2.13 Financial Markets: Structure, Functions and Types of Asset: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 15 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for the extended 25-mark essay only. A calculator is not required.

1 Define the money market in the context of the UK financial system and state its main function for short-term finance and liquidity management.

(Total for Question 1 is 2 marks)

2 Scenario: A UK manufacturing firm borrows overnight funds from a bank to cover payroll today, planning to repay on the next business day. Identify which type of financial market this transaction belongs to and explain briefly why.

(Total for Question 2 is 2 marks)

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3 Distinguish between primary and secondary capital markets, and state one advantage for a company of listing its shares on the secondary market after a primary issuance.

(Total for Question 3 is 3 marks)

4 Explain the difference between an equity investor and a bond investor in terms of claims on income and priority on the firm's assets in the event of liquidation, and state one implication for expected returns.

(Total for Question 4 is 3 marks)

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Mark scheme · 2.13 Financial Markets: Structure, Functions and Types of Asset: Test Pack

Question 1

a market for short-term borrowing and lending of funds and securities, typically with maturities under one year, such as Treasury bills and commercial paper **B1**

its main function is to provide short-term liquidity and enable firms, financial institutions and the government to manage cash flow and meet short-term financing needs **B1**

Answer: A market for short-term borrowing and lending (assets with maturities under one year) such as Treasury bills and commercial paper; it provides liquidity and short-term funding.

Question 2

identifies the money market **B1**

reason: the loan is very short term liquidity borrowing, typical of money market instruments and interbank/short-term funding **B1**

Answer: Money market, because this is very short-term borrowing to manage liquidity, characteristic of the money market.

Question 3

primary markets are where new securities are issued and sold for the first time, raising funds for issuers **B1**

secondary markets are where existing securities are traded between investors after the initial issuance **B1**

advantage: a liquid secondary market can make it easier and cheaper for the company to raise future finance and provides price discovery and reputational benefits **B1**

Answer: Primary markets issue new securities to raise funds; secondary markets trade existing securities among investors. Listing on a liquid secondary market aids price discovery, enhances the companys reputation and makes future fundraising easier.

Question 4

equity investors hold residual claims on profits (dividends) and ownership rights, returns are uncertain **B1**

bond investors have contractual claims to fixed interest payments and are higher priority creditors on assets in liquidation **B1**

implication: equities typically offer higher expected returns to compensate for greater risk and lower priority, while bonds offer lower but more predictable returns **B1**

Answer: Equity investors have residual claims on profits and ownership rights with uncertain dividends; bond investors have contractual interest claims and higher priority on assets in liquidation. Therefore equities tend to offer higher expected returns to compensate for higher risk, while bonds give lower but steadier returns.

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