Secondary Stage
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10
CBSE

Introduction to Financial Markets

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FULLMARKS

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Suman Batra

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PREFACE

Financial Skills encompass the capability to make well-informed judgments and decisions related to the utilization of financial resources. Cultivating these skills not only enhances the overall quality of life, but also elevates the standard of living through the encouragement of practices, such as budgeting, disciplined savings, judicious use of credit for endeavors like home acquisition, and strategic planning for significant life events such as children's education, marriage, and retirement. In the contemporary era, possessing Financial Skills is just as indispensable as proficiency in Computer Skills.

This book delves into the fundamental principles of Money Management, providing a comprehensive guide to understanding the basics of money and its effective management. By imparting this knowledge, the book empowers young readers to navigate the complexities of financial management, appreciate the significance of financial responsibility, and even share these valuable insights with their family members. The content of the is presented in a clear and accessible manner, starting from the origins of money and progressing to practical strategies for managing one's personal finances with efficiency.

Your comments and suggestions are always welcome for further improvement of the book.

–Publishers

INSIDE THE BOOK

Learning Resources

Learning Outcomes
Students will be able to know about

Learning Outcomes

1.1 Saving Vs Investment   1.2 Stock Exchange   1.3 Mutual Funds

Summary
This section provides summary of the chapter.

SUMMARY

- Investment involves deploying savings to generate returns over time. The key principles are to start early, contribute consistently, and adopt a long-term approach.
- Before committing to any investment, individuals should obtain comprehensive information, understand associated costs and benefits, assess risk-return profiles, and ensure compatibility with specific goals.
- A stock exchange facilitates the buying and selling of securities. Equity represents ownership in a company, while debt instruments involve contractual agreements for borrowing.
- Derivatives are financial products derived from underlying assets, and mutual funds pool money for diversified investments.
- An index reflects the movement of a specified portfolio of share prices, providing insights into market trends.
- A depository functions like a bank for holding securities in electronic form, and dematerialization involves converting physical certificates into electronic form.

Glossary
This section contains definitions of important terms.

Glossary

1. **Investment** : the process of converting savings into meaningful ventures
2. **Stock Exchange** : the body of individuals, established to assist, regulate, or control the business of buying, selling, or dealing in securities
3. **Debt Instrument** : a contractual agreement wherein one party lends money to another based on predetermined terms and the repayment of the principal amount by the borrower to the lender
4. **Derivatives** : a financial product whose value is derived from one or more basic variables, known as the underlying assets
5. **Mutual Fund** : a body corporate that pools money from individual and corporate investors
6. **Index** : a reflection of the movement of a specified portfolio of share prices, offering insights into market trends
7. **Depository** : a type of bank, where deposits consist of securities such as shares, debentures, bonds, government securities, units, etc., all held in electronic form
8. **Dematerialization** : the process through which physical certificates owned by an investor are transformed into an equivalent number of securities in electronic form

Sample Practical Work
Practical learning helps students learn more

PRACTICAL EXERCISE-1

Investment Basics

Learning Outcomes

- Objective
- Procedure
- Observation Points
- Reflection and Conclusion

Objective

To provide students with a comprehensive and hands-on experience in understanding fundamental concepts of investments, including risk tolerance, asset allocation, and building a diversified portfolio.

Procedure

- **Materials Needed:**
  - ➢ Whiteboard or flip chart
  - ➢ Markers
  - ➢ Computers or devices with internet access
  - ➢ Financial calculators or online investment calculators
  - ➢ Mock investment portfolios or virtual investment platforms
  - ➢ Scenario cards representing life events and financial goals
- **Introduction**

Investing is a fundamental aspect of financial planning, providing individuals with the opportunity to grow their wealth over time. This comprehensive guide aims to delve into the basics of investments through a structured classroom activity. By dividing the session into distinct steps, students will gain a hands-on understanding of essential concepts, participate in group discussions, create information boards, and engage in interactive presentations. The ultimate goal is to empower students to apply investment principles to their own financial goals.

➢ **Introduction to Investment Basics:** The journey begins with a concise overview of fundamental investment concepts such as risk, return, diversification, and time horizon. Emphasis is placed on the importance of setting financial goals and understanding individual risk tolerance. By establishing a solid foundation, students are better equipped to make informed investment decisions aligned with their unique financial objectives.

➢ **Group Formation and Financial Goals:** The class is divided into small groups, with each group assigned a hypothetical financial goal or life event. This could include scenarios like retirement, education, or purchasing a home. The groups are tasked with discussing and setting specific financial goals for their assigned scenario. This exercise encourages collaboration, critical thinking, and strategic planning.

Sample Project Work
It helps the students work outside the classroom environment while improving their practical skills.

PROJECT-1

Clearance and Settlement in Trading

Learning Outcomes

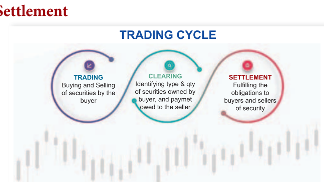
- Introduction
- Key Participants in Clearance and Settlement
- Conclusion
- Importance of Clearance and Settlement
- Future Trends and Innovations

Introduction

In the world of financial markets, clearance and settlement play a vital role in ensuring the smooth and secure completion of transactions. When investors buy or sell financial instruments such as stocks, bonds, or derivatives, clearance and settlement processes ensure that ownership is properly transferred, funds are exchanged, and any associated obligations are fulfilled.

The Importance of Clearance and Settlement

Risk Reduction: Clearance and settlement systems exist to minimize risks associated with trading. By verifying the authenticity of transactions and facilitating the exchange of assets and funds in a timely manner, these processes help prevent fraud, default, or other potential risks.



Efficiency and Liquidity: Clearing and settlement systems enhance market liquidity by expediting the finalization of transactions. This facilitates the swift movement of assets and funds, increasing the efficiency of trading activities.

Regulatory Compliance: Clearance and settlement procedures ensure compliance with applicable rules and regulations governing financial markets. Such systems adhere to established guidelines, promoting transparency and preventing illicit activities.

Key Participants in Clearance and Settlement

Clearance and settlement involve several key entities that work together to facilitate trading activities. These entities include:

- **Central Counterparty Clearinghouses (CCPs):** CCPs act as intermediaries between buyers and sellers, reducing counterparty risk by becoming the buyer to every seller and the seller to every buyer. They guarantee the settlement of transactions, ensuring the financial obligations are fulfilled even if one party defaults.

Assessment Tools

Activity

It provides an activity to the students allowing them to research and learn new things.

Activities

1. Create worksheets with real-world scenarios where students need to calculate simple interest for loans or investments. Include questions that involve different interest rates and time periods.

   Critical Thinking

2. Use online financial calculators to demonstrate the practical application of simple and compound interest calculations. Students can input values and observe how changes impact the results.

   Computational Thinking

3. Organize debates where students argue the advantages and disadvantages of simple interest versus compound interest.

   Experiential Learning

Exercise

It contains a variety of questions to assess the concepts taught in the unit/chapter.

Additional Questions with Answers

It contains MCQs, Fill in the blanks to test and improve their mental dexterity.

Exercises

CBSE Textbook Questions with Answers

Answer the following questions.

1. What is meant by 'Securities'?

Ans. The definition of 'Securities' as per the Securities Contracts Regulation Act (SCRA), 1956, includes instruments such as shares, bonds, scrips, stocks or other marketable securities of similar nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, interest and rights in securities, security receipt or any other instruments so declared by the Central Government.

2. What is the function of Securities Market?

Ans. Securities Markets is a place where buyers and sellers of securities can enter into transactions to purchase and sell shares, bonds, debentures etc. Further, it performs an important role of enabling corporates, entrepreneurs to raise resources for their companies and business ventures through public issues. Transfer of resources from those having idle resources (investors) to others who have a need for them (corporates) is most efficiently achieved through the securities market. Stated formally, securities markets provide channels for reallocation of savings to investments and entrepreneurship. Savings are linked to investments by a variety of intermediaries, through a range of financial products, called 'Securities'.

3. Which are the securities one can invest in?

Ans. Shares, Government securities, derivative products, and units of Mutual Funds etc., are some of the securities investors in the securities market can invest in.

4. Why does Securities Market need Regulators?

Ans. The absence of conditions of perfect competition in the securities market makes the role of the Regulator extremely important. The regulator ensures that the market participants behave in a desired manner so that securities market continues to be a major source of finance for corporate and government and the interest of investors are protected.

5. Who regulates the Securities Market?

Ans. The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI).

6. What is SEBI and what is its role?

Ans. The Securities and Exchange Board of India (SEBI) is the regulatory authority in India established under Section 3 of SEBI Act, 1992. SEBI Act, 1992 provides for establishment of Securities and Exchange Board of India (SEBI) with statutory powers for (a) protecting the interests of investors in securities (b) promoting the development of the securities market and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI has

Additional Questions with Answers

Choose the correct option.

1. What is the preferable utility of savings?
   (*a*) Leaving savings dormant (*b*) Spending immediately
   (*c*) Investing for future returns (*d*) None of the above
2. What is one important rationale for investment?
   i. Generating immediate income ii. Accumulating debts
   iii. Addressing inflation iv. Financial gains
   (*a*) i. and ii. (*b*) ii. and iii.
   (*c*) iii. and iv. (*d*) i and iv.
3. What is the goal when evaluating an investment's 'real' rate of return?
   (*a*) Matching inflation (*b*) Outpacing inflation
   (*c*) Ignoring inflation (*d*) Balancing inflation
4. What are the three fundamental principles for investors regarding investments?
   (*a*) Invest sporadically, contribute irregularly, adopt a short-term approach
   (*b*) Initiate investments early, consistently contribute, adopt a long-term approach
   (*c*) Invest late, contribute occasionally, adopt a short-term approach
   (*d*) None of the above
5. What is a precaution individuals should take before committing to any investment?
   (*a*) Investing without reading documents
   (*b*) Ignoring costs and benefits
   (*c*) Verifying the legitimacy of the investment
   (*d*) None of the above
6. What is the minimum investment period for bank fixed deposits?
   (*a*) 6 months (*b*) 12 months
   (*c*) 30 days (*d*) 1 year
7. What is the primary objective of money market or liquid funds?
   (*a*) Maximizing long-term returns (*b*) Capital protection and easy liquidity
   (*c*) Investing in real estate (*d*) None of the above
8. What is the maturity period of the Post Office Monthly Income Scheme?
   (*a*) 5 years (*b*) 10 years (*c*) 6 years (*d*) 15 years
9. What does the National Stock Exchange (NSE) exemplify?
   (*a*) Regional stock exchange (*b*) Government regulatory body
   (*c*) National stock exchange (*d*) Bond market
10. What does 'equity' represent in the financial context?
    (*a*) Fixed-income debt instrument
    (*b*) Share of a company's total equity capital
    (*c*) Mutual fund unit (*d*) Government security

SYLLABUS

	UNITS	DURATION IN HOURS
PART A	**Employability Skills**	
	Unit 1: Communication Skills-II	13
	Unit 2: Self-management Skills-II	07
	Unit 3: Information and Communication Technology Skills-II	13
	Unit 4: Entrepreneurial Skills-II	10
	Unit 5: Green Skills-II	07
	Total	**50**
PART B	**Subject Specific Skills**	
	Unit 1: Investment Basics	05
	Unit 2: Securities	06
	Unit 3: Primary Market	15
	Unit 4: Secondary Market	15
	Unit 5: Derivatives	06
	Unit 6: Depository	06
	Unit 7: Mutual Funds	10
	Unit 8: Miscellaneous	13
	Unit 9: Concepts & Modes of Analysis	13
	Unit 10: Ratio Analysis	06
	Total	**95**
PART C	**Practical Work**	
	Project	15
	Viva	
	Practical File	
	Demonstration of skill competency via Lab Activities	60
	Total	**75**
	Grand Total	**220**

NOTE: The detailed Curriculum/Topics to be covered under Part A: Employability Skills can be downloaded from CBSE website.

UNIT	SESSION/TOPIC	ACTIVITY/PRACTICAL
1. INVESTMENT BASICS	Saving Vs. Investment	**Session-1** • Meaning of Investment • Terms related to the topic -Investment • Options of Investment **Activity** • Interactive lecture: By giving situation to calculate the return on investment. • Find out the prevailing interest rates on Bank and Post Office Deposits
	Stock Exchange	**Session -2** • Meaning of Stock Exchange • Introduction of the terms Equity, Debt Instrument, Derivative, Index **Activity** Name of the Recognized Stock Exchange of India
	Mutual Funds	**Session -3** • Mutual Funds • Depository • Dematerialization **Activity** Find the Depositories of the Country.
2. SECURITIES	Securities Market	**Session -1** • Meaning , Function and examples of Securities **Activity** • Live Trading/Watch Business Channels
	Regulators	**Session -2** • Market Regulators and their functions • SEBI and its role **Activity** • Role Play of SEBI Representative
	Market Participants	**Session -3** • Participants in the Securities • Role of Intermediary in the Securities Market **Activity** • Make a PPT on the topic " Securities Market "
3. PRIMARY MARKET	New Issue Market	**Session -1** • Role of Primary Market • Explanation of a face value of a share , Debenture, Premium and Discount in a Security Market **Activity** • Visit in Stock Exchange to collect Reports and IPO Forms
	Issue of Shares	**Session -2** • Need for issue • Different kinds of issue • Difference between Public & Private Placement • Introduction of the terms IPO, Book building, Normal Public Issue, Cut off price, price Band **Activity** • Learn how to apply for IPO
	NSE & Foreign Capital Issuance	**Session -3** • Role of Registrar • Facilities provided by NSE • Foreign Capital Issuance – ADR , GDR **Activity** • Make a project on NSE
4. SECONDARY MARKET	Securities Market	**Session -1** • Difference between Primary Market and Secondary Market • Products in the Secondary Market **Activity** • Visit to Stock Exchange and Broking Houses in the nearby area for interaction with broker
	Stock Exchange	**Session -2** • Identify Demutualize Stock Exchange of India • Process of SBTS **Activity** • Operations of Online/Electronic Trading

	Trading	**Session -3** • Equity Investment • Debt Investment • Calculate Brokerage • Credit Rating Agencies **Activity** • Interactive lecture: Pre-trading/ Post- trading Instructions • Register Mock Portfolio on any website
5. DERIVATIVES	Futures and Options Market	**Session -1** • Meaning of Derivatives and its types • Difference between future and options **Activity** • Risk and Return of Derivative Trading • Mock Trading Techniques of Derivatives
	Commodity	**Session -2** • Identify the features of Commodity Derivatives • Distinguish between Commodity & Financial Derivatives **Activity** • Risk and Returns of Commodity Trading • Trading Techniques Basics of Commodity Market
6. DEPOSITORY	Holding of Securities	**Session - 1** • Similarities between Bank and Depository • Role of Depository **Activity** • Benefits of Holding Electronic Shares • Discussion on Physical Securities
	Ownership	**Session -2** • Benefits of participation in Depository • Meaning of DP, ISIN, Custodian • Role of Custodians **Activity** • Make a poster showing benefits of participation in Depository
	Dematerialization	**Session -3** • Conversion of Physical to Electronic form to shares • Demat Benefits **Activity** • All steps of Demat • Fill DRF
7. MUTUAL FUNDS	Basics of Mutual Fund	**Session -1** • Define MF • Benefits of MF • How to calculate NAV • Procedure of NFO **Activity** • Calculate Returns of the Schemes. • Find best suited scheme for each student
	Active/Passive Fund	**Session -2** • Tools and Techniques of Active and Passive Fund **Activity** • Risk and Returns of MF • Role plays portfolio manager
8. MISCELLANEOUS	Corporate Actions	**Session – 1** • Meaning of Corporate Actions • Types of Corporate Actions • Explanation and calculation Of Dividend Yield **Activity** • Why Company provide Corporate Benefits. • Calculate all Corporate Benefits.

	Corporate Actions & Index	**Session -2** • Stock Split and Buyback of shares • Index **Activity** • Presentation on Nifty - 50
	Clearing & Settlement	**Session -3** • Clearing & Settlement and Redressal **Activity** • How NSCCL Eliminate the Risk of Counter Party • Visit to clearing Dept. Of Exchange
	Post Market Activities	**Session -4** • Meaning of terms Ex- Dividend, No Delivery Period, Book Closure, Record Date, Ex-Date • Investor Grievances Cell **Activity** • Discuss the Arbitration Cases
9. CONCEPTS & MODES OF ANALYSIS	Time Value of Money	**Session-1** • Simple Interest • Compound Interest • Effective Annual Return **Activity** • Practice through Scientific Calculator
	Annual Report	**Session -2** • Identify Income Statement Position Statement • Fund Sources **Activity** • Draw Income and Position Statement. • Frame the Procedure of Loan and its Requirements
	Accounting terms and Technologies	**Session -3** • Identify Secured and Unsecured Loans • Net Gross Blocks • P/L Statement • Fund Applications **Activity** • Financial Needs of the Companies • Frame the Procedure of Loan and its Requirements
	Liquidity Ratio	**Session -1** • Current Ratio Acid Test Ratio Turnover Ratio Average Collection Period **Activity** • Interpretation on the basis of Ratio Analysis • Do Sums and Analysis
10. RATIO ANALYSIS	Leverage/ Capital Structure	**Session-1** • Debt - Equity Ratio • Debt - Total Asset Ratio • Interest Coverage Ratio **Activity** • Interpretation on the basis of Ratio Analysis • Do Sums and Analysis
	Profitability Ratio	**Session -2** • Gross Profit Ratio • Net Profit Ratio • Return on total Asset • Return on Capital Employed • Return on Shareholder Equity **Activity** • Interpretation on the Basis of Ratio Analysis • Do Sums and Analysis

CONTENTS

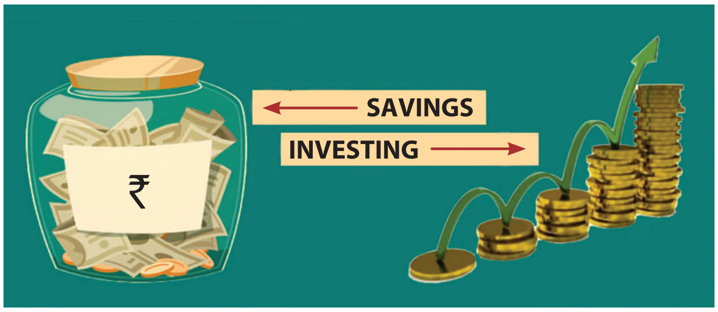
1 Investment Basics

Learning Outcomes

1.1 Saving Vs Investment　　**1.2** Stock Exchange　　**1.3** Mutual Funds

Introduction

An investment always concerns the outlay of some resource today—time, effort, money, or an asset—in hopes of a greater payoff in the future than what was originally put in. For example, an investor may purchase a monetary asset now with the idea that the asset will provide income in the future or will later be sold at a higher price for a profit.



1.1 Saving Vs Investment

1.1.1 Meaning of Investment

Income earned is typically divided between spending and saving for future needs. Instead of leaving savings dormant, a preferable approach is to invest them to yield returns over time. This process is commonly known as investment.

An investment is an asset or item acquired with the goal of generating income or appreciation. Appreciation refers to an increase in the value of an asset over time. When an individual purchases goods as an investment, the intent is not to consume the goods but rather to use it in the future to create wealth.

Investing is essential to:

1. Generate returns on idle resources.
2. Accumulate a specified sum for predefined life goals.
3. Provide for an unpredictable future.

An imperative motive for strategic investment is mitigating the impact of inflation. Inflation, the rise in the cost of living, erodes the purchasing power of money. Therefore, considering inflation in long-term investment strategies is crucial. Evaluating an investment's 'real' rate of return, accounting for inflation, becomes essential. The goal is to ensure the investment outpaces inflation, preserving and potentially growing its value.

1.1.2 Terms Related to Investment

Initiating investments at the earliest opportunity is advantageous. Early investments leverage the concept of compounding, allowing principal and accrued interest or dividends to grow over time. The three fundamental principles for investors are:

1. Initiate investments early.
2. Consistently contribute to investments.
3. Adopt a long-term, not short-term, investment approach.

Prior to committing to any investment, individuals should not forget the following 12 steps of investment:

1. Obtain comprehensive written explanations of the investment.
2. Thoroughly read and comprehend the provided documents.
3. Verify the legitimacy of the investment.
4. Understanding associated with costs and benefits.
5. Evaluating the risk-return profile.
6. Assessing liquidity and safety aspects.
7. Aligning the investment with specific goals.
8. Comparing with alternative investment opportunities.
9. Ensuring compatibility with existing or planned investments.
10. Conducting transactions through authorized intermediaries.
11. Seeking clarifications about both the intermediary and the investment.
12. Exploring contingency plans in case of unforeseen issues before making the investment.

1.1.3 Options of Investment

Investment avenues can be broadly categorized into:

- Physical assets like real estate, gold/jewelry, and commodities
- Financial assets, including fixed deposits, small savings instruments, insurance/provident/pension funds, and securities market instruments like shares, bonds, and debentures.

Understanding the various financial options available for investment is crucial for individuals seeking to optimize their returns while managing risk. This comprehensive analysis will delve into both short-term and long-term financial investment options, exploring their features, benefits, and considerations associated with each.

Short-Term Financial Options

1. **Savings Bank Account:** A savings bank account is often the initial choice for many individuals entering the realm of banking. However, it comes with a modest interest rate ranging from 4%-5% per annum. While it serves as a secure option, its returns are only marginally better than those offered by fixed deposits.
2. **Money Market or Liquid Funds:** Money market or liquid funds are specialized forms of mutual funds designed for short-term investments. These funds focus on extremely short-term fixed income instruments, providing easy liquidity. Unlike typical mutual funds, money market funds prioritize capital protection and aim to maximize returns. While they usually offer better returns than savings accounts, they fall short of the returns provided by bank fixed deposits.

3. **Fixed Deposits with Banks:** Fixed deposits, also known as term deposits, offer a secure avenue for short-term investment. The minimum investment period for bank fixed deposits is 30 days. These are suitable for investors with a low-risk appetite and are typically considered for a 6-12 month investment

period, as interest on deposits with a tenure of less than 6 months tends to be lower than money market fund returns.

Long-Term Financial Options

1. **Post Office Savings Schemes:** The Post Office Monthly Income Scheme is a low-risk savings instrument available through any post office. It offers an attractive 8% per annum interest rate, paid monthly. The minimum investment is ₹ 1,000, with additional investments in multiples of ₹ 1,000. The scheme has a maturity period of 6 years, and a bonus of 10% is paid at the time of maturity. Premature withdrawal is permitted after one year, subject to a 5% deduction from the principal amount, along with forfeiture of the 10% bonus.
2. **Public Provident Fund (PPF):** PPF is a long-term savings instrument with a 15-year maturity period, providing compounded annual interest at 8%. Investors can open a PPF account through a nationalized bank at any time during the year. Tax benefits can be availed for the invested amount, and interest accrued is tax-free. Withdrawals are allowed from the seventh financial year, limited to 50% of the balance at credit or the amount of the loan, if any.

3. **Company Fixed Deposit:** Company fixed deposits offer short to medium-term borrowings by companies at fixed interest rates, payable monthly, quarterly, semi-annually, or annually. These deposits may also be cumulative, with the entire principal and interest paid at the end of the loan period. Interest rates typically range between 6% and 9% per annum, with the received interest subject to tax deductions.
4. **Bonds:** Bonds are fixed-income debt instruments issued for periods exceeding one year to raise capital. Central or state governments, corporations, and similar institutions sell bonds. A bond is essentially a promise to repay the principal along with a fixed rate of interest on a specified maturity date.

5. **Mutual Funds:** Mutual funds are investment vehicles managed by investment companies, pooling money from the public and investing it in a diversified portfolio of assets, such as shares and debentures, in accordance with specific objectives. This financial instrument serves as a substitute for individuals who may lack the resources, time, or knowledge to invest directly in equities or debt. The advantages of mutual funds include professional money management, the ability to invest in small amounts, and diversification.

The units of mutual funds are issued and redeemed by the Fund Management Company based on the fund's Net Asset Value (NAV), determined at the end of each trading session. The NAV is calculated by subtracting expenses from the value of all the shares held by the fund and dividing the result by the number of units issued. While mutual funds are generally considered a long-term investment vehicle, there are specific categories, such as money market mutual funds, designed for short-term investments.

1.2 Stock Exchange

1.2.1 Meaning of Stock Exchange

A stock exchange, as defined by the Securities Contract (Regulation) Act, 1956 (SCRA), refers to any body of individuals, whether incorporated or not, established to assist, regulate, or control the business of buying, selling, or dealing in securities. Stock exchanges can be either regional, with a specified area of operation, or national, with nationwide trading permissions. The National Stock Exchange (NSE) was incorporated as a National Stock Exchange, exemplifying the latter.

1.2.2 Introduction of Equity, Debt Instrument, Derivative and Index

Equity, commonly known as a share, represents a unit of a company's total equity capital, which is divided into equal units of small denominations. For instance, if a company has a total equity capital of ₹ 600,00,000, divided into 40,00,000 units of ₹ 20 each, each of ₹ 20 unit is termed a share. Consequently, the company is deemed to have 40,00,000 equity shares of ₹ 20 each. Shareholders holding such shares are considered members of the company, possessing voting rights.

Debt Instruments

A debt instrument is a contractual agreement wherein one party lends money to another based on predetermined terms, encompassing interest rates, periodicity of interest, and the repayment of the principal amount by the borrower to the lender. In the Indian securities markets, the term 'bond' is specifically employed for debt instruments issued by the Central and State governments, as well as public sector organizations. Conversely, the term 'debenture' is reserved for instruments issued by the private corporate sector.

Derivatives

A derivative is a financial product whose value is derived from one or more basic variables, known as the underlying assets. These underlying assets can include equity, indices, foreign exchange (forex), commodities, or any other financial asset. Initially emerging as hedging devices against fluctuations in commodity prices, financial derivatives gained prominence post-1970 due to growing financial market instability. By the 1990s, they constituted about two-thirds of total transactions in derivative products.

Index

An Index serves as a reflection of the movement of a specified portfolio of share prices, offering insights into market trends. Comprising a basket of securities, the average price movement of this basket indicates the direction of the index, whether it is trending upward or downward.

Indices are a measurement of the price performance of a group of shares from an exchange. For example, the FTSE 100 tracks the 100 largest companies on the London Stock Exchange (LSE). Trading indices enables you to get exposure to an entire economy or sector at once, while only having to open a single position.

1.3 Mutual Funds

1.3.1 Mutual Funds

A Mutual Funds, registered with the Securities Exchange Board of India (SEBI), operates as a body corporate that pools money from individual and corporate investors. The collected funds are then invested in various financial instruments or securities, such as equity shares, government securities, bonds, and debentures. Mutual funds act as financial intermediaries, collecting funds from the public and investing on behalf of investors. Investors are issued units, and the appreciation of the fund's portfolio leads to an increase in the value of these units.

The investment objectives of a Mutual Fund, outlined in its prospectus, are binding on the Mutual Fund scheme. These objectives specify the class of securities a Mutual Fund can invest in. Mutual Funds diversify their investments across various asset classes, including equity, bonds, debentures, commercial paper, and government securities. Different funds offer various schemes, ranging from pure equity schemes to a mix of equity and bonds. Investors can choose to receive dividends periodically or participate solely in the capital appreciation of the scheme. Armed with this knowledge, investors can make informed decisions aligned with their financial goals and risk tolerance.

1.3.2 Depository

Just as you cannot open a bank account directly with the Reserve Bank of India, you cannot conduct trade directly with a stock exchange. This is the point at which a depository participant comes into the picture. The depository participant not only makes things easier to run for stock exchanges, but permits investors and traders a host of trade options. Examples of depository participants in India include Sharekhan, Motilal Oswal and Angel Broking, among others. It is important to know what role depository participants play if you want to trade in securities. However, first you should know what a depository is.

A bank holds your funds, and just like that, a depository contains your financial assets. A depository is a financial institute that does this and you have to pay certain Depository Participant charges to open an account with a depository participant linked to a main depository. The depository has the responsibility of keeping your financial assets like bonds, mutual funds, stocks, and other assets in dematerialized format safe. India has two primary depositories-NSDL (National Securities Depository Limited) and CSDL (Central Depository Services Limited). Since it isn’t possible to open an account and trade directly with either of these bodies, depository participants step in.

1.3.3 Dematerialization

Dematerialization refers to the process through which physical certificates owned by an investor are transformed into an equivalent number of securities in electronic form. These electronic securities are then credited to the investor's account with their Depository Participant (DP).

SUMMARY

- Investment involves deploying savings to generate returns over time. The key principles are to start early, contribute consistently, and adopt a long-term approach.
- Before committing to any investment, individuals should obtain comprehensive information, understand associated costs and benefits, assess risk-return profiles, and ensure compatibility with specific goals.
- A stock exchange facilitates the buying and selling of securities. Equity represents ownership in a company, while debt instruments involve contractual agreements for borrowing.
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4. **Derivatives** : a financial product whose value is derived from one or more basic variables, known as the underlying assets
5. **Mutual Fund** : a body corporate that pools money from individual and corporate investors
6. **Index** : a reflection of the movement of a specified portfolio of share prices, offering insights into market trends
7. **Depository** : a type of bank, where deposits consist of securities such as shares, debentures, bonds, government securities, units, etc., all held in electronic form
8. **Dematerialization** : the process through which physical certificates owned by an investor are transformed into an equivalent number of securities in electronic form

Abbreviations

SEBI : Securities Exchange Board of India
LSE : London Stock Exchange
NSDL : National Securities Depository Limited
CDSL : Central Depository Services Limited
PPF : Public Provident Fund
NAV : Net Asset value
SCRA : Securities Contract (Regulation Act)
NSE : National Stock Exchange

Exercises

CBSE Textbook Questions with Answers

Answer the following questions.

1. What is Investment?

Ans. The money you earn is partly spent and the rest saved for meeting future expenses. Instead of keeping the savings idle you may like to use savings in order to get return on it in the future. This is called Investment.

2. Why should one invest?

Ans. One needs to invest to:

- earn return on your idle resources
- make a provision for an uncertain future
- generate a specified sum of money for a specific goal in life
- to meet the cost of Inflation

3. When to start Investing?

Ans. The sooner one starts investing the better. By investing early you allow your investments more time to grow, whereby the concept of compounding (as we shall see later) increases your income, by accumulating the principal and the interest or dividend earned on it, year after year. The three golden rules for all investors are:

- Invest early
- Invest regularly
- Invest for long term and not short term

4. What care should one take while investing?

Ans. Before making any investment, one must ensure to:

1. obtain written documents explaining the investment
2. read and understand such documents
3. verify the legitimacy of the investment
4. find out the costs and benefits associated with the investment
5. assess the risk-return profile of the investment
6. know the liquidity and safety aspects of the investment
7. ascertain if it is appropriate for your specific goals
8. compare these details with other investment opportunities available
9. examine if it fits in with other investments you are considering or you have already made
10. deal only through an authorised intermediary
11. seek all clarifications about the intermediary and the investment
12. explore the options available to you if something were to go wrong, and then, if satisfied, make the investment

These are called the Twelve Important Steps to Investing.

5. What is meant by Interest?

Ans. When we borrow money, we are expected to pay for using it - this is known as Interest. Interest is an amount charged to the borrower for the privilege of using the lender's money. Interest is usually calculated as a percentage of the principal balance (the amount of money borrowed). The percentage rate may be fixed for the life of the loan, or it may be variable, depending on the terms of the loan.

6. What factors determine interest rates?

Ans. When we talk of interest rates, there are different types of interest rates -rates that banks offer to their depositors, rates that they lend to their borrowers, the rate at which the Government borrows in the Bond/ Government Securities market, rates offered to investors in small savings schemes like NSC, PPF, rates at which companies issue fixed deposits etc.

The factors which govern these interest rates are mostly economy related and are commonly referred to as macroeconomic factors. Some of these factors are:

- Demand for money
- Level of Government borrowings
- Supply of money
- Inflation rate
- The Reserve Bank of India and the Government policies which determine some of the variables mentioned above

7. What are various options available for investment?

Ans. One may invest in:

- Physical assets like real estate, gold/jewellery, commodities etc.

- Financial assets such as fixed deposits with banks, small saving instruments with post offices, insurance/ provident/pension fund etc. or securities market related instruments like shares, bonds, debentures etc.

8. What are various short-term financial options available for investment?

Ans. Broadly speaking, savings bank account, money market/liquid funds and fixed deposits with banks may be considered as short-term financial investment options:

- Savings Bank Account is often the first banking product people use, which offers low interest (4%-5% p.a.), making them only marginally better than fixed deposits.
- Money Market or Liquid Funds are a specialized form of mutual funds that invest in extremely short-term fixed income instruments and thereby provide easy liquidity. Unlike most mutual funds, money market funds are primarily oriented towards protecting your capital and then, aim to maximise returns. Money market funds usually yield better returns than savings accounts, but lower than bank fixed deposits.
- Fixed Deposits with Banks are also referred to as term deposits and minimum investment period for bank FDs is 30 days. Fixed Deposits with banks are for investors with low risk appetite, and may be considered for 6-12 months investment period as normally interest on less than 6 months bank FDs is likely to be lower than money market fund returns.

9. What are various long-term financial options available for investment?

Ans. Post Office Savings Schemes, Public Provident Fund, Company Fixed Deposits, Bonds and Debentures, Mutual Funds etc.

- **Post Office Savings:** Post Office Monthly Income Scheme is a low risk saving instrument, which can be availed through any post office. It provides an interest rate of 8% per annum, which is paid monthly. Minimum amount, which can be invested, is ₹ 1,000/- and additional investment in multiples of 1,000/-. Maximum amount is ₹ 3,00,000/- (if Single) or ₹ 6,00,000/- (if held Jointly) during a year. It has a maturity period of 6 years. A bonus of 10% is paid at the time of maturity. Premature withdrawal is permitted if deposit is more than one year old. A deduction of 5% is levied from the principal amount if withdrawn prematurely; the 10% bonus is also denied.
- **Public Provident Fund:** A long term savings instrument with a maturity of 15 years and interest payable at 8% per annum compounded annually. A PPF account can be opened through a nationalized bank at anytime during the year and is open all through the year for depositing money. Tax benefits can be availed for the amount invested and interest accrued is tax-free. A withdrawal is permissible every year from the seventh financial year of the date of opening of the account and the amount of withdrawal will be limited to 50% of the balance at credit at the end of the 4th year immediately preceding the year in which the amount is withdrawn or at the end of the preceding year whichever is lower the amount of loan if any.
- **Company Fixed Deposits:** These are short-term (six months) to medium-term (three to five years) borrowings by companies at a fixed rate of interest which is payable monthly, quarterly, semi-annually or annually. They can also be cumulative fixed deposits where the entire principal alongwith the interest is paid at the end of the loan period. The rate of interest varies between 6- 9% per annum for company FDs. The interest received is after deduction of taxes.
- **Bonds:** It is a fixed income (debt) instrument issued for a period of more than one year with the purpose of raising capital. The central or state government, corporations and similar institutions sell bonds. A bond is generally a promise to repay the principal along with a fixed rate of interest on a specified date, called the Maturity Date.
- **Mutual Funds:** These are funds operated by an investment company which raises money from the public and invests in a group of assets (shares, debentures etc.), in accordance with a stated set of objectives. It is a substitute for those who are unable to invest directly in equities or debt because of resource, time or knowledge constraints. Benefits include professional money management, buying in small amounts

and diversification. Mutual fund units are issued and redeemed by the Fund Management Company based on the fund's net asset value (NAV), which is determined at the end of each trading session. NAV is calculated as the value of all the shares held by the fund, minus expenses, divided by the number of units issued. Mutual Funds are usually long term investment vehicle though there some categories of mutual funds, such as money market mutual funds which are short term instruments.

10. What is meant by a Stock Exchange?

Ans. The Securities Contract (Regulation) Act, 1956 [SCRA] defines 'Stock Exchange' as any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. Stock exchange could be a regional stock exchange whose area of operation/jurisdiction is specified at the time of its recognition or national exchanges, which are permitted to have nationwide trading since inception. NSE was incorporated as a National Stock Exchange.

11. What is an 'Equity'/Share?

Ans. Total equity capital of a company is divided into equal units of small denominations, each called a share. For example, in a company the total equity capital of ₹ 300,00,000 is divided into 20,00,000 units of ₹ 10 each. Each such unit of ₹ 10 is called a Share. Thus, the company then is said to have 20,00,000 equity shares of ₹ 10 each. The holders of such shares are members of the company and have voting rights.

12. What is a 'Debt Instrument'?

Ans. Debt instrument represents a contract whereby one party lends money to another on pre-determined terms with regards to rate and periodicity of interest, repayment of principal amount by the borrower to the lender. In the Indian securities markets, the term bond' is used for debt instruments issued by the Central and State governments and public sector organizations and the term debenture' is used for instruments issued by private corporate sector.

13. What is a Derivative?

Ans. Derivative is a product whose value is derived from the value of one or more basic variables, called underlying. The underlying asset can be equity, index, foreign exchange (forex), commodity or any other asset.

Derivative products initially emerged as hedging devices against fluctuations in commodity prices and commodity-linked derivatives remained the sole form of such products for almost three hundred years. The financial derivatives came into spotlight in post-1970 period due to growing instability in the financial markets. However, since their emergence, these products have become very popular and by 1990s, they accounted for about two-thirds of total transactions in derivative products.

14. What is a Mutual Fund?

Ans. A Mutual Fund is a body corporate registered with SEBI (Securities Exchange Board of India) that pools money from individuals/corporate investors and invests the same in a variety of different financial instruments or securities such as equity shares, Government securities, Bonds, debentures etc.

15. What is an Index?

Ans. An Index shows how a specified portfolio of share prices are moving in order to give an indication of market trends. It is a basket of securities and the average price movement of the basket of securities indicates the index movement, whether upwards or downwards.

16. What is a Depository?

Ans. A depository is like a bank wherein the deposits are securities (viz. shares, debentures, bonds, government securities, units etc.) in electronic form.

17. What is Dematerialization?

Ans. Dematerialization is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited to the investor's account with his Depository Participant (DP).

Additional Questions with Answers

I. Choose the correct option.

1. What is the preferable utility of savings?
   - (*a*) Leaving savings dormant
   - (*b*) Spending immediately
   - (*c*) Investing for future returns
   - (*d*) None of these

2. What is one important rationale for investment?
   - i. Generating immediate income
   - ii. Accumulating debts
   - iii. Addressing inflation
   - iv. Financial gains

   - (*a*) i. and ii.
   - (*b*) ii. and iii.
   - (*c*) iii. and iv.
   - (*d*) i and iv.

3. What is the goal when evaluating an investment's 'real' rate of return?
   - (*a*) Matching inflation
   - (*b*) Outpacing inflation
   - (*c*) Ignoring inflation
   - (*d*) Balancing inflation

4. What are the three fundamental principles for investors regarding investments?
   - (*a*) Invest sporadically, contribute irregularly, adopt a short-term approach
   - (*b*) Initiate investments early, consistently contribute, adopt a long-term approach
   - (*c*) Invest late, contribute occasionally, adopt a short-term approach
   - (*d*) None of the above

5. What is a precaution individuals should take before committing to any investment?
   - (*a*) Investing without reading documents
   - (*b*) Ignoring costs and benefits
   - (*c*) Verifying the legitimacy of the investment
   - (*d*) None of the above

6. What is the minimum investment period for bank fixed deposits?
   - (*a*) 6 months
   - (*b*) 12 months
   - (*c*) 30 days
   - (*d*) 1 year

7. What is the primary objective of money market or liquid funds?
   - (*a*) Maximizing long-term returns
   - (*b*) Capital protection and easy liquidity
   - (*c*) Investing in real estate
   - (*d*) None of these

8. What is the maturity period of the Post Office Monthly Income Scheme?
   - (*a*) 5 years
   - (*b*) 10 years
   - (*c*) 6 years
   - (*d*) 15 years

9. What does the National Stock Exchange (NSE) exemplify?
   - (*a*) Regional stock exchange
   - (*b*) Government regulatory body
   - (*c*) National stock exchange
   - (*d*) Bond market

10. What does 'equity' represent in the financial context?
   (*a*) Fixed-income debt instrument
   (*b*) Share of a company's total equity capital
   (*c*) Mutual fund unit
   (*d*) Government security
11. What is the term reserved for debt instruments issued by private corporate sectors?
   (*a*) Bond
   (*b*) Debenture
   (*c*) Equity
   (*d*) Mutual fund
12. What is a derivative in financial terms?
   (*a*) Physical asset like real estate
   (*b*) Fixed deposit with a bank
   (*c*) Financial product derived from underlying assets
   (*d*) Government security
13. What is the purpose of a mutual fund?
   (*a*) Issuing government securities
   (*b*) Pooling money from the public and investing in various financial instruments
   (*c*) Trading on stock exchanges
   (*d*) Offering short-term returns
14. What does an index reflect in financial markets?
   (*a*) Currency exchange rates
   (*b*) Movement of a specified portfolio of share prices
   (*c*) Government borrowing rates
   (*d*) Bond market trends
15. What is the function of a depository?
   (*a*) Investing in mutual funds
   (*b*) Borrowing money from the government
   (*c*) Holding securities in electronic form
   (*d*) Trading on stock exchanges
16. What does dematerialization refer to in the financial context?
   (*a*) Transforming physical certificates into electronic securities
   (*b*) Trading physical commodities
   (*c*) Issuing government bonds
   (*d*) Withdrawing money from mutual funds
17. How is the Net Asset Value (NAV) of a mutual fund calculated?
   (*a*) Adding expenses to the value of all shares
   (*b*) Subtracting expenses from the value of all shares
   (*c*) Dividing expenses by the number of units issued
   (*d*) Multiplying expenses by the value of all shares

Answers:

1. (*c*) 2. (*c*) 3. (*d*) 4. (*b*) 5. (*c*) 6. (*c*) 7. (*b*) 8. (*c*) 9. (*c*)
10. (*b*) 11. (*b*) 12. (*c*) 13. (*b*) 14. (*b*) 15. (*c*) 16. (*a*) 17. (*b*)

II. Very Shot Answer Type Questions. **(1 Mark)**

1. What is the preferred approach for utilizing savings?
2. What is one important rationale for strategic investment?
3. Why is evaluating an investment's 'real' rate of return essential?
4. What are the three fundamental principles for investors?
5. Name one short-term financial option
6. What is the minimum investment period for bank fixed deposits?
7. Name one long-term financial option.
8. What does an Index reflect?
9. How does a depository function?
10. What does dematerialization refer to?

Answers:

1. Investing them to yield returns over time.
2. Addressing inflation.
3. To ensure the investment outpaces inflation, preserving and potentially growing its value.
4. Initiate investments early, consistently contribute to investments, and adopt a long-term investment approach.
5. Savings Bank Account. 6. 30 days.
7. Public Provident Fund (PPF).
8. The movement of a specified portfolio of share prices, offering insights into market trends.
9. Similar to a bank, where deposits consist of securities held in electronic form.
10. The process of transforming physical certificates into electronic securities credited to the investor's account with their Depository Participant (DP).

III. Shot Answer Type Questions. **(2 Marks)**

1. What is investment? Explain Rationale behind investment.
2. Explain any three short term-financial options.
3. Explain any three long term-financial options.
4. Explain mutual funds as a source of investment.

IV. Long Answer Type Questions. **(4 Marks)**

1. What precautions will you take before investing?
2. Explain different sources of short-term and long-term investments.
3. What is a stock exchange? What does it do?
4. Explain the following terms:
   Equity
   Mutual funds
   Index
   Depository Participant
   Derivatives

Previous Years' Board Questions

I. Multiple Choice Questions **(1 Mark)**

1. Which factor does not determine the interest rates? (*CBSE* 2021-22)
   (*a*) Level of Government borrowings (*b*) Supply of money
   (*c*) Inflation rate (*d*) Financial literacy

2. Which of the following products is not tradable in Indian securities market as per SC(R) A956? (*CBSE* 2021-22)
   (*a*) shares (*b*) bonds (*c*) debentures (*d*) crypto currency
3. Fixed Assets and Investments are examples of (*CBSE* 2022-23)
   (*a*) Sources of Funds (*b*) Application of Funds (*c*) Loan Funds (*d*) Shareholder's Funds
4. Choose the odd one out: (*CBSE* 2022-23)
   (*a*) Public Provident Fund (*b*) Post Office Savings (for 6 years)
   (*c*) Company Fixed Deposits of 5 years (*d*) Liquid Funds
5. Which of the following is an example of Physical Asset? (*CBSE* 2023-24)
   (*a*) Real Estate (*b*) Fixed Deposit (*c*) Provident Fund (*d*) Share
6. What is the other name of Preferential issues? (*CBSE* 2023-24)
   (*a*) Public Issue (*b*) Rights Issue (*c*) Private Placement (*d*) Bank Issue
7. What is the other name of Preferential issues? (*CBSE* 2023-24)
   (*a*) Public Issue (*b*) Rights issue (*c*) Private Placement (*d*) Bank Issue

II. Very Short Answer Type Questions (1 Mark)

1. What is Investment? (*CBSE* 2018-19)
2. Write any two financial assets. (*CBSE* 2019-20)
3. What do you understand by the term 'Interest?' (*CBSE* 2020-21)
4. " Ram opened a fixed deposit account with a bank." What is the other name of fixed deposit account with banks? (*CBSE* 2023-24)
5. How does Mutual Fund help the investor by spreading risk? (*CBSE* 2023-24)

III. Short Answer Type Questions (2 Marks)

1. What care should one take while investing? (*CBSE* 2018-19)
2. What factors determine the interest rate? (*CBSE* 2019-20)
3. What is Public Provident Fund? (*CBSE* 2019-20)
4. What is dematerialization? (*CBSE* 2020-21)

Activities

1. Invite participants and brainstorm a list of words that come to mind when you think of 'Investment'. Write these words in your notebook and think carefully how they make you aware before making investments.
Analytical Thinking

2. Visit the Post Office along with your parents and find the name of various Monthly Income Schemes. Then, write your findings in your notebook and make your class aware of the benefits of these schemes.
Knowledge Application

Suggested Learning Activities

A. Visit some banks along with your parents and find the prevailing interest rates on the savings deposits and fixed deposits. Then, write your findings on a cardboard. ***Knowledge Application***

B. Surf Internet and find the name of the Stock Exchange Board of India. ***Knowledge Enrichment***

C. Discuss with your parents and teachers and find the Depositories of the country. Also, find how they help the investors.
Communication

About the Book

Financial Skills encompass the capability to make well-informed judgments and decisions related to the utilization of financial resources. In the contemporary era, possessing Financial Skills is just as indispensable as proficiency in Computer Skills. The book **Introduction to Financial Markets** is designed on the guidelines published in the latest curriculum by CBSE. This book delves into the fundamental principles of Money Management, providing a comprehensive guide to understanding the basics of money and its effective management. By imparting this knowledge, the book empowers young readers to navigate the complexities of financial management, appreciate the significance of financial responsibility, and even share these valuable insights with their family members. The content is presented in a clear and accessible manner, starting from the origins of money and progressing to practical strategies for managing one's personal finances with efficiency.

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Phone: 011-43776625
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