a steady supply of capital.
4. Allocates capital to the most productive uses through market pricing.

### 3.3 Capital Market vs Money Market

Basis	Capital Market	Money Market
Participants	Banks, FIs, foreign investors, mutual funds, individuals, corporates	RBI, commercial banks, NBFCs, large corporates (no individuals)
Instruments	Equity shares, debentures, bonds, preference shares	T-Bill, CP, Call Money, CD, Commercial Bill
Investment outlay	Flexible - can be small (one share)	Large lot sizes
Duration	Medium / long (> 1 year)	Short (< 1 year)
Liquidity	Reasonably liquid (stock exchanges)	Highly liquid (DFHI)
Safety / risk	Higher risk (default + price)	Much safer
Expected return	Higher (dividend / interest + capital gain)	Lower (only interest / discount)

#### Quick Tip

The single deciding question for any instrument: *is the maturity less than one year?* Yes ⇒ money market. No ⇒ capital market.

## 4. Primary Market: Methods of Floatation

### Primary Market

The **primary market** (new-issues market) is the segment of the capital market through which firms raise fresh capital by issuing securities for the first time.

### 4.1 Why Companies Use the Primary Market

The primary market is the only way a company can raise *fresh* long-term capital from the public. Other sources (retained earnings, bank loans, debentures placed privately) either limit the size of the issue or load the company with interest obligations. A public issue, by contrast:

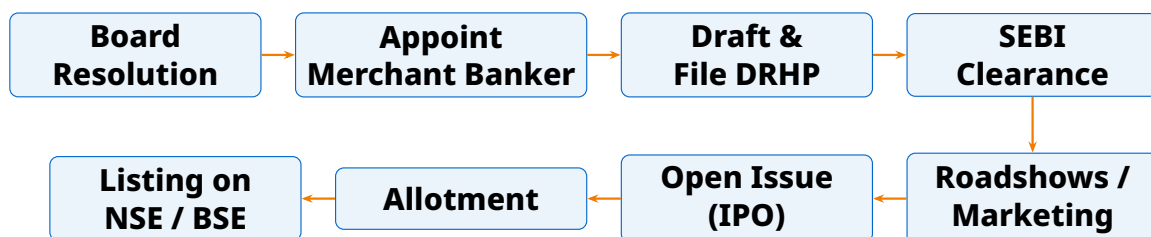
- Raises permanent capital with no fixed repayment burden.
- Spreads ownership over many investors, reducing concentration risk.
- Creates a market valuation for the firm.
- Improves brand visibility and credibility (post-IPO firms attract better partners and talent).

### 4.2 Five Methods of Floatation

1. **Offer through Prospectus (Public Issue / IPO).** The company invites the public to subscribe to its shares or debentures by issuing a detailed *prospectus*. Applications are invited through brokers and underwriters. Most popular method for an Initial Public Offer.
2. **Offer for Sale.** The company sells the entire block of new securities to an intermediary (issue house, broker) at an agreed price; the intermediary then resells to the public at a higher price. The company avoids the formalities of a public issue.
3. **Private Placement.** The company allots securities to a select group of investors (banks, mutual funds, insurance companies, FIIs) without inviting the general public. Fastest method; saves commission and underwriting fees.
4. **Rights Issue.** An offer is made by the company to its *existing shareholders* to subscribe to additional shares in proportion to their current holding. The shareholder can apply, renounce in favour of another, or let the offer lapse. Section 62 of Companies Act 2013 mandates a rights issue before a fresh public issue.
5. **e-IPO (electronic IPO).** A company issues its capital through the online system of the stock exchange. Information is uploaded; investors apply online; allotment is through the exchange platform.

**Memory Aid: PORP-E**

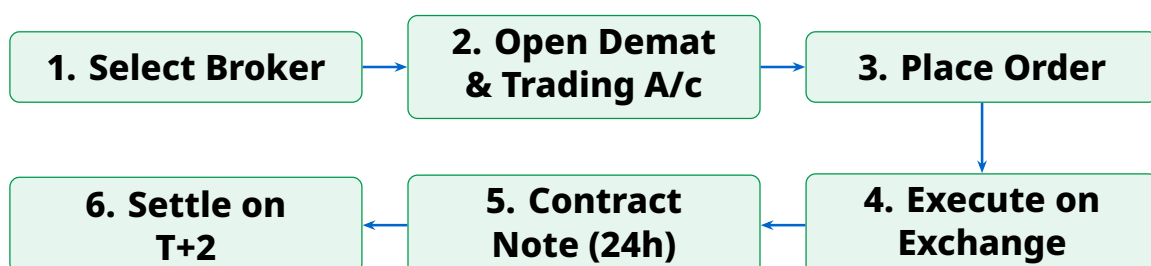
**P**rospectus, **O**ffer for sale, **R**ights issue, **P**rivate placement, **e-IPO**. Five methods, one acronym.

**4.3 Flowchart: A Public Issue from Plan to Listing****5. Secondary Market: Stock Exchange****Definition: Securities Contracts (Regulation) Act 1956**

A **stock exchange** is “an association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities”.

**5.1 Six Functions of a Stock Exchange**

1. **Liquidity and marketability** of existing securities through a continuous market.
2. **Pricing of securities** by interaction of demand and supply.
3. **Safety of transactions** via regulated membership and SEBI oversight.
4. **Contribution to economic growth** by channelising savings to productive uses.
5. **Spreading the equity cult** through investor education and information.
6. **Providing scope for speculation** (within controlled rules) for liquidity and price continuity.

**5.2 Trading Procedure: The Six-Step Flow**

**Step details:**

1. **Selection of a broker.** Investor selects a SEBI-registered broker; signs client agreement; provides PAN, address proof, bank details.
2. **Opening accounts.** *Trading account* with the broker (for placing orders); *Demat account* with a Depository Participant linked to NSDL / CDSL (for holding securities). Bank account is linked.
3. **Placing the order.** Order specifies security, quantity, price (limit / market) and validity. Placed in person, by phone or online.
4. **Executing the order.** Broker keys the order into the exchange's electronic system; orders match automatically. A trade-confirmation slip is generated.
5. **Contract note.** Within 24 hours, broker issues a contract note with security, quantity, price, brokerage, time, settlement date, unique order number.
6. **Settlement on T+2.** Investor pays the broker (buy) or delivers shares (sell) by pay-in. On pay-out day (T+2), shares are credited to the buyer's demat and cash to the seller's bank account.

**Common Mistake**

**Demat  $\neq$  Trading.** The trading account is opened with the broker for placing buy/sell orders. The demat account is opened with a Depository Participant for holding securities in electronic form. Both are required; they are not interchangeable.

### 5.3 National Stock Exchange (NSE)

The **NSE** was incorporated in 1992 and recognised as a stock exchange in 1993. It was set up by leading financial institutions to provide a modern, fully automated electronic trading system with nationwide reach. Its **five objectives**:

1. Establish a nationwide trading facility for all types of securities.
2. Ensure equal access to investors all over the country.
3. Provide a fair, efficient, transparent securities market.
4. Enable shorter settlement cycles and book-entry settlement.
5. Meet international securities-market benchmarks.

### 5.4 Difference: Capital Market vs Stock Market

A common board-exam trap is to treat "stock market" as the entire capital market. In fact, the stock market is only the *secondary* half:

- Capital market = primary market + secondary market.
- Stock market refers only to the secondary market (NSE, BSE).
- In the primary market the company receives the money; in the stock market money passes between investors.

**Quick Tip**

If the company gets the money, it's primary. If one investor pays another investor, it's secondary (stock market). One sentence; full marks.

## 5.5 Over the Counter Exchange of India (OTCEI)

**OTCEI** was incorporated in 1990 and operational from 1992. It was set up by financial institutions (UTI, ICICI, IDBI, IFCI, LIC, GIC, SBI Capital Markets) and modelled on *NASDAQ* of the USA. It was created for *small and medium-sized companies* with paid-up capital between Rs. 30 lakh and Rs. 25 crore that could not get listed on the major stock exchanges.

**Features:**

- Screen-based, electronically operated, ring-less, national.
- Companies must be *sponsored* by a member of OTCEI.
- *Market makers* give two-way (bid and ask) quotes.
- Investor can buy or sell from any OTCEI counter across the country.

## 6. SEBI - The Regulator

The **Securities and Exchange Board of India (SEBI)** was established on 12 April 1988 in response to malpractices in the securities markets (price rigging, insider trading, unofficial private placements, listing violations). It was given statutory status by the SEBI Act 1992.

### 6.1 Three Objectives of SEBI

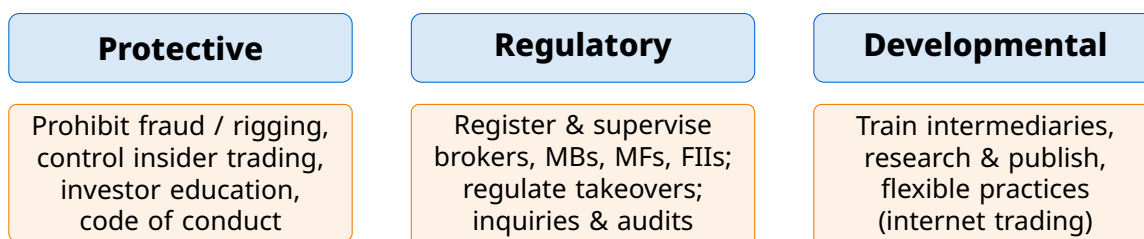
**Three Objectives**

1. **Regulate** stock exchanges and the securities industry, ensuring orderly functioning.
2. **Protect** the rights and interests of investors, particularly individual investors, through education and fair-dealing standards.
3. **Prevent** trading malpractices like insider trading, price rigging, and unofficial private placements.

**Memory Aid: R-P-P**

**Regulate, Protect, Prevent.** Three verbs answer "why SEBI exists".

## 6.2 Three Sets of Functions



### Protective Functions:

- Prohibition of fraudulent and unfair trade practices (price rigging, misleading statements).
- Controlling insider trading; imposing penalties on insiders.
- Investor protection: education drives, grievance redressal via SCORES portal.
- Promoting fair practices and a code of conduct for intermediaries.

### Regulatory Functions:

- Registration of brokers, sub-brokers, merchant bankers, mutual funds, FIIs.
- Regulation of activities of stock brokers and other intermediaries.
- Regulation of takeover bids by companies.
- Inquiries, audits and inspections of stock exchanges and intermediaries.
- Framing rules and regulations for orderly working of the market.

### Developmental Functions:

- Training of intermediaries through the National Institute of Securities Markets (NISM).
- Conducting research and publishing useful information to all market participants.
- Promoting flexible practices (optional underwriting; internet trading through registered brokers).
- Investor awareness campaigns in regional languages.

#### Real-World Application

SEBI's SCORES (Securities Complaints Redress System) portal accepts investor complaints online against any registered intermediary. By 2024, over 5 lakh complaints had been resolved through SCORES, with most settled within 30 days.

## 7. Capital Market Reforms and Dematerialisation

Since 1991, Indian capital markets have been reshaped by a series of reforms aimed at making them efficient, transparent, safe and globally competitive. Seven

reforms together built the modern market.

## 7.1 Seven Major Reforms

1. **Setting up of SEBI** (1988; statutory 1992).
2. **New exchanges:** NSE (1994) and OTCEI (1992); BSE modernised to BOLT.
3. **Screen-based trading** replaced open outcry; NSCCL (National Securities Clearing Corporation, 1995) guarantees settlement.
4. **Dematerialisation** via depositories: NSDL (1996) and CDSL (1999).
5. **Investor protection:** Investor Protection Fund; the SCORES grievance portal; tighter disclosure norms for issuers.
6. **Rolling settlement:** replaced the weekly settlement with T+2 (and now T+1).
7. **FIIs and Indian companies overseas:** foreign institutional investors allowed in; Indian firms allowed to raise capital abroad through GDRs and ADRs.

## 7.2 Dematerialisation: The Engine of the Modern Market

### Definition

**Dematerialisation** is the process by which physical share certificates of an investor are converted into an equivalent number of securities in electronic form, held in an account with a depository (NSDL or CDSL) via a depository participant (DP).

### Four impacts:

1. **Eliminates paper certificates.** No bad deliveries, no forgery, no signature mismatch, no theft.
2. **Faster settlement.** Book-entry transfers enabled the move from week-long to T+2 (and now T+1) rolling settlement.
3. **Lower cost.** Reduced stamp duty on demat transfer; no postage, insurance or signature-verification costs.
4. **Wider participation.** A demat-account holder anywhere in India can buy or sell on any exchange through any broker. Demat accounts crossed 15 crore in India in 2024.

### 7.3 NSDL vs CDSL

Basis	NSDL	CDSL
Full form	National Securities Depository Limited	Central Depository Services (India) Limited
Year set up	1996	1999
Promoted by	IDBI, UTI, NSE	BSE
Linked exchange (primary)	NSE	BSE

#### Quick Tip

For a board-exam case study mentioning “demat”, the answer flow is: physical → electronic via DP → depository (NSDL / CDSL) → settlement on T+2.

#### Real-World Application

A demat account opened on Zerodha or Groww links to either NSDL or CDSL behind the scenes; the investor never deals with the depository directly. The DP (Zerodha, Upstox, Groww, ICICI Direct) is the only touch-point.

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## 8. JEE / NEET-Style Extensions

While Business Studies sits outside the JEE / NEET syllabus, the chapter content is directly relevant for *CUET (UG)* and several commerce-stream entrance exams. The vocabulary and the exam framing differ slightly from CBSE board paper.

### 8.1 CUET-Style Vocabulary

- **Yield** (vs “return”): the annualised effective interest rate on a debt instrument. A T-Bill bought at Rs. 97,000 redeemed at Rs. 1,00,000 in 91 days yields approximately 12.4 percent.
- **Bid – Ask spread** (vs “two-way quote”): the gap between the market maker’s buying and selling price. A small spread signals high liquidity.
- **IPO grading** (now discontinued by SEBI): the practice of rating an IPO from 1 (poor) to 5 (strong) before listing.
- **Book building**: a price discovery process for an IPO where investors bid in a price band and the final cut-off is the price at which demand fills the offer.

## 8.2 Numerical Style Questions

### Quick Tip

A 91-day T-Bill of face value Rs. 1,00,000 is issued at Rs. 98,000. Return =  $\frac{2000}{98000} \approx 2.04\%$  for 91 days. Annualised yield =  $2.04\% \times (365/91) \approx 8.2\%$ .

## 8.3 SEBI Acts & Regulations (for CUET extension)

- **SEBI Act 1992** – statutory backbone; defines SEBI's powers.
- **Securities Contracts (Regulation) Act 1956** – governs stock exchanges and the listing of securities.
- **Depositories Act 1996** – created NSDL and CDSL; mandates demat for listed securities.
- **Companies Act 2013** – governs IPOs, rights issues, private placements, public deposits (Sec. 62 mandates rights issue first).

## 9. Quick Reference Summary

### 9.1 Five Money-Market Instruments

1. **T-Bill** – RBI / Govt, 14–364 days, discount-to-par.
2. **Commercial Paper** – Large corporates, 15 days–1 yr, unsecured.
3. **Call Money** – Banks, 1–15 days, call rate.
4. **Certificate of Deposit** – Banks / DFIs, 91 days–1 yr, tight-liquidity tool.
5. **Commercial Bill** – Trade-credit bill of exchange, discountable.

### 9.2 Five Methods of Floatation

1. Prospectus / Public Issue (IPO).
2. Offer for Sale.
3. Private Placement.
4. Rights Issue.
5. e-IPO.

### 9.3 SEBI's Three-Fold Mandate

SEBI's mandate has three legs:

- **Protective:** prohibit fraud and insider trading; investor education; SCORES.
- **Regulatory:** register and supervise brokers, MBs, MFs, FIIs; regulate takeovers.

- **Developmental:** train intermediaries (NISM); research; flexible practices like internet trading.

### 9.4 Six-Step Trading Procedure

Select Broker → Open Demat & Trading Account → Place Order → Execute on Exchange → Contract Note (24 h) → Settle on T+2.

### 9.5 Three Mnemonics

- **M-P-L-R** – four functions of a financial market.
- **PORP-E** – five methods of floatation.
- **R-P-P** – three SEBI objectives.

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