



# Collegedunia NCERT Solutions

Step-by-step solutions, alternate methods & exam tips for Class 12 Business Studies

## Chapter 10: Financial Markets

### About this Chapter

Chapter 10 of Class 12 Business Studies, **Financial Markets**, explains how savings flow from households to business firms through organised markets. It covers the meaning and functions of financial markets, the two broad segments (*money market* and *capital market*), money-market instruments (T-bills, commercial paper, call money, certificate of deposit, commercial bill), the capital market and its two parts (primary and secondary), methods of floating new issues, stock exchange functions and trading procedure, and the role of **SEBI** as the regulator. Solutions for 2026-27 follow NCERT Reprint 2026-27.

**Topics covered:** Meaning & functions of financial markets • Money market • Capital market • Money-market instruments • Primary vs secondary market • Methods of floatation • Stock exchange • Trading procedure • NSE & OTCEI • SEBI

#### Quick Formula Sheet

**Two segments of financial market:**

Money market (short term, < 1 year) •  
Capital market (medium / long term, > 1 year)

**Money-market instruments:**

T-Bill • Commercial Paper •  
Call Money • Certificate of Deposit  
• Commercial Bill

**Capital market = Primary + Secondary**

**Methods of floatation (primary):**

Public issue (prospectus / IPO) •  
Offer for sale • Private placement  
• Rights issue • e-IPO

**SEBI three objectives:**

Protect investors • Develop the market  
• Regulate the market

Also see for this chapter: [Revision Notes](#) | [Handwritten Notes](#)

### Very Short Answer Type Questions

**Q 10.1** What are the functions of a financial market?

#### SOLUTION

**Concept used.** A **financial market** is the market for the creation and exchange of financial assets such as shares, debentures, bonds, T-bills and commercial paper. It is the mechanism through which the savings of households are channelised into productive use by business firms and the government. Four main functions are performed by it.

- Step 1. Mobilisation of savings and channelising them into the most productive use.** The financial market acts as a link between savers and investors. Surplus funds of households are pooled and lent to firms that have profitable investment opportunities.
- Step 2. Facilitating price discovery.** The interaction of demand for and supply of funds in the financial market helps establish the price of a financial asset, that is, the return that the buyer (saver) earns and the cost the seller (firm) pays.
- Step 3. Providing liquidity to financial assets.** A well-developed financial market provides a ready market in which financial assets can be bought and sold easily, so that investors can convert their securities into cash whenever they wish.
- Step 4. Reducing the cost of transactions.** The financial market provides information about the securities being traded, saving every participant the effort and cost of searching for buyers or sellers, and the cost of negotiating individual deals.

**Final Answer:** Financial markets perform four functions: **mobilisation of savings, price discovery, providing liquidity, and reducing transaction costs.**

#### Exam Tip

Memorise the four functions in the order **MPLR**: *Mobilise, Price-discovery, Liquidity, Reduce-cost*. One mark per function in a 4-mark question.

**EXPERT'S SOLUTION** : *Aarav Sharma, M.Com, Delhi University*

**Quick reading.** Financial market = pipeline from savers → investors. Four jobs: move savings, discover prices, give liquidity, cut transaction costs.

- Step 1.** Mobilise savings; route them to the best users.
- Step 2.** Set the price (return / cost) of funds.
- Step 3.** Make securities easy to buy back into cash.
- Step 4.** Provide ready information, cutting search and negotiation costs.

**Final Answer:** Mobilise savings, price discovery, liquidity, lower transaction cost.

#### **Q 10.2** What is meant by a 'Call Money'?

**SOLUTION**

**Concept used.** **Call money** is a short-term finance instrument of the money market. It refers to funds borrowed and lent among commercial banks themselves for very short periods, ranging from *one day to fifteen days*. It is used by banks to meet temporary cash shortages and to fulfil the Cash Reserve Ratio (CRR) requirements of the RBI.

**Step 1. Borrowers and lenders.** The participants are commercial banks; one bank with a short surplus lends to another with a short deficit.

**Step 2. Maturity.** The maturity period is extremely short: one day (overnight) up to a maximum of fifteen days.

**Step 3. Interest rate.** The rate of interest paid on call money is called the *call rate*. The call rate is highly volatile, changing from hour to hour and day to day in response to demand for and supply of funds.

**Step 4. Purpose.** Banks use call money to bridge a temporary mismatch between cash inflows and outflows, and to meet the CRR requirement of the central bank.

**Final Answer:** Call money is a money-market instrument under which funds are borrowed and lent for one day to fifteen days, mainly between commercial banks, at a volatile rate called the *call rate*.

**EXPERT'S SOLUTION** : Priya Iyer, M.Com, Christ University Bangalore

**Quick reading.** Banks lending to other banks for 1–15 days. The rate is the call rate; it bounces around with day-to-day demand and supply.

**Step 1.** Maturity = 1 to 15 days.

**Step 2.** Participants = banks (chiefly).

**Step 3.** Use = meet CRR / patch temporary cash deficit.

**Step 4.** Rate = volatile call rate.

**Final Answer:** Inter-bank short-term lending of 1–15 days at the call rate.

**Q 10.3** What is a 'Treasury Bill'?

**SOLUTION**

**Concept used.** A **Treasury bill**, popularly called a *T-bill*, is a short-term instrument issued by the *Reserve Bank of India* on behalf of the *Government of India* to meet the government's short-term funding needs. It is a promissory note (zero-coupon bond) with a maturity of *less than one year*.

**Step 1. Issuer.** The RBI issues T-bills on behalf of the Government of India.

**Step 2. Maturity.** T-bills have a maturity of less than one year (typical maturities are 14 days, 91 days, 182 days and 364 days).

**Step 3. How return is earned.** T-bills are issued at a *discount* on the face value and are redeemed at *par*. The difference between the issue price and the redemption price is the holder's return.

**Step 4. Form.** They are available in a minimum amount of Rs. 25,000 and in multiples thereof, and are negotiable instruments freely transferable.

**Step 5. Investors.** Banks, financial institutions, corporate firms and individuals can invest in T-bills.

**Final Answer:** A **Treasury bill** is a short-term (less than one year) instrument issued by the RBI for the Government of India, sold at a *discount* and redeemed at *par* – a zero-coupon money-market instrument.

**Worked numeric**

A T-bill of face value Rs. 1,00,000 issued at Rs. 97,000 for 91 days returns Rs. 3,000 to the holder over 91 days. Annualised:  $3000/97000 \times 365/91 \approx 12.4\%$ .

**EXPERT'S SOLUTION** : Vivaan Mehta, M.Com, Symbiosis Pune

**Quick reading.** Govt borrowing for under-a-year, issued by RBI. Buy cheap (discount), redeem at face value. Difference = your return.

**Step 1.** Issuer: RBI on behalf of Government of India.

**Step 2.** Maturity: 14, 91, 182, 364 days (all < 1 year).

**Step 3.** Issued at discount, redeemed at par; no coupon.

**Step 4.** Highly safe (sovereign), highly liquid, freely tradeable.

**Final Answer:** Short-term zero-coupon Government paper sold at a discount.

**Q 10.4** Distinguish between Capital market and Money market.**SOLUTION**

**Concept used.** The **financial market** has two segments. The **money market** deals in *short-term funds* (less than one year), while the **capital market** deals in *medium- and long-term funds* (one year and above). The two segments differ on a number of dimensions.

Basis	Capital Market	Money Market
Participants	Banks, FIs, foreign investors, mutual funds, individual investors, corporates	RBI, commercial banks, NBFCs, large corporate houses, mutual funds (excludes individuals)
Instruments traded	Equity shares, debentures, bonds, preference shares	T-bills, commercial paper, call money, certificate of deposit, commercial bill
Investment outlay	Investment in capital market does not necessarily require large sums – units may be small (e.g. one share)	Investment requires huge sums (T-bills in Rs. 25,000+, CPs in Rs. 5 lakh+)
Duration	Medium and long term: above one year, often many years	Short term: maximum of one year
Liquidity	Securities are tradeable on stock exchanges; reasonably liquid	Highly liquid; formal arrangements like Discount and Finance House of India (DFHI) provide ready liquidity
Safety / risk	Higher risk; both default risk and price risk	Much safer; issuers are financially strong and maturities are very short
Expected return	Higher; includes dividend / interest plus capital appreciation	Lower; only interest or discount earned over a short period

**Final Answer:** In short: **money market** = short term (< 1 yr), large lots, low risk, low return, institution-dominated. **Capital market** = medium / long term (> 1 yr), small lots possible, higher risk, higher return, both institutional and retail.

**Exam Tip**

Six points of distinction usually expected: *participants, instruments, investment outlay, duration, liquidity, safety / return*. Two-column table format scores full marks.

**EXPERT'S SOLUTION** : Ananya Reddy, MBA Finance, IIM Bangalore

**Strategic angle.** If the maturity is under a year, it is money market; if it is over a year, it is capital market. Everything else (participants, ticket size, risk, return) follows from that one tenure difference.

**Step 1.** Tenure: short (< 1 yr) vs medium / long.

**Step 2.** Participants: institutions only (mostly) vs everyone including retail.

**Step 3.** Ticket size: very large vs flexible.

**Step 4.** Risk and return: low / low vs higher / higher.

**Step 5.** Instruments: T-bill, CP, call money vs equity, debenture, bond.

**Final Answer:** Money market = short, large, safe, low return. Capital market = long, flexible, risky, higher return.

**Q 10.5** What is the difference between Capital market and Stock market?**SOLUTION**

**Concept used.** The **capital market** is the segment of the financial market that deals in medium- and long-term funds; it has two parts – the **primary market** (new-issues market) and the **secondary market** (**stock market** / stock exchange). A stock market is therefore one component of the capital market, not the whole of it.

**Step 1. Scope.** Capital market is the wider concept: it covers *both* the primary market (where new securities are issued) and the secondary market (where existing securities are bought and sold). The stock market refers only to the secondary part.

**Step 2. What is traded.** In the primary part of the capital market, fresh securities are sold by the issuing company to investors. In the stock market, only existing securities already issued earlier are traded between investors.

**Step 3. Cash flow to the company.** A company receives funds when it sells a security in the primary market. In the stock market, money passes between two investors – the company is not a party to that transaction.

**Step 4. Examples.** The primary part includes IPOs, rights issues, e-IPO, etc. Stock markets include BSE and NSE.

**Final Answer:** Capital market = primary market + secondary market. The stock market is only the *secondary* part where already-issued securities trade between investors.

**EXPERT'S SOLUTION** : Rohan Kapoor, B.Com (H), Shri Ram College of Commerce

**Quick reading.** Stock market is a subset of the capital market: it is the secondary half. The primary half is where new shares are first sold by the company.

**Step 1.** Capital market = primary + secondary.

**Step 2.** Stock market = secondary only.

**Step 3.** Primary  $\Rightarrow$  company gets the money.

**Step 4.** Secondary  $\Rightarrow$  one investor pays another.

**Final Answer:** Capital market is the whole; stock market is its secondary half.

## Short Answer Type Questions

**Q 10.6** What are the functions of a Stock Exchange?

### SOLUTION

**Concept used.** A **stock exchange** is an organised market where existing securities of joint-stock companies, government and semi-government bodies are bought and sold. According to the 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”. It performs *five* key functions.

**Step 1. Providing liquidity and marketability to existing securities.** A stock exchange offers a continuous, ready market where shareholders can convert their securities into cash whenever they wish, and where new investors can buy securities easily.

**Step 2. Pricing of securities.** Constant interaction between large numbers of buyers and sellers helps to establish the *fair price* of each security; this price reflects

the demand for the security, the strength of the company, and prevailing economic conditions.

- Step 3. Safety of transaction.** The membership of a stock exchange is regulated, and its functioning is governed by laid-down rules and regulations approved by the government and SEBI. This minimises the risk of fraud or manipulation.
- Step 4. Contributes to economic growth.** The stock exchange channelises savings into the most productive investment proposals. By providing liquidity to existing securities, it makes *disinvestment and reinvestment* possible – savings keep moving to the most productive uses.
- Step 5. Spreading of equity cult.** The stock exchange encourages people of all income levels to participate in industry by buying shares, thus spreading share ownership widely through investor education and information.
- Step 6. Providing scope for speculation.** The stock exchange permits a healthy degree of speculation under controlled conditions to ensure liquidity and price continuity in the market.

**Final Answer:** Stock exchanges perform six functions: **liquidity & marketability, fair pricing, safety of transactions, contribution to economic growth, spread of the equity cult, and a controlled outlet for speculation.**

### ♥ Why This Matters

A vibrant stock exchange is the difference between savings that sleep in lockers and savings that build factories. Every job, every road, every public-sector dividend traces back to capital that was, at some point, raised through markets like the NSE or BSE.

### EXPERT'S SOLUTION : Sneha Patel, MBA Finance, IIM Lucknow

**Strategic angle.** A stock exchange does *four economic jobs* and *two investor-facing jobs*. Pair them in your answer: liquidity, price discovery, safety, economic growth (economy-side) + spread of equity cult, controlled speculation (investor-side).

**Step 1.** Liquidity: continuous market makes shares easy to convert into cash.

**Step 2.** Pricing: large numbers of trades reveal fair value.

**Step 3.** Safety: regulated membership and SEBI oversight reduce risk.

**Step 4.** Economic growth: savings routed to the most productive firms.

**Step 5.** Equity cult: investor education spreads ownership widely.

**Step 6.** Speculation: a controlled outlet ensures continuous price discovery.

**Final Answer:** Six functions: liquidity, price discovery, safety, economic growth, equity cult, controlled speculation.

**Q 10.7** What are the objectives of the SEBI?

**SOLUTION**

**Concept used.** The **Securities and Exchange Board of India (SEBI)** was established on 12 April 1988 and given statutory status by the SEBI Act 1992. Its formation was a response to the malpractices in the securities markets (price rigging, insider trading, unofficial private placements, violation of listing rules) that were eroding investor confidence. Three objectives guide its work.

**Step 1.** To regulate stock exchanges and the securities industry so as to promote their orderly functioning and ensure that the market operates by laid-down rules.

**Step 2.** To protect the rights and interests of investors, particularly individual investors, and to guide and educate them so that they get a fair deal and accurate information from issuers and intermediaries.

**Step 3.** To prevent trading malpractices such as insider trading, price rigging, and unofficial private placements; to achieve a balance between self-regulation by the securities industry and statutory regulation by SEBI; to develop a code of conduct for intermediaries (brokers, merchant bankers, sub-brokers); and to promote the development of and regulate the working of mutual funds.

**Final Answer:** Three objectives of SEBI: **regulate** the stock exchanges and securities industry, **protect** the rights of investors, and **prevent trading malpractices**.

 **Exam Tip**

SEBI's purpose is captured in three verbs: **Regulate, Protect, Prevent**. The full mandate (protective + regulatory + developmental functions) flows from these three.

**EXPERT'S SOLUTION** : *Karthik Subramaniam, MBA Finance, IIM Calcutta*

**Strategic angle.** Remember the trigger: market malpractices in the late 1980s. SEBI was created to set the rules, defend the investor, and stop fraud.

**Step 1.** Regulate stock exchanges and securities-market intermediaries.

**Step 2.** Protect investors; guide and educate them.

**Step 3.** Prevent malpractices (insider trading, price rigging).

**Final Answer:** Regulate the market, protect investors, prevent malpractice.

**Q 10.8** State the objectives of the NSE.

#### SOLUTION

**Concept used.** The **National Stock Exchange (NSE)** of India 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. It works towards five objectives.

**Step 1. Establish a nationwide trading facility** for all types of securities – equities, debt instruments, hybrids, government securities, and so on.

**Step 2. Ensure equal access to investors all over the country** through an appropriate communication network so that geographical location does not disadvantage an investor.

**Step 3. Provide a fair, efficient and transparent securities market** using electronic trading systems and visible order books.

**Step 4. Enable shorter settlement cycles and book-entry settlements,** reducing the time between trade and final settlement and eliminating paperwork delays.

**Step 5. Meet international securities-market benchmarks and standards** so that Indian markets are at par with global stock exchanges.

**Final Answer:** NSE's five objectives: **nationwide trading reach, equal access, fair & transparent trading, shorter settlement cycles, and international benchmarks.**

**EXPERT'S SOLUTION** : Aarav Sharma, M.Com, Delhi University

**Quick reading.** NSE was the first fully electronic, nationwide exchange in India. Its objectives all turn on *access, transparency, efficiency, and global standards.*

**Step 1.** Nationwide trading platform.

**Step 2.** Equal access regardless of location.

**Step 3.** Fair, efficient, transparent system.

**Step 4.** Shorter settlement (book-entry).

**Step 5.** Meet international benchmarks.

**Final Answer:** Reach, access, transparency, fast settlement, global standards.

**Q 10.9** What is OTCEI?

**SOLUTION**

**Concept used.** The **Over the Counter Exchange of India (OTCEI)** is an electronic stock exchange that was incorporated in 1990 and made fully operational in 1992. It was set up by financial institutions like UTI, ICICI, IDBI, IFCI, LIC, GIC and SBI Capital Markets, modelled on the lines of NASDAQ (the over-the-counter market of the USA). It was created specifically for *small and medium-sized companies* that could not get listed on the major stock exchanges.

**Step 1. Meaning.** OTCEI is a screen-based, electronically operated, ring-less, national and fully automated stock exchange. “Over-the-counter” originally meant trading directly between buyer and seller without a central trading floor.

**Step 2. Purpose.** To provide an organised trading platform for small and medium-sized companies whose paid-up capital is between Rs. 30 lakh and Rs. 25 crore.

**Step 3. Features.** Companies must be sponsored by a member of OTCEI; trading is screen based; the system has market makers who give two-way quotes (bid and ask); the system is nationwide so an investor can buy or sell shares from any OTCEI counter.

**Step 4. Advantages.** Cheaper access to capital for small firms; transparency through screen-based trading; investor protection through the market-maker mechanism.

**Final Answer:** OTCEI is the *Over the Counter Exchange of India* – a fully electronic, nationwide stock exchange (modelled on NASDAQ) created in 1990 for *small and medium* companies with paid-up capital between Rs. 30 lakh and Rs. 25 crore.

**EXPERT'S SOLUTION** : Priya Iyer, M.Com, Christ University Bangalore

**Quick reading.** OTCEI = India's NASDAQ; created in 1990 for small / medium companies that the BSE would not list. Fully electronic, screen-based, with market makers.

**Step 1.** Set up in 1990 by FIs (UTI, ICICI, IDBI, LIC, GIC, SBI Caps).

**Step 2.** Modelled on NASDAQ (USA).

**Step 3.** Screen-based, ring-less, national.

**Step 4.** For small / medium firms (Rs. 30 L to Rs. 25 Cr).

**Step 5.** Market makers give bid–ask quotes.

**Final Answer:** Electronic national exchange for small and medium companies.

## Long Answer Type Questions

**Q 10.10** Explain the various Money Market Instruments.

### SOLUTION

**Concept used.** The **money market** is the market for short-term funds (less than one year). It deals in monetary assets having a maturity of one year or less. The instruments allow large corporates, banks, NBFCs and the government to manage their short-term liquidity. Five major instruments operate in the Indian money market.

**Step 1. Treasury Bill (T-bill).** A short-term promissory note issued by the RBI on behalf of the Government of India to meet short-term needs. It is a zero-coupon instrument: issued at a *discount* to face value and redeemed at *par*. Maturities are 14, 91, 182 and 364 days. Minimum amount Rs. 25,000. Highly liquid and risk-free, also called Zero Coupon Bonds.

**Step 2. Commercial Paper (CP).** A short-term unsecured promissory note issued by *large and creditworthy companies* to raise short-term funds at rates lower than the bank rate. Maturity is 15 days to one year. Sold at a discount and redeemed at par. Used for working capital, seasonal financing, and *bridge financing* for new floats. Minimum issue size Rs. 5 lakh.

**Step 3. Call Money.** Short-term finance, repayable on demand, used by *commercial banks* to meet temporary cash shortages and CRR requirements. Maturity is 1 to 15 days. Interest is the *call rate* which is highly volatile.

**Step 4. Certificate of Deposit (CD).** An unsecured, negotiable, short-term instrument

in bearer form, issued by *commercial banks* and development financial institutions. Maturities range from 91 days to 1 year. CDs are issued to individuals, corporations and companies during periods of tight liquidity, when deposit growth is slow but credit demand is high.

**Step 5. Commercial Bill.** 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 in turn can *re-discount* the bill with the RBI or the DFHI.

**Final Answer:** Five money-market instruments: **T-Bill, Commercial Paper, Call Money, Certificate of Deposit, Commercial Bill.** All have maturities of one year or less and are designed for short-term liquidity management.

### ♥ Why This Matters

When you read in the news that the RBI “conducted a 14-day variable rate repo” or that “commercial paper yields spiked”, you are watching the money market in action. These instruments are the plumbing through which the Indian financial system stays liquid every single day.

**EXPERT’S SOLUTION** : *Karthik Subramaniam, MBA Finance, IIM Calcutta*

**Strategic angle.** Five instruments. Sort them by issuer to remember: Government → T-bill; Corporates → Commercial paper + Commercial bill; Banks → Certificate of deposit + Call money.

**Step 1. T-Bill:** Government short-term paper, discount to par, <1 yr.

**Step 2. Commercial Paper:** Big firms borrow short, unsecured, discount.

**Step 3. Call Money:** Bank-to-bank, 1–15 days, call rate.

**Step 4. Certificate of Deposit:** Banks raise short money during liquidity squeeze.

**Step 5. Commercial Bill:** Bill of exchange for trade credit; discountable at the bank.

**Final Answer:** T-Bill (Govt), CP (firms), Call money (banks), CD (banks), Commercial bill (trade).

**Q 10.11** What are the methods of floatation in the primary market?

**SOLUTION**

**Concept used.** The **primary market** (or new-issues market) is the segment of the capital market through which firms raise fresh capital by issuing securities for the *first time*. Five common methods are used to bring new securities to the public.

**Step 1. Offer through Prospectus (Public Issue / IPO).** The company invites the public to subscribe to its shares (or debentures) by issuing a detailed *prospectus* that discloses the company's objectives, finances, promoters and risks. Applications are invited through a network of brokers and underwriters. This is the most popular method for an Initial Public Offer (IPO).

**Step 2. Offer for Sale.** The company sells the entire block of new securities to an intermediary (an issue house or a stock broker) at an agreed price. The intermediary then re-sells the securities to the investing public at a higher price. The company avoids the formalities of a public issue.

**Step 3. Private Placement.** The company allots securities to a select group of investors – typically institutional investors like banks, mutual funds, insurance companies, FIIs – without inviting the general public. It saves on commission and underwriting fees and is the fastest method.

**Step 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 has the *right* (not the obligation) to apply, and can renounce it in favour of someone else. Section 62 of the Companies Act 2013 makes the rights issue mandatory before a fresh public issue by an existing company.

**Step 5. e-IPO (electronic IPO).** A company can issue its capital through an on-line system of the stock exchange. The company appoints brokers, signs an agreement with the exchange, and the issue is offered electronically. Information is uploaded; investors apply online; allotment happens through the exchange platform.

**Final Answer:** Five methods of floatation in the primary market: **prospectus / public issue, offer for sale, private placement, rights issue, and e-IPO.**

**Mnemonic**

**PORP-E:** Prospectus, Offer for sale, Rights, Private placement, e-IPO. Five methods, one acronym.

**EXPERT'S SOLUTION** : Sneha Patel, MBA Finance, IIM Lucknow

**Strategic angle.** Group the methods by who the buyer is. Public method → prospectus and e-IPO; intermediary method → offer for sale; private method → private placement; shareholders only → rights issue.

- Step 1.** Prospectus (IPO): document-led public issue.
- Step 2.** Offer for sale: securities sold to broker, broker resells to public.
- Step 3.** Private placement: select institutions only.
- Step 4.** Rights issue: existing shareholders, in proportion to holdings.
- Step 5.** e-IPO: online IPO via the exchange.

**Final Answer:** Prospectus, offer for sale, private placement, rights issue, e-IPO.

**Q 10.12** Explain the capital market reforms in India.

**SOLUTION**

**Concept used.** Indian **capital market reforms** began in 1991 as part of the broader economic liberalisation. The reforms aimed to make the market *efficient, transparent, safe and globally competitive*. Six major reforms have shaped today's capital market.

**Step 1. Establishment of SEBI.** SEBI was set up in 1988 and given statutory status in 1992 to protect investor interests and to develop and regulate the securities market. It frames rules for primary issues, listing, intermediaries (merchant bankers, brokers), mutual funds, and insider trading.

**Step 2. Establishment of creditable trading mechanisms.** The setting up of the *National Stock Exchange* (NSE, 1994) and the *Over the Counter Exchange of India* (OTCEI, 1992) provided modern, screen-based trading with nationwide reach. This triggered the BSE to also modernise (BOLT system).

**Step 3. Screen-based trading and the National Securities Clearing Corporation.** Open outcry on a trading floor was replaced by transparent, screen-based trading. The NSCCL (National Securities Clearing Corporation Ltd, 1995) guarantees settlement, removing counterparty risk.

**Step 4. Dematerialisation (demat).** Physical share certificates were replaced by electronic (demat) holdings through depositories like the National Securities Depository Limited (NSDL, 1996) and Central Depository Services (India) Limited (CDSL, 1999). This eliminated bad deliveries, fake certificates and theft.

**Step 5. Investor protection.** An Investor Protection Fund has been set up; SEBI conducts investor education programmes; grievance redressal mechanisms (SCORES) accept investor complaints online; disclosure norms for issuers have been tightened.

**Step 6. Rolling settlement.** The earlier “weekly settlement” was replaced by rolling settlement (T+2 day) – trades on any given day are settled within two working days, reducing speculation and risk.

**Step 7. Allowing FIIs and Indian companies in foreign markets.** Foreign Institutional Investors (FIIs) have been allowed to invest in Indian securities, and Indian companies have been allowed to raise capital abroad through GDRs and ADRs.

**Final Answer:** Capital market reforms since 1991: **SEBI (1988/1992)**, NSE & OTCEI, screen-based trading + NSCCL, **dematerialisation (NSDL/CDSL)**, investor protection (IPF, SCORES), **rolling settlement (T+2)**, and FII / GDR / ADR access.

### ♥ Why This Matters

Without these reforms, an investor in Patna in 2026 could not buy a Mumbai-listed share in 90 seconds on her phone. The combination of SEBI, demat accounts, NSE and rolling settlement collapsed a week-long, paper-heavy process into seconds and made the Indian capital market one of the most efficient emerging markets in the world.

**EXPERT’S SOLUTION** : Ananya Reddy, MBA Finance, IIM Bangalore

**Strategic angle.** The reforms answered four 1991 problems: *no regulator, no modern trading, paper share certificates, weekly settlement*. The seven reforms are the answers.

**Step 1.** SEBI created (1988) and made statutory (1992).

**Step 2.** NSE (1994) + OTCEI (1992): new exchanges; BSE also modernised.

**Step 3.** Screen-based trading + NSCCL (1995): transparent and guaranteed.

**Step 4.** Dematerialisation: NSDL (1996), CDSL (1999); paper certificates gone.

**Step 5.** Investor protection: Investor Protection Fund, SCORES grievance portal.

**Step 6.** Rolling settlement (T+2): faster and safer than weekly settlement.

**Step 7.** FIIs and GDR/ADR: capital flows opened up both ways.

**Final Answer:** SEBI, NSE/OTCEI, screen trading + NSCCL, demat (NSDL/CDSL), investor protection, rolling settlement, FII/GDR/ADR access.

**Q 10.13** Explain the various functions of the Securities and Exchange Board of India (SEBI).

**SOLUTION**

**Concept used.** SEBI performs its role through three broad sets of functions: *protective, regulatory, and developmental*. Protective functions defend investor interests; regulatory functions discipline the market; developmental functions help the market grow.

**Step 1. Protective functions.**

1. Prohibition of fraudulent and unfair trade practices like price rigging and making misleading statements.
2. Controlling insider trading and imposing penalties on insiders who trade on unpublished price-sensitive information.
3. Undertaking steps for investor protection: investor education campaigns, grievance redressal through SCORES.
4. Promotion of fair practices and a code of conduct in securities markets.

**Step 2. Regulatory functions.**

1. Registration of brokers, sub-brokers, merchant bankers, mutual funds, FIIs and other intermediaries.
2. Regulation of stock-broker activities and other intermediaries through guidelines and rules.
3. Regulation of takeover bids by companies.
4. Inquiries, audits and inspections of stock exchanges and intermediaries.
5. Framing rules and regulations for the orderly working of all institutions in the securities markets.

**Step 3. Developmental functions.**

1. Training of intermediaries (brokers, merchant bankers).
2. Conducting research and publishing useful information to all market participants.
3. Undertaking measures to develop the capital markets by adapting a flexible approach (for example, permitting underwriting to be optional in some cases to reduce cost of issue, permitting internet trading through registered brokers).

**Final Answer:** SEBI performs three sets of functions: **protective** (investor protection, prohibition of malpractice), **regulatory** (registration and supervision of intermediaries), and **developmental** (training, research, market development).

**Exam Tip**

For a 6-mark question, write *three* headings (protective / regulatory / developmental) and

list 3–4 points under each. For a 4-mark question, give 1–2 points under each.

**EXPERT'S SOLUTION** : Rohan Kapoor, B.Com (H), Shri Ram College of Commerce

**Strategic angle.** Three buckets answer SEBI's whole mandate: *protect the investor, police the market, push the market forward.*

**Step 1.** Protective: prohibit price rigging, ban insider trading, run SCORES.

**Step 2.** Regulatory: register and supervise brokers, mutual funds, FIIs, takeovers.

**Step 3.** Developmental: train intermediaries, conduct research, push reforms (internet trading, flexible underwriting).

**Final Answer:** Protective + regulatory + developmental.

**Q 10.14** Explain the steps involved in the trading procedure on a stock exchange.

#### SOLUTION

**Concept used.** The **trading procedure** on a modern Indian stock exchange is fully screen based, electronic, and operates on a rolling-settlement (T+2) basis. The process from investor's order to delivery of securities involves six distinct steps.

**Step 1. Selection of a broker.** The investor selects a broker (or sub-broker) who is a registered member of a recognised stock exchange. An agreement is signed; the investor provides PAN, identity proof, address proof, bank account details and opens a *Demat account* with a Depository Participant linked to NSDL or CDSL.

**Step 2. Opening a Demat and Trading account.** The investor opens a *trading account* (with the broker, for placing buy/sell orders) and a *demat account* (with the DP, to hold the securities in electronic form). A bank account is linked for funds.

**Step 3. Placing the order.** The investor instructs the broker to buy or sell a specified quantity of a specified security at a specified price (or at the prevailing market price). The order can be placed in person, over the phone, or online through the broker's web portal or mobile app.

**Step 4. Executing the order / Match on exchange.** The broker enters the order into the exchange's electronic trading system. The order is automatically matched against an opposite order at the best available price. Once matched, a *trade-confirmation slip* is generated and sent to the investor.

**Step 5. Issue of contract note.** Within 24 hours of the trade, the broker issues a *contract note* to the investor giving full details: securities, quantity, price,

brokerage charged, the trade time, settlement date and the unique order number.

**Step 6. Settlement on T+2.** The investor must pay the broker the trade amount (for a buy order) or deliver the securities (for a sell order) on or before the *pay-in day*. On the *pay-out day* (the second working day after the trade, T+2), the securities are credited to the buyer's demat account and the sale proceeds are credited to the seller's bank account.

**Final Answer:** The trading procedure has six steps: **select broker, open demat & trading account, place order, execute the trade on the exchange, receive contract note, settle on T+2.**

#### ✗ Watch Out

Many students confuse *trading account* (with the broker) and *demat account* (with the DP). The trading account places orders; the demat account holds the shares. Both are needed.

**EXPERT'S SOLUTION** : Vivaan Mehta, M.Com, Symbiosis Pune

**Strategic angle.** Picture six dominoes from “open accounts” to “shares in your demat on day T+2”. Each one triggers the next.

**Step 1.** Pick a SEBI-registered broker; sign client agreement.

**Step 2.** Open demat (NSDL/CDSL) + trading account; link bank.

**Step 3.** Place order: quantity, price, security.

**Step 4.** Broker keys it into the exchange; matched electronically.

**Step 5.** Contract note within 24 hours.

**Step 6.** Settlement on T+2: shares credited or cash credited.

**Final Answer:** Broker, account, order, match, note, settle (T+2).

**Q 10.15** Explain the role of ‘dematerialisation’ in promoting the New Stock Market.

#### SOLUTION

**Concept used.** **Dematerialisation** (or **demat**) 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). Dematerialisation has transformed Indian capital markets in four major ways.

- Step 1. Elimination of paper certificates.** Physical share certificates are bulky, can be lost or stolen, can be forged, and create “bad deliveries” (signature mismatch, torn certificates). Demat replaced all this with a secure electronic record.
- Step 2. Faster settlement.** With securities in electronic form, ownership changes happen in book entry; this enabled the move from a 14-day account-period settlement to T+2 rolling settlement, and ultimately T+1.
- Step 3. Lower cost and effort.** Stamp duty on transfer of demat shares is much lower; there are no postage or insurance costs for sending certificates; the investor receives electronic credits for dividends and bonus shares automatically.
- Step 4. Wider investor participation.** A demat-account holder anywhere in India can buy or sell on any stock exchange through any broker, supporting the equal-access objective of the NSE. This has expanded retail participation in the market.

**Final Answer:** Dematerialisation promotes the new stock market by **removing paper certificates, enabling faster (T+2/T+1) settlement, cutting transaction costs, and widening retail investor participation.**

### ♥ Why This Matters

The number of demat accounts in India crossed 15 crore in 2024 – almost five times the level of just five years earlier. That entire boom is built on top of NSDL and CDSL: a stock market on paper could never have absorbed 15 crore accounts.

**EXPERT'S SOLUTION** : *Karthik Subramaniam, MBA Finance, IIM Calcutta*

**Strategic angle.** Demat replaced paper. Once paper was gone, everything downstream (speed, cost, reach, scale) got cheaper and faster.

**Step 1.** Paper certificates → electronic book entries (NSDL, CDSL).

**Step 2.** Settlement compressed from days to T+2 / T+1.

**Step 3.** Stamp duty cut; no postage / insurance / signature checks.

**Step 4.** Investors anywhere; brokers anywhere; the market scaled to crores.

**Final Answer:** No paper ⇒ faster, cheaper, broader, deeper market.

**Q 10.16** Distinguish between Primary and Secondary Markets.**SOLUTION**

**Concept used.** The **capital market** has two parts. The **primary market** (or new-issues market) is where companies sell securities for the *first time*. The **secondary market** (or stock exchange / stock market) is where *existing* securities already issued in the past are traded among investors. The two differ on seven key dimensions.

Basis	Primary Market	Secondary Market
What is traded	New / fresh securities issued for the first time	Existing securities issued earlier
Buyers & sellers	The company sells; the investor buys	Investor sells to another investor through brokers
Capital formation	Direct capital formation: money flows to the company	Indirect: ownership changes hands but no fresh money flows to the company
Where it takes place	No fixed geographical location; happens through prospectus, allotment etc.	Located at fixed places: stock exchange premises with screen-based trading
Pricing	Price determined by the company (with merchant banker / SEBI guidance)	Price determined by demand-supply forces in the market
Number of transactions in a security	Only one sale of a given new security	A given security can be traded numberless times
Intermediaries	Merchant bankers, underwriters, brokers	Brokers, sub-brokers, depository participants

**Final Answer:** Primary market = new securities, capital flows to the company, one-time sale. Secondary market = existing securities, money changes hands between investors, repeated trading.

**EXPERT'S SOLUTION** : Sneha Patel, MBA Finance, IIM Lucknow

**Strategic angle.** The deciding question for any transaction is: *does the company get the money?* If yes, it is primary. If the money goes from one investor to another, it is secondary.

**Step 1.** Primary: new shares, company is the seller, capital formation.

**Step 2.** Secondary: old shares, investor is the seller, no capital formation.

**Step 3.** Primary: no fixed venue.

**Step 4.** Secondary: stock exchange.

**Step 5.** Primary: price set by company / merchant banker.

**Step 6.** Secondary: price set by market forces.

**Final Answer:** New vs existing; company sells vs investors trade; capital formation vs liquidity.

**Q 10.17** Explain the development functions of SEBI.

### SOLUTION

**Concept used.** SEBI's **developmental functions** are the activities through which SEBI helps the securities market grow, become more sophisticated, and serve the wider economy. Unlike its protective or regulatory roles, developmental functions are facilitative rather than restrictive.

**Step 1. Training of intermediaries.** SEBI provides training programmes and certifications for stock-market intermediaries (brokers, sub-brokers, merchant bankers, mutual-fund distributors, research analysts) to raise professional standards. The NISM (National Institute of Securities Markets) was set up by SEBI to run these courses.

**Step 2. Conducting research.** SEBI undertakes and publishes research on the working of the securities market, sectoral trends, market microstructure, and global best practices, and makes the data available to participants.

**Step 3. Promoting flexible and adaptable approaches.** SEBI promotes:

1. *Optional underwriting* of public issues to reduce the cost of issue.
2. Internet trading through registered stock brokers to widen retail access.
3. Direct listing of company shares without prior IPO under specified frameworks.

**Step 4. Investor awareness programmes.** SEBI runs investor education programmes, publishes guides in regional languages, and organises seminars, all aimed at developing an informed investor base.

**Step 5. Promoting fair practices and self-regulation.** Encouraging stock exchanges and intermediary associations to evolve their own codes of conduct, with SEBI as the long-stop regulator.

**Final Answer:** SEBI's developmental functions: **train intermediaries, conduct & publish research, promote flexible market practices (optional underwriting, internet trading), run investor awareness campaigns, and encourage self-regulation.**

**EXPERT'S SOLUTION** : Ananya Reddy, MBA Finance, IIM Bangalore

**Strategic angle.** Development = anything SEBI does to make the market *bigger, deeper or smarter*. Training, research, awareness, flexibility.

**Step 1.** Train: NISM courses for brokers, MBs, analysts.

**Step 2.** Research: data and reports on markets, sectors.

**Step 3.** Flexibility: optional underwriting, internet trading, direct listing.

**Step 4.** Awareness: investor education in many languages.

**Step 5.** Self-regulation: encourages intermediary codes of conduct.

**Final Answer:** Training, research, flexible practices, investor awareness, self-regulation.

### Key Takeaways

- A **financial market** performs four functions: mobilising savings, price discovery, providing liquidity, and reducing transaction costs.
- The financial market has two segments: the **money market** (short term, <1 year) and the **capital market** (medium and long term, >1 year).
- Five money-market instruments: *Treasury bill, Commercial paper, Call money, Certificate of deposit, Commercial bill.*
- The capital market is split into the **primary market** (new issues) and the **secondary market** (stock exchange). The stock market is only the secondary half.
- Five methods of floatation in the primary market: *prospectus, offer for sale, private placement, rights issue, e-IPO.*
- A **stock exchange** delivers liquidity, price discovery, safety, economic growth, equity-cult spread, and a controlled outlet for speculation. The NSE and OTCEI brought screen-based trading and nationwide access.
- **SEBI** was set up in 1988 (statutory 1992) with three objectives – regulate the market, protect investors, prevent malpractice – delivered through protective, regulatory and developmental functions.

- The trading procedure has six steps: *select broker, open demat & trading account, place order, execute trade, receive contract note, settle on T+2.*

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