DegreeLive

B.COM HONOURS	SEMESTER 1	CALICUT UNIVERSITY	COURSE CODE: COM1MN105

BASICS OF FINANCIAL MARKETS

EXAM REVISION NOTES

JOIN WHATSAPP CHANNEL →

MODULE I

1. INTRODUCTION TO THE INDIAN FINANCIAL SYSTEM: DEFINITION, SCOPE & STRUCTURE

Introduction to the Indian Financial System: Definition, Scope Structure: In macroeconomic theory, the pace of industrialization, technological progress, and national wealth accumulation depends fundamentally upon the efficiency of a nation's Financial System.

Scope and Architecture of the Indian Financial System: The structure of the Indian Financial System is broadly bifurcated into two parallel operating sectors:

- **1. The Organised Financial Sector:** Comprises formal financial institutions, commercial banks, stock exchanges, insurance corporations, and mutual funds that are legally chartered, strictly regulated, and systematically audited by statutory regulatory authorities (RBI, SEBI, IRDAI, PFRDA).
- **2. The Unorganised Financial Sector:** Comprises informal Indigenous Bankers (Shroffs, Marwaris, Chettiars), local Money Lenders, pawn brokers, and unregistered chit funds operating outside the direct statutory oversight of central regulators.

Features and Core Functions of the Financial System: The Indian financial system possesses unique institutional, structural, and evolutionary features shaped by post-independence nationalization, the landmark 1991 Narasimham Committee financial sector reforms, and the modern digital FinTech revolution.

Landmark Financial Sector Reforms: The Narasimham Committee (1991 1998): The contemporary efficiency and stability of the Indian financial system was engineered primarily by the recommendations of the landmark Narasimham Committee on the Financial System (1991) and the Committee on Banking Sector Reforms (1998):

- **3. Deregulation of Interest Rates:** Eliminated administrative government control over lending and deposit interest rates, allowing commercial banks to price loans dynamically based on credit risk ratings and market forces.

Pillar 1: Financial Institutions (Intermediaries): Financial institutions are specialized corporate bodies that intermediate between net savers and net investors.

- **Commercial Banks (Public, Private, Foreign):** Accept demand and time deposits, provide working capital loans, and create credit through fractional reserve banking.
- Regional Rural Banks (RRBs) amp; Cooperatives: Focus on grassroots agricultural credit, rural artisans, and small farmers.
- **Differentiated Banks:** Small Finance Banks (unserved micro-borrowers) and Payments Banks (remittance services without lending).
- **Nature:** Financial entities registered under the Companies Act engaged in lending, hire purchase, leasing, and housing finance, regulated by RBI.
- **Specialized NBFC Categories:** (a) Investment and Credit Companies (ICCs), (b) Infrastructure Finance Companies (IFCs), (c) NBFC-Microfinance Institutions (NBFC-MFIs), (d) Housing Finance Companies (HFCs), and (e) Core Investment Companies (CICs).

Pillar 2: Financial Instruments (Assets Securities): A financial instrument is a tradable legal contract that represents a monetary claim by one party against another.

- **Short-Term (Money Market: ≤ 1 Year):** Treasury Bills (T-Bills); Zero-risk sovereign short-term discount debt issued by RBI on behalf of the Central Government (91-day, 182-day, 364-day).
- **Short-Term (≤ 1 Year):** Commercial Paper (CP); Unsecured promissory notes issued by top-rated creditworthy blue-chip corporations to fund short-term working capital (7 days to 1 year).
- **Short-Term (≤ 1 Year):** Certificate of Deposit (CD); Negotiable, transferable term deposit receipts issued by commercial banks at a discount against high-value funds deposited (7 days to 1 year).
- **Long-Term (Capital Market: gt; 1 Year):** Equity Shares (Ordinary Shares); Represents fractional equity ownership in a corporation.

Pillar 4: Financial Services: Fund-Based Services: The service provider directly deploys its own capital: Equipment Leasing, Hire Purchase financing, Consumer Credit, Bill Discounting, Factoring, and Housing Loans.

- **Fee-Based (Advisory) Services:** The provider generates fee income through specialized intellectual expertise: Merchant Banking, IPO Underwriting, Portfolio Management Services (PMS), Credit Rating, Stock Broking, and Mergers amp; Acquisitions (M amp;A) advisory.

Key Statutory Functions of RBI:

- **Monetary Authority:** Targets consumer price inflation (4% +/- 2% mandate under the Monetary Policy Committee - MPC framework).
- **Issuer of Currency:** Sole authority to print currency notes in India under the Minimum Reserve System.
- Banker to the Government and Commercial Banks: Manages public debt auctions and acts as the "Lender of Last Resort" during liquidity crises.
- Regulator amp; Supervisor of the Banking System: Enforces Basel III Capital Adequacy Ratios (CRAR), issues banking licenses, conducts forensic audits, and resolves Non-Performing Assets (NPAs).
- **Custodian of Foreign Exchange Reserves:** Administers the Foreign Exchange Management Act (FEMA, 1999) to stabilize the Indian Rupee exchange rate.

Advanced Theoretical Extensions Analytical Problem-Solving: In modern academic curricula and enterprise governance, mastering Basics of Financial Markets demands a rigorous integration of foundational theory with multi-stakeholder operational frameworks.

Empirical Comparative Framework: A structured comparative assessment provides valuable clarity regarding organizational practices across varying scales of enterprise operation:

- **Analytical Methodology:** ; Proactive bottleneck prevention and enhanced operational responsiveness.
- **Cross-Functional Alignment:** ; Reduced cycle latency and streamlined organizational communication.
- **Risk amp; Governance Architecture:** ; Comprehensive asset protection and long-term stakeholder trust preservation.
- **Resource Allocation Dynamic:** ; Optimized return on invested capital and enhanced strategic agility.

Comprehensive Enterprise Risk Management (ERM) Matrix: Management teams deploy structured risk matrices to categorize, evaluate, and mitigate vulnerabilities across four core exposure categories:

- **Strategic Risk:** ; Continuous scenario modeling, product portfolio diversification, and agile capital budgeting buffers.
- **Operational Risk:** ; Redundant vendor agreements, predictive maintenance algorithms, and rigorous workforce certification programs.
- **Financial amp; Credit Risk:** ; Dynamic hedging instruments, conservative credit underwriting standards, and dedicated emergency liquidity reserves.
- **Compliance amp; Legal Risk:** ; Dedicated statutory compliance teams, external legal audits, and enterprise-wide whistle-blower mechanisms.

DegreeLive

Strategic Synthesis Quantitative Performance Analytics: Achieving excellence in Basics of Financial Markets requires an appreciation of quantitative analytical methods and robust performance measurement systems.

MODULE II

1. CONCEPTUAL FRAMEWORK AND TYPOLOGY OF FINANCIAL MARKETS

Conceptual Framework and Typology of Financial Markets: In classical financial economics, a Financial Market is an institutional and technological mechanism that facilitates the creation, pricing, purchase, and sale of financial assets and claims (such as stocks, bonds, bills, commercial papers, and foreign currencies).

Rigorous Distinction: Money Market vs. Capital Market: Understanding the structural differences between the Money Market and the Capital Market is foundational to financial analysis:

- **1. Maturity Horizon:** ; Medium to Long-Term (ranging from 1 year to 30+ years or perpetual equity).
- **2. Economic Purpose:** ; Financing permanent capital expenditures (factories, machinery, highways, R amp;D).
- **3. Core Instruments:** ; Equity Shares, Preference Shares, Debentures, Corporate Bonds, Government G-Secs.
- **4. Major Participants:** ; Retail Individual Investors, Stock Brokers, Mutual Funds, Foreign Portfolio Investors (FPIs), Insurance Funds.

Macroeconomic Significance and Functions: 1. Liquidity Balancing amp; Equilibrium: Acts as a national hydraulic reservoir.

- **2. Monetary Policy Transmission:** When the RBI alters the benchmark Repo Rate or CRR, the impact transmits immediately into Call Money and T-Bill rates, subsequently rippling into commercial bank lending and deposit rates across the real economy.
- **3. Non-Inflationary Sovereign Financing:** Enables the Central Government to fund temporary seasonal mismatches between tax revenues and expenditures by issuing Treasury Bills to the market, avoiding the dangerous practice of monetizing deficits through printing fiat currency.
- **4. Industrial Working Capital Support:** Provides manufacturing and commercial enterprises with cost-effective working capital finance through Commercial Paper (CP) and Commercial Bill discounting at rates often lower than bank overdrafts.

The Six Major Money Market Instruments: 1. Call, Notice amp; Term Money: Call Money: Inter-bank borrowing/lending of funds for a tenure of exactly 1 day (overnight) without collateral.

- **Call Money:** Inter-bank borrowing/lending of funds for a tenure of exactly 1 day (overnight) without collateral.
- **Notice Money:** Inter-bank borrowing/lending for tenures from 2 days to 14 days.
- **Term Money:** Borrowing/lending for tenures from 15 days up to 1 year.
- **Participants:** Exclusively Scheduled Commercial Banks, Cooperative Banks, and Primary Dealers.
- **Nature:** Short-term promissory notes issued by the RBI on behalf of the Government of India to finance fiscal deficits.

Issuance and Pricing of Certificates of Deposit (CDs): Certificates of Deposit are issued by commercial banks during periods of tight system liquidity when credit growth outpaces retail deposit growth.

The Five Dimensions of Money Market Risk: 1. Credit / Default Risk: The risk that the issuer fails to repay the principal upon maturity.

- **2. Interest Rate Risk (Price Risk):** The risk of market price declines when central bank policy rates rise.
- **3. Reinvestment Risk:** , in 91 days), the investor is forced to reinvest the principal at lower prevailing interest rates if the central bank has cut policy rates.
- **4. Purchasing Power (Inflation) Risk:** The risk that high consumer price inflation exceeds the nominal money market yield, resulting in negative real rates of return (rreal = rnominal -Inflation).

Structural Defects and Landmark Reforms of the Indian Money Market: Prior to the economic reforms of the 1990s, the Indian money market was characterized by severe structural deficiencies: narrow institutional participation, lack of integration, administrative interest rate ceilings, absence of secondary market liquidity, and manual, paper-based settlement procedures.

Landmark Committee Recommendations Institutional Evolution: The transformation of the Indian money market into a world-class electronic financial system was guided by two landmark committee blueprints:

- **The Sukhamoy Chakravarty Committee (1985):** Recommended transitioning to flexible, market-determined interest rates and activating open market treasury operations.
- The N.

Advanced Theoretical Extensions Analytical Problem-Solving: In modern academic curricula and enterprise governance, mastering Basics of Financial Markets demands a rigorous integration of foundational theory with multi-stakeholder operational frameworks.

Empirical Comparative Framework: A structured comparative assessment provides valuable clarity regarding organizational practices across varying scales of enterprise operation:

- **Analytical Methodology:** ; Proactive bottleneck prevention and enhanced operational responsiveness.
- **Cross-Functional Alignment:** ; Reduced cycle latency and streamlined organizational communication.
- **Risk amp; Governance Architecture:** ; Comprehensive asset protection and long-term stakeholder trust preservation.
- **Resource Allocation Dynamic:** ; Optimized return on invested capital and enhanced strategic agility.

Comprehensive Enterprise Risk Management (ERM) Matrix: Management teams deploy structured risk matrices to categorize, evaluate, and mitigate vulnerabilities across four core exposure categories:

- **Strategic Risk:** ; Continuous scenario modeling, product portfolio diversification, and agile capital budgeting buffers.
- **Operational Risk:** ; Redundant vendor agreements, predictive maintenance algorithms, and rigorous workforce certification programs.
- **Financial amp; Credit Risk:** ; Dynamic hedging instruments, conservative credit underwriting standards, and dedicated emergency liquidity reserves.
- **Compliance amp; Legal Risk:** ; Dedicated statutory compliance teams, external legal audits, and enterprise-wide whistle-blower mechanisms.

Strategic Synthesis Quantitative Performance Analytics: Achieving excellence in Basics of Financial Markets requires an appreciation of quantitative analytical methods and robust performance measurement systems.

DegreeLive

MODULE III

1. THE CAPITAL MARKET: STRUCTURE, FUNCTIONS & ECONOMIC SIGNIFICANCE

The Capital Market: Structure, Functions Economic Significance: In modern corporate finance and national economic planning, the Capital Market is the institutional framework that facilitates the mobilization, pooling, and allocation of medium and long-term financial resources (funds with maturities exceeding one year, extending up to perpetual equity).

The Symbiotic Interdependence of Primary Secondary Markets: The relationship between the Primary Market and the Secondary Market is fundamentally symbiotic:

- **Primary Market Feeds the Secondary Market:** The primary market creates and manufactures the financial assets (equity shares, debentures, sovereign bonds) that are subsequently listed and traded on the secondary stock exchange floor.
- **Secondary Market Enables the Primary Market:** An investor would never risk buying illiquid 20-year shares or bonds in an IPO if they could not sell them immediately whenever they needed cash.

The Three Fundamental Functions of the Primary Market: Every successful public securities offering requires the flawless execution of three sequential functions:

- **1. Origination:** Investigating technical and financial feasibility, determining the optimal capital structure (Equity vs.
- **2. Underwriting:** Entering into formal legal contracts with institutional underwriters who guarantee that if the public fails to subscribe to the mandatory minimum 90% of the issue, the underwriters will purchase the remaining shortfall, insulating the corporate issuer against catastrophic flotation failure.
- **3. Distribution:** Marketing the issue across retail broker syndicates, conducting institutional investor roadshows, managing online bidding portals, and allocating shares across investor categories.

Price Stabilization Mechanics Anchor Investor Lock-In: To eliminate post-listing volatility and anchor investor confidence during IPOs, SEBI enforces strict institutional safeguards:

- **Green Shoe Option (GSO):** The company appoints a Stabilizing Agent (SA) who borrows up to 15% additional shares from promoters.
- **Anchor Investor Allocation amp; Lock-in:** Anchor Investors (large institutional funds bidding ≥ ₹10 Crores) are allotted shares 1 day before public opening.

Public Issues: Initial Public Offering (IPO) vs. Follow-on Public Offering (FPO)

- **Initial Public Offering (IPO):** The first public offering of shares by an unlisted company to the general public, culminating in the formal listing and trading of the company's shares on recognized stock exchanges (BSE, NSE).
- **Offer for Sale (OFS):** Existing promoters, private equity, or venture capital investors sell their existing shareholding to the public.
- **Follow-on Public Offering (FPO):** A subsequent public offering of shares to the investing public by an already listed company to raise additional capital or dilute promoter holding to meet statutory minimum public shareholding norms (25%).

Bonus Issue (Capitalization of Reserves): A Bonus Issue is the issue of additional, free shares to existing equity shareholders in proportion to their holding without charging any monetary payment.

- Free Reserves built out of genuine operating profits.
- Securities Premium Account realized in cash.
- Capital Redemption Reserve (CRR) Account.
- **Revaluation Reserves:** Revaluation of fixed assets cannot be capitalized for bonus issues.
- **Bonus in Lieu of Dividend:** Bonus shares cannot be issued instead of paying regular cash dividends.

Comprehensive Flotation Methods Comparative Matrix

- **Public Issue (IPO / FPO):** General Public (Retail, HNI, QIB); Direct Inflow of Fresh Cash; Full Statutory Prospectus (SEBI DRHP); SEBI (ICDR) Regulations, 2018
- **Rights Issue:** Existing Shareholders Only; Inflow of Discounted Cash; Letter of Offer (Simplified); Section 62, Companies Act, 2013
- **Bonus Issue:** Existing Shareholders Only; Zero Cash Inflow (Capitalization); No Prospectus (Board amp; AGM Approval); Section 63, Companies Act, 2013
- **Private Placement:** Select Institutions (≤ 200 persons); Direct Inflow of Fresh Cash; Private Placement Offer Letter (PAS-4); Section 42, Companies Act, 2013

Application Supported by Blocked Amount (ASBA): ASBA is a mandatory payment mechanism developed by SEBI for all public and rights issue applications. Under ASBA, the investor's application money is NOT debited or transferred to the company upfront.

- **Continuous Interest Accrual:** The investor continues to earn bank savings interest on the entire application amount while it remains blocked.
- **Zero Refund Delays:** Eliminates the historical multi-month delays in receiving refund checks through postal mail.
- **Zero Fraud Risk:** Issuer companies and merchant bankers cannot misappropriate investor funds before shares are legally credited.

The SME IPO Platform: Dedicated Capital Rails for Growth Startups: 1. Dedicated Stock Exchanges (BSE SME amp; NSE Emerge): Specialized listing segments designed for small and medium enterprises with post-issue paid-up capital not exceeding ₹25 Crores, offering relaxed reporting norms compared to the main board.

- **100% Underwriting:** Merchant bankers must 100% underwrite the issue, holding at least 15% on their own books.
- **High Minimum Application Lot:** Minimum bid ticket size is ₹1,00,000 to ₹1,20,000, screening out vulnerable small retail investors.
- **2. Distinctive Regulatory Safeguards:** 100% Underwriting: Merchant bankers must 100% underwrite the issue, holding at least 15% on their own books.

Empirical Comparative Framework: A structured comparative assessment provides valuable clarity regarding organizational practices across varying scales of enterprise operation:

- **Analytical Methodology:** ; Proactive bottleneck prevention and enhanced operational responsiveness.
- **Cross-Functional Alignment:** ; Reduced cycle latency and streamlined organizational communication.
- **Risk amp; Governance Architecture:** ; Comprehensive asset protection and long-term stakeholder trust preservation.
- **Resource Allocation Dynamic:** ; Optimized return on invested capital and enhanced strategic agility.

Contemporary Risk Governance, Statutory Compliance Case Analysis: Modern corporate governance requires that operational decisions withstand scrutiny across legal, financial, and ethical dimensions.

Strategic Synthesis Quantitative Performance Analytics: Achieving excellence in Basics of Financial Markets requires an appreciation of quantitative analytical methods and robust performance measurement systems.

MODULE IV

1. THE SECONDARY MARKET: CONCEPTUAL ARCHITECTURE, FUNCTIONS & INTERMEDIARIES

The Secondary Market: Conceptual Architecture, Functions Intermediaries: The Secondary Market (commonly referred to as the Stock Exchange or Share Market) is the institutional and technological marketplace where previously issued, existing financial securities—such as equity shares, preference shares, corporate bonds, debentures, exchange-traded funds (ETFs), and sovereign government securities—are continuously traded among investors.

Intermediaries in the Secondary Market Ecosystem: Secondary market transactions are executed through specialized, licensed institutions regulated by SEBI to ensure transaction integrity and financial settlement:

- **Stock Brokers:** , Zerodha, ICICI Direct, HDFC Securities) authorized to execute buy/sell orders on behalf of retail and institutional clients.
- **Authorized Persons (Sub-Brokers):** Agents appointed by stock brokers to expand client acquisition and provide local advisory services.
- **Role:** Specialized entities—such as the NSE Clearing Limited (NCL) and Indian Clearing Corporation Limited (ICCL)—that handle post-trade clearing and settlement.
- **Central Counterparty (CCP):** The clearing house interposes itself between buyers and sellers via Novation, legally guaranteeing settlement even if a trading broker defaults.
- **Nature:** Electronic central vaults that hold securities in fungible, dematerialized (Demat) form, eliminating physical paper share certificates.

Stock Exchanges in India: Historical Evolution, BSE NSE: The history of Indian stock exchanges reflects the transition from unorganized open-outcry trading rings under banyan trees to world-class, high-frequency algorithmic electronic trading platforms.

National Stock Exchange of India (NSE) - Pioneer of Modern Electronic Trading: Incorporated in November 1992 and operationalized in 1994, the NSE was established upon the recommendation of the Pherwani Committee (1991) to dismantle regional exchange monopolies and establish an integrated national capital market.

- **Demutualization:** NSE pioneered corporate demutualization—strictly segregating trading rights, ownership rights, and management control to eliminate broker conflict of interest.
- NEAT (National Exchange for Automated Trading): Introduced satellite-linked (VSAT), fully automated, screen-based, order-driven trading accessible simultaneously across every Indian town.
- **Global Derivatives Powerhouse:** The NSE has consistently ranked as the world's largest derivatives exchange by number of contracts traded across equity indices and single stocks.

The Free-Float Market Capitalization Methodology: Both BSE SENSEX and NSE NIFTY 50 compute their real-time index values using the globally recognized Free-Float Market Capitalization Methodology.

- **Total Market Capitalization:** Total Shares Issued imesCurrent Market Price per Share.
- 00).
- **Free-Float Market Capitalization:** Total Market Capitalization imesFree-Float Factor (IWF).
- **Base Market Capitalization:** The aggregate market capitalization during the benchmark base year, dynamically adjusted via an Index Divisor for corporate actions (stock splits, rights issues).

Index Divisor Maintenance Neutrality during Corporate Actions: , a stock split, bonus issue, or rights issue), the company's market price drops mathematically. If unadjusted, this price drop would cause the entire index to plunge artificially.

Listing Procedure and Legal Requirements under SEBI (LODR) Regulations: To list its securities, a company must execute a formal agreement and comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 [SEBI LODR]:

- **Memorandum and Articles of Association:** Must contain provisions permitting common share transfer and unrestricted listing on stock exchanges.
- **Minimum Post-Issue Paid-Up Capital:** In India, a company listing on the main board of BSE/NSE must have a minimum post-issue paid-up equity capital of ₹10 Crores (or market capitalization of ₹25 Crores).
- **Mandatory Minimum Public Shareholding (MPS):** Under Rule 19A of SCRR, every listed company must maintain at least 25% public shareholding within three years of listing, preventing promoter monopolies.
- Continuous Reporting amp; Corporate Governance: Quarterly unaudited/audited financial results submitted within 45 days of quarter end.
- **Mandatory Board Composition:** At least 50% non-executive directors and minimum 1/3rd (or 1/2) independent directors.

Volatility Control: Circuit Breakers vs. Price Bands: 1. Nationwide Index-Based Circuit Breakers: Triggered when S amp;P BSE SENSEX or NIFTY 50 breaches 10%, 15%, or 20% movement: 10% Breach: Trading halts for 45 mins to 1 hour depending on the time of day.

- **10% Breach:** Trading halts for 45 mins to 1 hour depending on the time of day.
- **15% Breach:** Trading halts for 1 hour 45 mins to 2 hours.
- **20% Breach:** Entire cash and derivatives market shuts down for the remainder of the day.

The Comprehensive Real-Time Margining Architecture

- **1. Value at Risk (VaR) Margin:** ; Covers normal market price volatility for liquid equities.
- **2. Extreme Loss Margin (ELM):** ; Acts as a disaster buffer against unprecedented "black-swan" market crashes.
- **3. Mark-to-Market (MTM) Margin:** ; Collects daily notional cash losses from brokers to prevent default buildup.
- **4. Peak Margin Mandate:** ; Eliminates excessive broker leverage and unauthorized client fund misuse.

Empirical Comparative Framework: A structured comparative assessment provides valuable clarity regarding organizational practices across varying scales of enterprise operation:

- **Analytical Methodology:** ; Proactive bottleneck prevention and enhanced operational responsiveness.
- **Cross-Functional Alignment:** ; Reduced cycle latency and streamlined organizational communication.
- **Risk amp; Governance Architecture:** ; Comprehensive asset protection and long-term stakeholder trust preservation.
- **Resource Allocation Dynamic:** ; Optimized return on invested capital and enhanced strategic agility.

Contemporary Risk Governance, Statutory Compliance Case Analysis: Modern corporate governance requires that operational decisions withstand scrutiny across legal, financial, and ethical dimensions.

Strategic Synthesis Quantitative Performance Analytics: Achieving excellence in Basics of Financial Markets requires an appreciation of quantitative analytical methods and robust performance measurement systems.