MODULE-4

Define Circular flow of national income.

` **CIRCULAR FLOW OF NATIONAL INCOME**

Circular Flow of income refers to the flow of money income or the flow of goods and services across different sectors of an economy in a circular flow. The circular flow is of two types

i) product flow or real flow ii)money flow.

In the economy products and money flow in opposite directions in a circular manner.

Explain the four sectors of the economy?

FOUR SECTORS OF THE ECONOMY

1. Household sector: It includes consumers of goods and service. Households are also owners of the factors of production**.**

2. Producer sector: It includes all producing units (firms) in the economy. For the production of goods and services, the firms hire/purchase factors of production (land, labour, capital and entrepreneurial skill) from the household.

3. <u>Government sector</u>: It includes (i) Government as a welfare agency, and (ii) Government as a producer. Government as a welfare agency performs such welfare functions as of law and order and of defense.

4<u>. External sector (Rest of the world sector/Foreign sector)</u> -It includes all such activities which are related to export and import of goods and the flow of capital between the domestic economy and rest of the world.

<u>CIRCULAR FLOW OF INCOME IN A TWO SECTOR ECONOMY</u>

In a simple two sector model two sectors are households and firms. Households possess all factors of production .They supply these factor services to firms and get factor payments in the form of rent, interest, wages and profit. This income is spend for buying goods and services produced by firms.

Firms hire the factor services of households and produce various goods and services .They sell these goods and services to households .These flows are depicted in the following chart(Fig 1).**This model is built on the assumption that the entire income received by the households are spent on goods and services .**

Y=FP=V

Where Y=household income, FP =Factor payments=money value of output

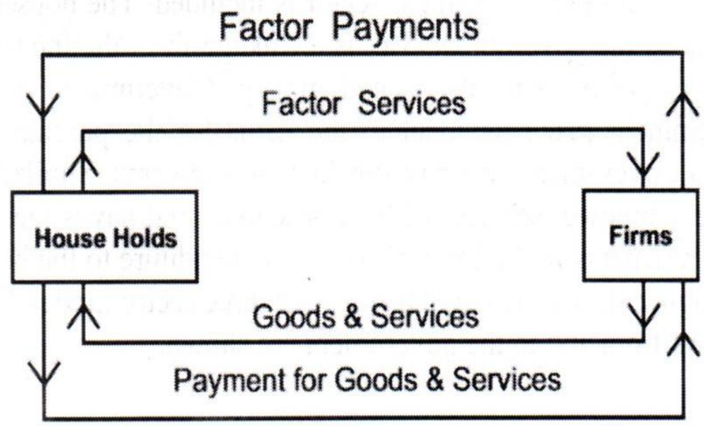

Fig.1 CIRCULAR FLOW OF NATIONAL INCOME INA TWO-SECTOR MODEL

market. In the factor market there is flow of factor services from the household sector to the firms. In return there is flow of factor payments from firms to households. In the goods market there is flow of goods and services from firms to households. In return there is flow of payment for goods and services from household sector to firms. Thus the money flows and real flows are completed.

TWO SECTOR ECONOMY WITH FINANCIAL MARKET

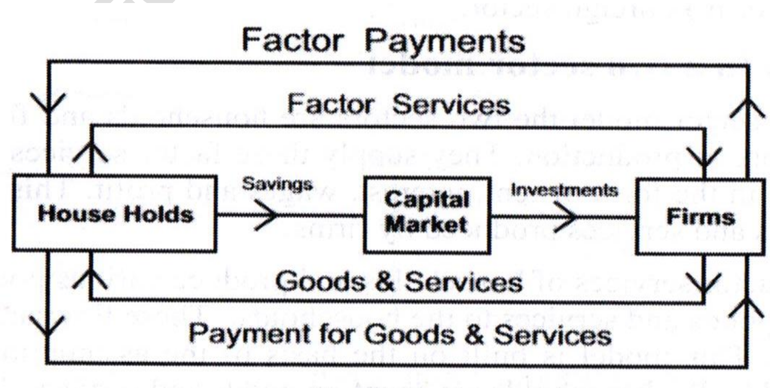

Fig.2 CIRCULAR FLOW OF NATIONAL INCOME INA TWO-SECTOR MODEL

Household may not spend their entire income on goods and services .They may save a part of their income. Unspent income is leakage from the economy. This saving is coming into capital market or financial market. Firms borrow the savings of the households and they invest. Investment is an additional expenditure and it is an injection. When saving equals investment there will not be any problem in the economy. Two sector model with financial market is shown on figure 2.

CIRCULAR FLOW IN A THREE SECTOR MODEL

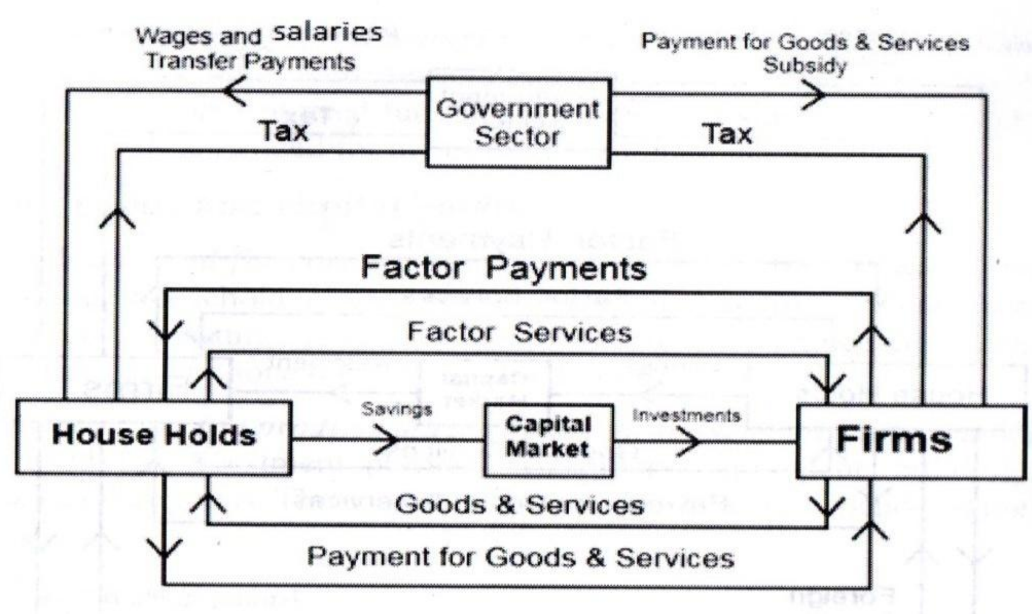

Fig: 3 CIRCULAR FLOW OF INCOME IN A THREE SECTOR

Circular flow of income in a three sector economy consists of **households, firms, government**. (fig.3).The household sector and the firms pay tax to the government. Tax is a leakage from the income stream. Like other two sectors government also spends money. Government makes payments to the firms for the payments of goods and services. Further Government also pay subsidies to the firms. Similarly Government make use of manpower services of households and pay wages and salaries as well as transfer payments in the form of welfare expenditure to the household sector.

Explain the circular flow of national income in a four sector economy?

<u>CIRCULAR FLOW OF INCOME IN A FOUR SECTOR MODEL</u>

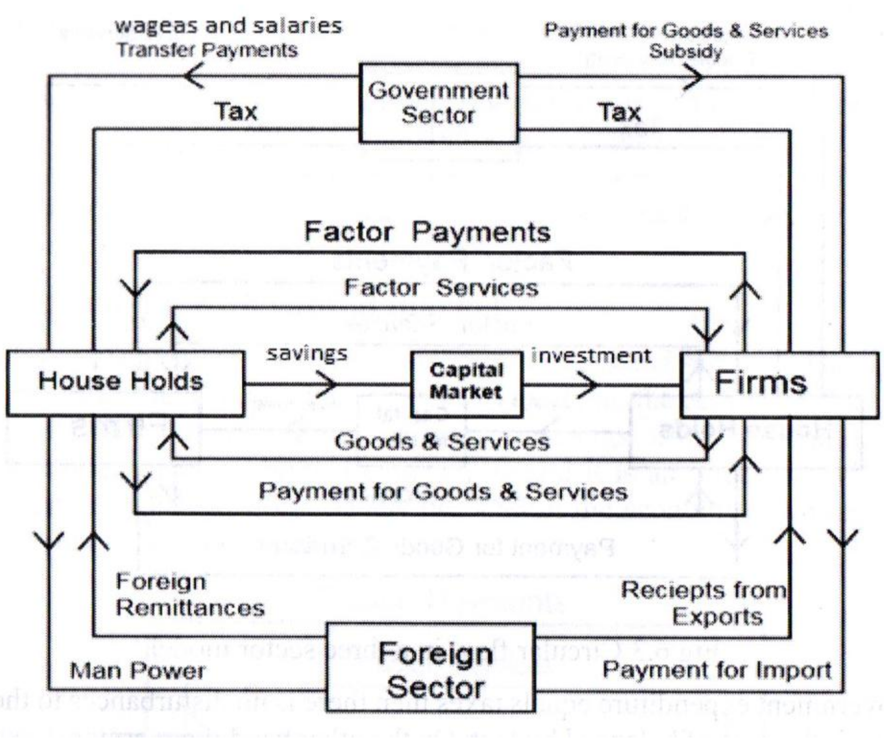

Fig: 4 CIRCULAR FLOW OF INCOME IN A FOUR SECTOR ECONOMY

In a four sector model, the fourth sector is the **foreign sector**. Households export their manpower into the foreign sector and in return they get foreign remittances.

Firms export their goods and services to the foreign sector and get receipts from exports. At the same time firms import raw materials and other inputs from the foreign sector and they make payments for their imports. Export is an injection to the economy but import is a leakage.

SIGNIFICANCE OF CIRCULAR FLOW OF NATIONAL INCOME

1. Circular flow models help to understand interdependence among different sectors of the economy.
2. Circular flow models facilitate the estimation of national income.
3. The magnitude of circular flow determines the size of national income.
4. It tells us the level of economic activity.

QUESTIONS

1. Examine the circular flow of national income in a two sector economy with diagram? Describe the circular flow concept using a three sector model.
2. Explain the circular flow of national income in a four sector economy?
3. Define circular flow of national income.
4. Explain the importance of circular flow of national income?
5. Explain the circular flow of income in a two sector model

7. In a three sector model what are the money flows between the government sector and firms, and the government sector and household sector.

MODULE -4

NATIONAL INCOME AGGREGATES

&

MEASUREMENT OF NATIONAL INCOME

National income is the sum value of all **final** goods and services produced in a country over a period of one year.

Differentiate factor income & transfer income.

Factor income and Transfer Income

Factor Income is the income received for supplying a factor service. It can be in the form of interest, rent, wages or profit. When a factor income is made either a product or service is produced. For estimating national income factor income alone are taken in to account.

On the other hand **Transfer payments are unilateral or one sided payments**. They do not create any production of goods or services. Donations to charity, unemployment allowance, old age pension, gifts etc are examples of transfer payment. Tax is a compulsory transfer payment. Transfer payments are excluded from national income accounting.

Differentiate Intermediate goods &Final goods.

Intermediate goods & Final goods

Goods which are used in the production of other goods and services are called intermediate goods. Raw materials, fuel, electricity etc are intermediate goods. Intermediate goods are not taken into account while calculating national income estimation.

Goods which are ready for consumption or investment are called Final goods. Consumer goods like dress, vehicles and electronic items, machinery etc are examples of final goods. They don't need further processing. They are finished products. The values of final goods are added in the calculation of national income.

Consumer goods & Capital goods

Goods which are used for consumption purpose are called consumer goods. Food items, clothing, household electronics and electrical items etc are examples of

consumer goods. Consumer goods can be durable like TV, fridge etc., semi durable like shoes dress etc or none durable like food items.

Goods which are used to produce other goods and services are called capital goods. They are used for investment purpose. Machinery, equipment, building etc are examples of capital goods. The economic growth of a country depends on the stock of capital goods.

What do you mean by factor cost & market price?

FACTOR COST & MARKET PRICE

Factor cost is a measure of national income or output based on the cost of production. Itis the incomes received by the owners of the production (the households) for rendering their factor services to the producers. Corresponding to the real flow of factor services from the households to the producers, there is a money flow from the producers to the households in the form of rent, interest, profit, and wages.

FACTOR COST=MARKET PRICE –INDIRECT TAXES

Market price is the economic price for which a good or service is offered in the marketplace.

National Income is estimated at both factor cost and market price.

Differentiate GDP & GNP.

GROSS DOMESTIC PRODUCT

It is the sum value of all **final goods and services produced** in a country over period of one year.

GROSS NATIONAL PRODUCT

GNP=GDP+ Net factor income earned from abroad.

We may receive income from abroad. Indians who are working in other countries send their income to home country. This income has to be included in national income calculation. At the same time foreigners who are working in India send their income to their home countries. This income has to be excluded from the calculation of national income. **The difference between the two is Net Factor Income from abroad**.

NET DOMESTIC PRODUCT

NDP=GDP-Depreciation

Depreciation is the reduction in the value of an asset due to its continuous use. This depreciation value has to be deducted inorder to get the exact national income value.

NET NATIONAL PRODUCT

NNP=GNP-Depreciation

NATIONAL INCOME AGGREGATES

1. Gross Domestic Product at Market Prices

2. Gross National Product at Market Prices

3. Net Domestic Product at Market Prices

4. Net National Product at Market Prices

5. Gross Domestic Product at Factor cost

6. Gross National Product at Market Price

7. Net Domestic Product at Factor Cost

8. Net National Product at Factor Cost

NATIONAL INCOME AGGREGATES

1. **Gross Domestic Product at Market Price; GDP$_{MP}$:** It is the sum value of final goods and services at prices prevailing in the market produced in the domestic territory of a country during a given year.

2.**Gross National Product at Market Prices; GNP$_{MP}$:** It is defined as the aggregate market value of all final goods and services produced by normal residents of a country. To get GNP$_{MP}$ from GDP$_{MP}$ we have to add to GDP$_{MP}$ the net factor income earned from abroad.

$$\mathbf{GNP_{MP} = GDP_{MP} + Net\ factor\ income\ earned\ from\ abroad}$$

3. **Net Domestic Product at Market Prices;NDP$_{MP}$:** It is the market value of all final goods and services at prices prevailing in the market produced in the domestic territory of a country during a given year after making allowance for depreciation

$$\mathbf{NDP_{MP} = GDP_{MP} - Depreciation}$$

4. **Net National Product at Market Prices; NNP$_{MP}$**: It shows the market value of goods and services produced by normal residents of country during a year after making allowance for depreciation.

$$\mathbf{NNP_{MP} = GNP_{MP} - Depreciation}$$

NNP$_{MP}$ is considered to be a more accurate measure of the true output of the economy than GNP$_{MP.}$

5. **Gross Domestic Product at Factor Cost; GDP$_{FC}$:**It is the sum total earnings received by various factors of production in terms of wages interest, rent, profits etc. within the domestic territory of a country in a year.

$$\mathbf{GDP_{FC} = GDP_{MP}\text{-Net Indirect Taxes}}$$

6. **<u>Gross National Product at Factor Cost;GNP$_{FC}$</u>:** It is the sum total of earnings received by various factors of production in terms of wages, rent, interest, etc. by normal residents of a country .It differs from GNP$_{MP}$ to the extent of net indirect taxes.

$$\mathbf{GNP_{FC} = GNP_{MP}\text{-Net Indirect Taxes}}$$

7. **<u>Net Domestic Product at Factor Cost;NDP$_{FC}$</u>:** Net Domestic Product at factor cost is the estimate of the domestic product in terms of earnings of factors of production within the domestic territory of a country **net of depreciation** during a year. **NDP$_{FC}$ =GDP$_{FC}$-Depreciation**

8. **<u>Net National Product at Factor Cost;NNP$_{FC}$</u>:** When we calculate the value of all final goods and services produced by normal residents of a country, whether operating within the domestic territory of a country or outside it, at their factor cost, it is called **Net National Product at Factor Cost or National Income**. National income can be defined as the factor income accruing to the normal residents of a country during a year.

NNP$_{FC}$ or **National Income=Domestic Factor Income + Net Factor Income earned from abroad.**

NNP$_{FC}$ or **National Income =GNP$_{FC}$-Depreciation**

Technically national income is taken in the sense of Net National Product at Factor Cost **(NNP$_{FC}$)**.

<u>Private Income:</u> It refers to the income of non-governmental entities from all sources over a period of one accounting year. It represents the income of firms and households from all possible sources.

Private Income= NNP$_{FC}$ –domestic product accruing to the government sector+ transfer payments+ Interest on public debt.

Personal Income: It is the income of the household sector from all sources during a financial year

Personal Income=Private Income-(Corporation tax+ Undistributed profit)

Personal Disposable Income: It is defined as the part of personal income left for consumption and saving after payment of taxes. It is the take home income

Personal Disposable Income=Personal Income-Direct Taxes

Percapita income

It is the total national income of a country divided by the population

$$\textbf{Percapita Income}=\frac{\textbf{\textit{Total National Income}}}{\textbf{\textit{Total Population}}}$$

National Income at Current Prices and National Income at Constant Prices

In an economy without any increase in real output national income estimate may show an increase in national income. This is because of the increase in price of goods and services. Hence in every country national income is estimated at current prices and constant prices.

National income estimated according to the prices of goods and services prevailed in the current year (the year to which national income is estimated) is known as **National income at Current prices or Nominal National Income.**

National income estimated according to the prices of goods and services prevailed in base year is known as **National Income at Constant prices or Real income**. When there is an increase in national income at constant prices it shows that economic growth in that country has increased. In India national income is estimated on the basis of prices of goods and services prevailed in the year 2011-2012.

GNP DEFLATOR

This is an adjustment factor used to convert nominal GNP into real GNP .It is the ratio of price index number (PIN) of a chosen year to the price index number of the base year.PIN of the base year is 100.The chosen year is the year whose real GNP is to be estimated.

PIN is a percentage number that shows the average change in the price of a basket of goods over a period of time as compared with prices in the base year. Base year is standard year taken for comparison and its PIN is taken as 100.If PIN for a year is 125 it means that 25%increase in the price of goods and services when compared to base year.

$$\textbf{GNP Deflator} = \frac{PIN\ of\ the\ chosen\ year}{100}$$

$$\textbf{Real GNP} = \frac{Nominal\ GNP}{GNP\ Deflator}$$

MEASUREMENT OF NATIONAL INCOME

Explain the various methods of measuring national income?

Measurement of national income is an extremely gigantic and complicated task. However, economists have devised various ways of estimating national income. In India the task of estimating national income is entrusted with the C S O (Central Statistical Organization), a department of ministry of Planning and Programme Implementation.

For the purpose of national income calculation we have divided the economy into three sectors.i) **Primary sector: –Agriculture**

ii) **Secondary sector-Industry**

iii) **Tertiary Sector-Services.** It includes sectors such as health, insurance, banking, transport &communication etc.

In developed countries the tertiary sector contributes the largest share towards national income. Even though India is a developing country the largest share of its national income is contributed by the tertiary sector.

THREE WAYS TO MEASURE NATIONAL INCOME

There are 3 different ways or methods of measuring national income.

1) Net Product Method or Value Added Method.

2) Income method

3) Expenditure Method

NET PRODUCT METHOD

The net product or value added method measures national income as the sum total of **net final output** produced or **net value added** by all the producing units in an economy during a year.

National Income= Net Value added at factor cost of: (Primary sector Secondary sector Tertiary sector) +Net factor income from method.

INCOME METHOD

The income method measures national income at the distribution side at the phase of factor payments made to primary factors for the use of their factor services .Under this method national income is calculated by adding up all the incomes generated in the course of producing the national product.

National income=Compensation of Employees+ Operating Surplus +Mixed Income+ Net factor income earned from abroad.

EXPENDITURE METHOD

It measures the national income at the disposition stage that is disposition of final products. In other words it measures national income by estimating expenditure on final products.

$$Y=C+I_n+G+(X-M)-NIT+NYA$$

Where

Y-national income,   C-consumption Expenditure, I_n-Net investment

G-Government expenditure,(X-M)- Net exports, NIT-Net indirect tax

NYA- Net income from abroad

To sum up each method provides a different view of the economy. Depending upon which phase of the national income we should analyze which method to use for estimating national income.

Explain the difficulties in measuring national income?

DIFFICULTIES IN MEASURING NATIONALINCOME

i) **Inclusion of services:** There is the basic problem of what items should be included in national income .The problem is associated with the inclusion of services in national income.

ii) **Identifying Intermediate goods**: National income comprises only final goods and services, while intermediate goods are excluded from the calculation of national income. But in actual practice it is difficult to draw a clear-cut distinction between intermediate goods and final goods. Intermediate goods are those goods which are used for further production of final goods.

iii) **Services of the Housewives and other similar services**: There are many payments for which no money payment is made. One of these services is services of housewife in their own home such as cooking, taking care of the children etc. No payment is made for these services and therefore they are not included in national income.

PRACTICAL DIFFICULTIES WITH REFERENCE TO INDIA

1. **Lack of occupational specialization:** For national income calculation it is necessary that producers be classified into various specific occupations. But in developing countries like India occupational classification of producers into distinct groups is almost impossible, particularly in the agriculture sector.
2. **Non-Monetized sector**: Non-monetized sector refers to that part of the economy where goods and services are exchanged through barter without the use of money .In India agriculture is carried on a subsistence basis. A very large production does not come to the market for sale .It is partly kept back by producers for their personal consumption and is partly exchanged for other goods.
3. **Unreported Illegal Income**: Sometimes people distort facts and provide false information about their income to evade income-tax and wealth tax. ***This leads to generation of black money ie.the income which is evaded from income tax.*** Therefore the income such generated goes as unreported income.
4. **Non availability of statistical data**: The most important difficulty in the estimation of national income in a developing country like India is the non-availability of reliable data.

ITEMS THAT ARE EXCLUDED FROM NATIONAL INCOME CALCULATION

→ Winning of a lottery prize.

→ Profit earned by foreign banks in India.

→ Sale of used goods.

→ Transfer payments such as old age pension, widow pension will not be included in national income calculation.

→ Value of intermediate products is not considered. Only the final value of goods will be taken for national income calculation.

QUESTIONS

1. What is national income?

2. What do you mean by Gross domestic product?

3. Mention the various aggregates of national income.

4. a) Explain the methods of measuring national income

b) What is the implication of the following statement?

GNP is Rs 58, 33,558 crore and NNP is Rs55, 01,067 crore. (5. What are the difficulties in measuring national income?

7. What are transfer earnings?

8. Define Percapita income.

9. What is real income and nominal income?

10. What is primary sector, secondary sector and tertiary sector?

11. Differentiate GDP and GNP

12. Estimate NDPMP and national income from the data given below

GDPMP=850 , Depreciation=50, Net factor income from abroad=210, Indirect Tax=50

Subsidy=40

13. From the following data given below calculate national income:

Items	Rs (in crores)
Indirect taxes	125
Depreciation	100
Royalty	10
Profits	100
Subsidies	20
Gross domestic product at market price	900
Interest	25
Rent	50
Net factor income from abroad	20

14. Are the following items included in estimating a country's national income? Give reasons

1. Expenditure on purchase of old house 2. Brokerage on sale of goods

3. Meals given to beggars 4. Production for self –consumption by farmer

5. Income from smuggling 6. Sale of shares

7. Construction of a new house 8. Receipts of scholarship from Government

9. Pocket money receive from parents 10. Widow pension.

15. Calculate the values of GNP_{MP} and GNP_{FC}

Items	Rs (in crores)
Amount of tea produced	2000
Market price of tea per kg	100
Amount of Coffee produced	1500
Market price of coffee per kg	300
Value of industrial products	600000
Value of intermediate products	300000
Net indirect taxes	1,00,000

16. From the data given below estimate GNP_{MP}, GNP_{FC}, NNP_{MP} and National Income.

$GDP_{MP=}$5000,NFIA=-50,Indirect Tax=70,Subsidy=20,Depreciation=30

17. A bicycle manufacturing company in India produce and sold 100 bicycles at a price of Rs 2500 per unit in the market. Out of this Rs 300 has gone to the government as tax per unit. The owner of this company is a foreigner and he got a profit of Rs 500 per bicycle and the entire profit has gone to the country which he belongs. Because of the production of 100 bicycles there was a depreciation of Rs 20,000 to the company. How much is the contribution of this company to the GDP_{MP} as well as national income of India?

18.Define GNP, NNP, NI, PIandDPI.

19. Distinguish between a) GDP and GNP b) GDP and NDP

20. a) Estimate GDPmp and GNPfc from the following data(given in crores) according to the expenditure method. Private final consumption expenditure(C) = 6000, Investment(I)=4000, Government consumption expenditure(G)=1400, Net- exports(X-M)=600, Net indirect tax =500, Net factor income from abroad =1000.

MODULE-4

INFLATION

Define Inflation.

Inflation is generally defined ***as a process of persistent and appreciable rise in the general level of prices.*** That is the availability of goods is less when compared to the supply of money. It shows a state of disequilibrium between the aggregate demand and aggregate supply at the existing prices. Inflation refers to a situation of ***appreciable*** **or** ***considerable*** **rise in prices**. The value of money varies inversely with price level.

$$\textbf{Value of money} = \frac{1}{price\ level}$$

Explain the various types of inflation?

TYPES OF INFLATION

There are several types of inflation which are classifies on different basis .Based on the rate, inflation can be classified as follows.

a) **Creeping Inflation:** When the price rise is very slow, that is less than 3% per annum, it is called creeping inflation. It is mild inflation and is considered as good for economic growth.
b) **Walking Inflation:** When prices rise moderately and the annual inflation rate is 3% to 6%, it is called walking inflation. Inflation at this rate is a warning signal for the government.
c) **Running Inflation:** When price rises rapidly and the rate of increase is 10% to 20% per annum, it is called running inflation. It requires strong monetary and fiscal measures and it is a dangerous situation.
d) **Galloping or Hyper Inflation**: When price rises between 20% to 100% per annum or even more, it is called galloping inflation. Such a situation brings total collapse of the monetary system because of the continuous fall in the purchasing power of money.

Differentiate demand pull and cost push inflation.

DEMAND PULL INFLATION

Demand pull inflation occurs ***when the demand for goods and services exceeds the supply available at existing prices***, *i.e.*, when there is excess demand for goods and services. This is a situation of disequilibrium which can be corrected partly by increase in prices and partly by increase in output up to full-employment level, and entirely by increase in prices beyond full employment level.

COST-PUSH INFLATION

Cost push inflation refers to ***inflationary rise in rises which arises due to increase in costs***. When the cost of producing a commodity increases, the price of the commodity also increases. Increase in the wages of labourers is also a reason for cost push inflation.

Explain the causes of inflation?

CAUSES OF INFLATION

1. **Increase in money supply:** Increase in money supply represents an increase in purchasing power with the people. Unless increase in purchasing power is offset by increase in supply of goods and services, it will exercise an upward pressure on prices.
2. **Deficit financing**: Deficit financing is another important cause of inflationary rise prices. In India, deficit financing is taken to mean the excess of the government expenditure over current revenue and public borrowing.
3. **Increase in public expenditure:** Increase in public expenditure may lead to increase in prices by increasing the aggregates demand.
4. **Increase in export demand:** Export demand is an important component of aggregate demand. An increase export demand, there for, results in and increased aggregate demand

5. **Increase in population –** Increase in population means increased demand for most of the consumer goods. It increases the aggregate demand for goods and services and puts pressure on the existing supply of goods and services.
6. **Higher wage rates --**Higher wage rates are responsible for rise in prices in and important way. Modern economies are characterized by the presence of strong trade union. They are able to pressurize the entrepreneurs to grand them increase in money wages in excess of increase in labour productivity
7. **Higher taxes –**Another cause of rise in prices is imposition of higher taxes, mainly indirect taxes like excise duties, sales tax, etc. Indirect taxes are largely passed over by the producers to the consumers by increasing the prices of goods and services by the amount of taxes.
8. **Hoarding:** Hoarding of commodities especially by the traders for profiteering is also responsible for rise in prices. During the period of scarcity and rising prices, traders merchants and even consumers indulge in hoarding of commodities .This will lead to increase in the price of commodities.

9. **Higher administered prices:**In India the prices of commodities are determined by Government .For example the prices of food grains are determined by the government. So in order to protect the interest of the farmers the Government may increase the price of commodities. This will lead to inflation.

10. **Supply shocks**: supply shocks in the form of higher oil prices by the OPEC (Organization of Petroleum Exporting Countries) are a major factor for price rise in recent years. Petroleum prices are of crucial importance because petroleum is used directly and indirectly in almost all the sectors of the economy.

<u>EFFECTS OF INFLATION</u>

Examine the effects of inflation on various sections of the society

1. **<u>Effects on production</u>**

i. Inflation affects the pattern of production: During inflation profits rise sharply. Therefore, business men, traders, and merchants are able to indulge in luxuries.

ii. It leads to hoarding: The traders and merchants indulge in hoarding in-order to earn higher profits in future.

2. **Effects on distribution of income:** Inflation leads to inequitable and arbitrary redistribution of income and wealth in the society. It results in the redistribution of income.

i. **Debtors and Creditors**: During the period of inflation, debtors as a group stand to gain while creditors tend to lose. Debtors benefit during inflation.

ii. **Profit earners:** Entrepreneurs, traders, merchants, etc…whose incomes are derived from profits tend to benefit during inflation.

iii. **Wage earners and salaried class:** Wage earners and salaried class tend to lose during inflation. Though in the modern economies wages and salaries are linked with the cost of living, even the labourers and salaried class are likely to lose during inflation.

iv. **Pensioners:** Pensioners and similarly placed fixed income groups suffer during inflation. Retired people who survive on pensions are likely to lose during inflation for two reasons.

v. **Farmers:** Farmers as a group stand to gain during inflation. Farmers like other producers, tend to gain because the price of agricultural products outpaces the increase in price of farm inputs. Moreover, farmers are generally debtors.

3. **Adverse effect on savings:** Inflation decreases the saving capacity of the people which badly affect the economic growth of country.

4. **Effect on public revenue:** Inflation is likely to have favorable effect on public revenue. The government would get more revenue from taxes, such as excise duties, sales tax, etc will also increase.

5. **Confidence on the currency:** A high rate of inflation can undetermined the confidence of people in the currency. When people lose confidence in the currency, money cannot function as money. People will not like to hold currency.

6. **Social and moral degradation:** Period of hyperinflation is often associated with social and moral degradation. Inflation has led to thefts, robberies and widespread corruption.

7. **Political instability:** Continuous inflation in many cases has shaken the foundations of political system. It has become a major political issue during many elections. History is full of instances when many governments lost power because of persistent rise in prices.

MEASUREMENT OF INFLATION

Inflation is measured by calculating the changes to price index numbers (PINs) over a period of time. Rate of inflation is the percentage rate of change in the price index for a given period of time.

$$\text{Rate of inflation} = \frac{\mathbf{PINt - PINt-1}}{\mathbf{PINt-1}} \times \mathbf{100}$$

Where PINt=Price index for the year t

PINt-1=Price index for the year t-1

Price index measures the average change in the price of goods and services over a period of time .It can be consumer price index or whole sale price index.

CONSUMER PRICE INDEX

CPI is widely used to measure inflation. It is a measure of consumer goods and services. It is based on the price of shelter, clothing, fuel, transportation, medical care, and other commodities purchased for day to day living. We construct the price index by giving weightage to each price according to the economic importance of the commodity. Each item is assigned a fixed weight proportional to its relative importance in consumer's expenditure budget.

Inflation occurs when there is an increase in general increase in price level .The rate of change of price level is measured by CPI.

$$\textbf{Rate of inflation for a given year} = \frac{\boldsymbol{CPIforagivenyear - CPIforapreviousyear}}{\boldsymbol{CPIforapreviousyear}} \times \mathbf{100}$$

CONTROL OF INFLATION

How a central bank does controls inflation?

Explain the various quantative & qualitative measures used to control inflation?

Explain the various monetary measures used to control inflation?

Examine the fiscal measures used to control inflation.

Describe the quantative & qualitative measures used to control inflation.

There are two methods to control inflation. They are

MONETARY POLICY AND FISCAL POLICY

The policy used by the central bank of a country is monetary policy. Fiscal policy tool is used by the Government.

I.MONETARY MEASURES: These are the measures adopted by the Central Bank of a country to control credit and money supply in the economy**. In India monetary policy is adopted by RBI**. It can be classified as **Quantitative measures and Qualitative measures.**

A. QUANTITATIVE MEASURES: It aims at influencing the overall availability of bank credit and its cost. Open market operations, bank rate and legal reserve ratio are the main quantitative credit control measures. Each measures of RBI are explained below.

1) **Open Market Operations:** The RBI is in charge of buying and selling of Government securities. If there is an inflationary situation the RBI sells securities to the public through commercial banks. By doing so it will reduce the supply of money in the economy.

(**Government Securities:** These are bonds, notes and other instruments sold by a government to finance its borrowings .It is generally long-term securities with the highest market ratings)

2) **Repo rate:** It is the rate at which RBI advances loan to commercial banks. When there is an inflationary situation RBI will increase will repo rate which in turn

increases the lending rate of commercial banks. This will increase the cost of credit and people will prefer fewer loans and thereby the total money supply is regulated.

3) **Reverse Repo rate:** When the commercial banks have excess money supply, they will advance to RBI, for which the commercial banks will get interest from RBI. This rate is known as reverse repo rate. The RBI will increase the reverse repo if there is an increase in money supply.

4) **Cash Reserve Ratio:** Every commercial bank have to keep a portion of their deposits with RBI as reserve and the remaining only they can lend for loans. This is mandatory and is known as Cash Reserve Ratio-CRR. If there is inflation RBI will increase CRR there by reducing the lending capacity of commercial banks.

5) **Statutory Liquidity Ratio:** The commercial banks have to keep a portion of their deposits in gold and approved Government Securities. This rate is determined by RBI.If there is inflation RBI will increase the SLR.

6) **Bank rate policy:** The bank rate is the rate at which RBI rediscount approved first class bill of exchange. During inflation RBI raises the bank rate due to which cost of borrowing goes up. As a result commercial banks borrow less money from RBI and thereby the flow of money from commercial banks to public reduces.

B: QUALITATIVE OR SELECTIVE CREDIT CONTROL MEASURES

Under this method, extension of credit to essential purposes is encouraged .It ensures that credit is being extended to deserving economic sectors.

1) **Margin requirements**: Margin means proportion of the value of the security against which loan is not given. In other words 'Margin 'refers to the difference between market value of securities and the amount of loan granted against these securities. For productive purposes margin requirements will be less.

2) **Publicity –** RBI informs all the scheduled banks about the nation's economic needs and the procedures to be followed in order to cater to them. It may issue warning to the people and commercial banks, substantiating its views by facts, figures and statements, through the media of publicity.

3) **Direct action –** Under Banking Regulations Act, the RBI is empowered to initiate direction action against those commercial banks which ignore its advice, in such cases RBI can impose restriction on sanctioning of loans.
4) **Moral Suasion:**These are the informal request by the central bank to commercial banks to contract credit in times of inflation and expand credit in times of deflation. The central bank issues periodical letters to commercial banks and discussions are held with authorities of commercial banks in this respect.
5) **Control of bank advances –** This is also used as selective control method. The Reserve Bank has fixed from time to time maximum limits for some kinds of loans and advances.

II. FISCAL POLICY (Government Policy)

Fiscal policy is the policy of Government expenditure and revenue. Contractionary fiscal policy can be used to reduce aggregate demand and thereby control demand pull inflation.

1) **Public expenditure:** Public expenditure, i.e., expenditure by the government is an important component of aggregate demand. In order to control inflation it is essential that government expenditure must be reduced.

i. **Taxation:** The major plank of anti-inflationary fiscal policy is to increase the tax burden by increasing the tax rate and by imposing new taxes. Direct taxes can be used for this purpose.

ii. **Public borrowing:** Public borrowing, i.e., borrowing by the government from public, can also be used in controlling inflation. Public borrowing enables the government to meet its expenditure and thereby reduces the need for deficit financing.

2) **Price control and rationing**: A direct measure to control inflation is to introduce price controls and rationing of essential goods. Under price control policy, the government fixes the maximum price at which certain commodities could be sold.

3) **Increasing the availability of goods:** The basic solution to the problem of inflation is to increase the availability of goods in the economy.

a) Production should be increased.

b) Domestic production of essential goods may be supplemented by imports of these goods so as to reduce shortages and reduce inflationary pressures.

QUESTIONS

1.What is inflation? How inflation does affect the various section of the society?

2. Explain how RBI controls inflation?

3.a) What are causes of inflation in an economy ?

b) How does a central bank controls inflation. ?

4. What are the quantitative methods of credit control?

5.a) What is inflation? What adjustments can be made in CRR and SLR to bring down level of inflation?

6. Consider there is an inflationary situation in the economy. What changes would you make to the following parameters?

a) Repo rate b) Reverse reporate c)Cash reserve ratio

a) Statutory Liquidity Ratio e)Bank rate

7. What is deflation? What are the various methods to control deflation?

8. What is inflation? What are the monetary policy measures to control inflation**?**

10. What is demand pull inflation? How does it differ from cost push inflation?

MODULE -4 BUSINESS FINANCING

1. Explain the various internal and external sources of finance available for a company?

Finance is essential for a business's operation, development and expansion. Funds can be procured from different sources and therefore procurement is always considered as a complex problem by business concerns. It is crucial for businesses to choose the most appropriate source of finance for its several needs as different sources have its own benefits and costs. Broadly speaking, a company can have two main sources of funds;

A. INTERNAL FINANCING

Internal sources refer to sources from within the company such as **funds raised from retained earnings or the savings of the company and personal capital**.

1.**Retained earnings:**It is the portion of profit which is not distributed among shareholders and is retained and used in the business. It is also called ploughing back of profits. It is a permanent source of funds available to an organization. It is an uncertain source of funds as the profits are fluctuating.

B. EXTERNAL FINANCING

External sources refer to outside sources consisting of **equity finance (share capital) and debt finance** (debenture capital, loans and advance, etc.)

SOURCES OF EXTERNAL FINANCE

1. SHARES: When a big amount of capital is required is collected, it can be made possible through the issuance of share issued to public. Shares can be issued at any time; generally these are issued at the time of starting of new business, expanding or reorganizing the existing concern.

2.LOANS FROM BANKS: Commercial banks play an important role in funding of the business enterprises. Apart from supporting businesses in their routine activities (deposits, payments, etc.) they play an important role in meeting the long term and short term needs of a business enterprise. It is a flexible source of finance as loans can be repaid when the need is met. Finance is available for a definite period; hence, it is not a permanent burden. Less time and cost is involved as compared to issue of shares, debentures, etc.

3.BANK OVERDRAFT: Bank overdraft is a short term credit facility provided by banks for its current account holders. This facility allows businesses to withdraw more than their bank account balances hold. Interest has to be paid on the amount overdrawn. Bank overdraft is the ideal source of finance for short-term cash flow problems.

4. TRADE CREDIT: Trade credit is commonly used by business organizations as a source of short-term financing. Trade credit extended by one trader to another for the purchase of goods and services. Trade credit facilitates the purchase of supplies without immediate payment. The volume and period of credit extended depends on factors such as reputation of the purchasing firm, financial position of the seller, volume of purchases, past record of payment and degree of competition in the market.

5.PUBLIC DEPOSITS: Another source is public deposits. It is also a debt-instrument, mostly for short-term finance. Under this system, people keep their money as deposit with these companies or managing authorities for a period of six months, a year, two years, three years or so. Depositors receive a fixed interest. This money is used by companies to meet their needs of working capital.

6. DEVELOPMENT FINANCE INSTITUTIONS: Development finance institutions cater to the needs of large and small industries. The few institutions supplying industrial finance are Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Reconstruction Bank of India, State Finance Corporation, and State Industrial Development Corporations. These institutions provide huge quantity of finances for setting up of new industries, or meeting their several needs and in several needs and in several forms. The EXIM bank provides credit for export-import transactions.

SHARES & BONDS

When companies want to raise capital, they can issue Shares or bonds.

A share is a stake in the ownership of a company. It is a security that is also sometimes referred to as an equity. When a company issue shares, they are selling a certain amount of ownership in their company. An investor who buys the shares has a claim to the company earnings and assets.

When more shares are issued, future earnings must be shared among a larger pool of investors. More shares can cause a decrease in earnings per share (EPS), putting less money in owners pockets. EPS is also one of the indicators that investors look at when evaluating firm's health. A declining EPS number is generally viewed as an unfavorable development

Shares are perpetual investments and they do not have specific maturity period. The most attractive feature of stock issuance is that the money does not need to be repaid.

Bonds are a loan agreement that a company enters into with the investor. By buying a bond, in investor is lending money to a company for a pre-agreed period of time. For its part, the company agrees to pay back the money lent by the investor on a fixed date and to make regular interest payments during the period of the loan or in bulk at the time of maturity. When the bond reaches its maturity date, the company repays the investor. Unlike shares, bonds are temporary investments which have fixed lifecycles. Although elements of the lifecycle may vary from bond to bond, the stages are the same from issue 10 maturity. Bond financing is often less expensive than equity.

Bond issuance enables corporations to attract a large number of lenders in an efficient manner. Record keeping is simple because all bondholders get the same deal. For any given bond, they all have the same interest rate and maturity date.

State the difference between share & bond.

BONDS	SHARES
The investor lends money to the company	The investor owns part of the company
The Issuers of bonds are Govt. institutions, financial companies, etc.	Shares are issued by corporate enterprises
Risk is relatively low	Risk is very high
Bond holders get Interest, as fixed payment.	Shareholders gets dividend
Return is certain	Return is uncertain
As bondholders have higher on assets, investors may recover some of initial capital.	When a company is declared bankrupt stocks will worthless and investors may lose 100% their capital.
The capital is paid back in full to investor at maturity.	The amount of capital the investor gets back depends on the share price when stocks are sold.
Maturity period is fixed	No maturity period for shares

<u>QUESTIONS</u>

1. Explain the various internal and external sources of finance available for a company?

2. What are the internal sources of capital?

3.Differentiate share & bond

MODULE: 4 BUSINESS FINANCING

MODULE -4

FINANCIAL MARKET

Financial market is the market that facilitates transfer of funds between investors or lenders and borrowers or users. It consists of individual investors, financial institutions and other intermediaries for trading the various financial assets and credit instruments. **Financial markets are of two types;Money market& Capital Market**. Money market is where extremely liquid financial instruments are traded for **short term period.**ACapital market is ***where*** buying and selling in securities is done to raise **long-term** fundsfor the entity.

Define money market.

Sate any 3 functions of money market.

MONEY MARKET

The money market is that part of a financial market which deals in the **borrowing and lending of short term loans generally for a period of less than or equal to one year**. It is a mechanism to clear short-term monetary transaction in an economy. Money market instruments have the characteristics of **liquidity (quick conversion into money),** minimum transaction cost and low loss .Mostly government, banks and financial institutions dominate this market. **Some of the instruments used in the money market are certificates of deposits, bills of exchanges, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money.**The money works under the full control of **Reserve Bank of India**.

FUNCTIONS OF MONEY MARKET

The major functions of money market are given below.

1. **Financing trade***:*Money market plays crucial role in financing both internal as well as international trade.

2. **To maintain monetary equilibrium***:*It means to keep a balance between the demand for and supply of money for short term monetary transactions.
3. **To promote economic growth***:* Money market can do this by making funds available to various units in the economy such as agriculture, small scale industries, etc.
4. **To help in implementing monetarypolicy***:* It provides a mechanism for an effective implementation of the monetary policy.
5. **Profitable investment***:*Money market enables the commercial banks to use their excess reserves in profitable investment.

Define capital market.

Sate any 3 functions of capital market.

CAPITAL MARKET

Capital market may be defined as a market for borrowing **long-term capital funds** required by business enterprises**.** Capital market offers an ideal source of external finance. It refers to all the facilities and the institutional arrangement for borrowing and lending medium-term and long-term fund. It channels the wealth of savers to those who can put it in long term productive use, such as companies or governments making long-term investment. **The important capital market instruments are shares, bonds, debentures etc**.The capital market works under the full control of **SEBI –Securities & Exchange Board of India.**

The instruments which are traded in capital market includes shares, bonds, debentures etc whose maturity period is not limited up to one year. Capital market may be divided into two categories: Primary Market & Secondary Market. A market where fresh securities are offered to the public for subscription is known as Primary market whereas already issued securities are traded among investors is known as Secondary market.

FUNCTIONS OF CAPITAL MARKET

The main functions of capital market are as follows.

1. **Allocation function**:Capital market allows for the channelization of savings of innumerable investors into various production avenues of investment.
2. **Liquidity function**:Capital market provides a means whereby buyer and sellers can exchange securities at mutually agreed prices. This allows better liquidity for the securities that are traded.
3. **Indication function** – A capital market acts as a barometer showing not only the progress of a company, but also of the economy a whole through share price movement.
4. **Savings and investment function** – Capital market provides a means of quickly confidence long-term investment into liquid funds, thereby generating confidence among investor and speeding up the process of saving and investment.
5. **Promotes economic growth**: It helps in mobilizing the saving resources of a country and thereby encouraging economic growth by proper allocation of resources.

State the difference between money market & capital market.

	Money Market	**Capital Market**
1.	It is a place where s**hort-term** marketable funds are traded.	It is a place where **long-term** marketable funds are traded.
2.	The risk is very low.	They carry high risk.
3.	They give less return.	The returns are higher.
4.	The maturity is one year.	The maturity period is more than one year.
5.	It helps in liquidity of the economy.	It helps in mobilization of savings.
6.	The major institutions that work in money market are central bank, commercial banks , acceptance	The major institutions are stock exchange, commercial banks etc.

	houses, etc.	

QUESTIONS

1. Differentiate Money market and capital market.
2. What are ways of attaining short term loans? Explain the short term credit instruments
3. How does capital market helps in attaining long-term finance?
4. Explain the functions of money market and capital market?

MODULE: 4

STOCK MARKET

Define a stock market.

The stock market refers to the collection of markets and exchanges where regular activities of buying, selling, and issuance of shares of publicly held companies take place. According to the Securities Contracts (Regulation) Act, 1956, "Stock Exchange means an association, organization or body of individual whether incorporated or not, constituted for the purpose of assisting, regulating, or controlling the business of buying, selling or securities.

In short, stock market is an institution which provides a platform for buying and selling of existing securities. While both terms - stock market and stock exchange - are used interchangeably, the latter term is generally a subset of the former. If one says that he trades in the stock market, it means that he buys and sells shares/equities on one (or more) of the stock exchange(s) that are part of the overall stock market.

While today it is possible to purchase almost everything online, there is usually a designated market for every commodity. A stock market is a similar designated market for trading various kinds of securities in a controlled, secure and managed environment. Since the stock market brings together hundreds of thousands of market participants who wish to buy and sell shares, it ensures fair pricing practices and transparency in transactions.

As a primary market, the stock market allows companies to issue and sell their shares to the common public for the first time through the process of initial public offerings (IPO). This activity helps companies raise necessary capital from investors. A listed company may also offer new, additional shares through other offerings at a later stage. Following the 1 first-time share issuance called the listing process, the stock exchange also serves as the trading platform that facilitates regular buying and selling of the listed shares. This constitutes the secondary market. As almost all major stock markets across the globe now operate electronically, the exchange maintains trading systems that efficiently manage the buy and sell orders from various market participants.

Explain the functions of stock market?

The following are some of the important functions of stock market.

1. **Providing Liquidity and Marketability to Existing Securities:** The basic function of a stock market is the creation of a continuous market where securities are bought and sold. It gives investors the chance to disinvest and reinvest. This provides both liquidity and easy marketability to already existing securities in the market.

2.Pricing of Securities: Share prices in stock market are determined by the forces of demand and supply. A stock exchange is a mechanism of constant valuationthrough which the prices of securities are determined. Such a valuation provides important instant information to both buyers and sellers in the market.

3.Safety of Transaction: The membership of a stock market is well-regulated and its dealings are well defined according to the existing legal framework. This ensures that the investing public gets a safe and fair deal on the market.

4.Contributes to Economic Growth: A stock market is a market in which existingsecurities are resold or traded. Through this process of disinvestment and reinvestment savings get channelized into their most productive investment avenues. This leads to capital formation and economic growth.

5.Spreading of Equity Cult: The stock market can play a vital role in ensuring wider share ownership by regulating new issues, better trading practices and takingeffective steps in educating the public about investments.

6.Providing Scope for Speculation: The stock market provides sufficient scope within the provisions of law for speculative activity in a restricted and controlled manner. It is generally accepted that a certain degree of healthy speculation is necessary to ensure liquidity and price continuity in the stock market

Define NSE.

NSE-NATIONAL STOCK EXCHANGE

NSE -The National Stock Exchange of India Limited (NSE) is the leading stock exchange of India, located in Mumbai. was established in 1992 as the first dematerialized electronic exchange in the country. It is the world's 10th-largest stock exchange according to May 2021 data. It was recognised as a stock exchange by SEBI in April 1993 and commenced operations in 1994 with the launch of the wholesale debt market, followed shortly after by the launch of the capital market segment.

In 1996, the NSE was the first exchange in India that planned to trade derivatives specifically on an equity index. In February 2000, the NSE started an Internet trading system. NSE provides a trading platform for various types of securities for investors under one roof- equity, debentures, central and state government securities, Treasury bills, commercial papers, certificate of deposits, mutual fund units etc.

Define BSE.

BSE-BOMBAY STOCK EXCHANGE

BSE (formerly known as Bombay Stock Exchange) was started in 1875. However, in 1850s, five stock brokers gathered together under a Banyan tree in front of Mumbai Town Hall. A decade later, the brokers moved their location to under another banyan trees at the junction of Meadows Street. With a rapid increase in the number of brokers, they had to shift places repeatedly. At last, in 1874, the brokers found a permanent location, the one that they could call their own. The brokers group became an official organization known as "The Native Share & Stock Brokers Association" in 1875. BSE is Asia's first & the Fastest Stock Exchange in world with the speed of 6 micro seconds and one of India's leading exchange groups. Over the past 145 years, BSE has facilitated the growth of the Indian corporate sector by providing it an efficient capital-raising platform

STOCK EXCHANGE INDICES

Stock market indices are the barometers of the stock market. They mirror the stock market behaviour. With some 7,000 companies listed on the Bombay stock exchange; it is not possible to look at the prices of every stock to find out whether the market movement is upward or downward. The indices give a broad outline of the market movement and represent the market. Some of the stock market indices are BSE Sensex, BSE200, Dollex, NSE-50, CRISIL-500, Business Line 250 and RBI Indices of Ordinary Shares. Mr. Charles Dow created the first stock market index known as the Dow Jones index back in May of 1896.

What is NIFTY?

NIFTY

NIFTY is a market index introduced by the National Stock Exchange. It is a blended word - National Stock Exchange and Fifty coined by NSE on 21st April 1996. NIFTY 50 is a benchmark based and also the flagship of NSE, which showcases the stocks traded in the stock exchange out of a total of 1600 stocks. 50 equity

These stocks span across 12 sectors of the Indian economy which include information technology, financial services, consumer goods, entertainment and media, financial services, metals, pharmaceuticals, telecommunications, cement and its products, automobiles, pesticides and fertilizers, energy, and other services.

NIFTY contains a host of indices - NIFTY 50, NIFTY IT, NIFTY Bank, and NIFTY Next 50. Nifty is owned by India Index Services and Products Ltd. (IISL). It is calculated using the free float market capitalization weighted method where the level of index reflects the total market value of the stocks relative to a particular base period. The base period selected for calculating Nifty50 index is the close price on Nov 3, 1995. The base value has been set at 1000.

Define SENSEX.

SENSEX

The BSE SENSEX (also known as the S&P Bombay Stock Exchange or Sensitive Index or simply the SENSEX) is a free-float market-weighted stock market index of 30 well established and financially sound companies listed on Bombay Stock Exchange. These 30 companies are known as Blue chip companies. The 30 component companies which are some of the largest and most actively traded stocks are representative of various industrial sectors of the Indian economy. Published since 1 January 1986, the S&P BSE SENSEX is regarded as the pulse of the domestic stock markets in India. The base value of the SENSEX was taken as 100 on 1 April 1979 and its base year as 1978-79. On 25 July 2001 BSE launched DOLLEX-30, a dollar-linked version of the SENSEX.

Historically Sensex used the weighted market capitalization methodology, but from September 1, 2003, it shifted to Free Float Market Capitalization methodology. All the major indices in the world use the same methodology. The performance of the 30 selected key stocks directly reflects the level of the index.

If a person wants to trade in the stock market, he must obtain a Demat and trading account.

Explain the working of a stock market?

What is a Demat account?

DEMAT ACCOUNT

Demat account is used to hold the shares purchased in digital or electronic form. During online trading, shares are bought and held in a Demat account, thus facilitating easy trade for the users. A Demat account holds all the investments an individual makes in shares, government securities, exchange-traded funds, bonds and mutual funds in one place. At any point or time, Demat account will show the shares and securities that a person is currently holding. In other words, it is a storage space to hold the shares and securities purchased. It is only a repository. It is similar to a bank account in which we hold deposits with the bank and the record of debit/credit balances are maintained in a bank passbook. In the same way, when we purchase or sell shares, it will be credited or debited to/from our Demat Account respectively.

Dematerialisation is the process of converting the physical share certificates into electronic form, which is a lot easier to maintain and is accessible from anywhere throughout the world. An investor who wants to trade online needs to open a Demat with a Depository Participant (DP-broker). The purpose of dematerialisation is to eliminate the need for the investor to hold physical share certificates and facilitating a smooth tracking and monitoring of holdings.

Demat account is an easy and convenient way to hold securities. It is safer than paper shares and reduces paperwork for transfer of securities. It also reduces transaction cost and a single account can hold investments in both equity and debt instruments. Another advantage is that a person can trade from anywhere.

What is a trading account?

<u>**TRADING ACCOUNT**</u>

A trading account is used to buy and sell shares and securities in the stock market. A trading account provides an interface to buy and sell shares from the stock market. Previously, the stock exchange functioned on the open outcry system. In this, the traders used hand signals and verbal communication to convey their buying/selling decisions. Soon after the stock markets adopted the electronic system, trading accounts replaced the open outcry system. Most commonly, trading account refers to a day trader's primary account. These investors tend to buy and sell assets frequently, often within the same trading session.

In the online method, the buyers and sellers don't have to be physically present at the stock exchange to place orders. Instead, they open a trading account with a registered stock market broker, who conducts trading on their behalf. Each trading account has a unique trading ID which is utilised to perform online transactions. Nowadays, brokers provide facilities to the investors to perform transactions by themselves.

A trading account acts like a link between Demat account and bank account of an investor When an investor wants to buy shares, he places an order through his trading account. The said transaction goes for processing in the stock exchange. Upon execution, the required number of shares get credited into his Demat account and a proportionate sum gets deducted from his bank account.

A similar kind of process is followed in order to sell equity. The investor places a sale order with the help of his trading account. It goes for processing in the relevant stock exchange. When the order is executed, the required number of shares are debited from his Demat account and a proportionate sum gets credited to his bank account. At any point of time, a trading account will show the transactions we carried out in the stock market.

Thus, if we want to trade in the stock market, we need both the accounts. To open these accounts, documents like proof of identity, address proof, Pan card etc. are needed.

'Shares' usually refers to units of ownership in a specific company-for example, you could say that you own ten Amazon shares.

Stocks' is generally used to refer to portions of ownership of multiple companies – for example, you could say that you own stock in Amazon and Microsoft. That is, total amount of shares owns in more than one company. Equity' is the term used for total ownership stake in the company - for example, if a company had 10,000 shares, and you owned 1000 of them, you could say that you held a 10% equity stake in that company. Usually, these terms are used interchangeably.

QUESTIONS

1. Define a stock market. Explain the important functions of stock market? **(7 marks)**

2. Define the following (**5 marks each)**

   i) National Stock Exchange

   ii) Bombay Stock Exchange

iii) NIFTY

iv) SENSEX

v) Demat account

vi) Trading Account

3. a) Explain the working of a stock market?**(7 marks)**

b) Differentiate share and stock. **(3 marks**)