

INSTITUTE OF ACTUARIES OF INDIA

Subject CB2 - Business Economics

May 2026 Examination

INDICATIVE SOLUTION

Introduction:

The indicative solution has been written by the Examiners with the aim of helping candidates. The solutions given are only indicative. It is realized that there could be other points as valid answers and examiners have given credit for any alternative approach or interpretation which they consider to be reasonable.

Solution 1 : C	[2]
Solution 2 : B	[2]
Solution 3: B	[2]
Solution 4 : B	[2]
Solution 5 : B	[2]
Solution 6 : A	[2]
Solution 7 : C	[2]
Solution.8 : C	[2]
Solution.9 : C	[2]
Solution 10: C	[2]
Solution 11 : A	[2]
Solution 12 : A	[2]
Solution 13 : B	[2]
Solution 14 : A	[2]

Solution 15: Explanation of Limit Pricing Implementation

- To maximize short-run profits, CloudServe would normally produce at the output level where marginal cost equals marginal revenue.
- CloudServe would then charge the corresponding higher price found on the average revenue or demand curve.
- To implement limit pricing, CloudServe intentionally sacrifices short-run profits by increasing output and lowering its price below this profit-maximizing level.
- CloudServe sets this new limit price equal to or just below the lowest anticipated point on NovaHost's average total cost curve.
- At this intentionally suppressed price point, NovaHost will be completely unable to cover its average costs if it enters the market.
- Facing inevitable economic losses, NovaHost is deterred from entering the regional corporate cloud-hosting market entirely.

Conditions for Success

- CloudServe must possess accurate knowledge or a highly reliable estimate of NovaHost's specific minimum average cost structure.
- CloudServe must maintain a significant absolute cost advantage or benefit from substantially greater economies of scale compared to NovaHost.
- The dominant firm's own average total cost must remain below the limit price to ensure CloudServe can sustain the strategy without incurring losses.

- CloudServe needs the existing infrastructure and spare capacity to immediately satisfy the higher market demand generated by the lower price.
- The regional cloud-hosting market must feature substantial structural barriers to entry, such as massive fixed costs for establishing server hardware, which creates the steep economies of scale necessary to force the new entrant's average total cost significantly higher than the incumbent's.
- The strategy must act as a highly credible threat where NovaHost firmly believes CloudServe will actually maintain this low price post-entry rather than raising it.

[4 Marks]

Solution 16:**Mechanisms for increasing broad money:**

- Lowering the CRR reduces the minimum mandatory reserves banks must hold.
- A reduced reserve ratio directly increases the theoretical money multiplier.
- This releases ₹2.5 lakh crore, giving commercial banks excess reserves to lend.
- Banks use these excess reserves to issue loans, which creates new deposits.
- Cutting the repo rate lowers the marginal cost of borrowing for commercial banks.
- Cheaper bank funds lead to lower lending rates, stimulating public credit demand.

Difficulties/Reasons for weaker-than-expected growth:

- Banks may choose to hold the released funds as voluntary excess reserves.
- Banks might restrict lending if they perceive high default risks in the economy.
- Households and firms might lack confidence, refusing to take on new debt.
- The public may choose to hold physical cash rather than bank deposits.
- This increased cash preference actively reduces the operational size of the money multiplier.
- Banks often do not fully pass repo rate cuts to consumers immediately

[4 Marks]

Solution 17 :**i) Marginal Revenue and Marginal Cost Functions**

- **Market 1 Total Revenue**

$$TR_1 = 200Q_1 - 5Q_1^2$$

$$MR_1 = \frac{d(TR_1)}{dQ_1} = 200 - 10Q_1$$

- **Market 2 Total Revenue**

$$TR_2 = 160Q_2 - 5Q_2^2$$

$$MR_2 = \frac{d(TR_2)}{dQ_2} = 160 - 10Q_2$$

- **Total Cost**

$$TC = 100 + 20Q + 2.5Q^2$$

$$MC = \frac{d(TC)}{dQ} = 20 + 5Q$$

$$\text{Substitute } Q = Q_1 + Q_2:$$

$$MC = 20 + 5Q_1 + 5Q_2$$

[1.5]

ii) Profit-Maximising Output per Market

- To maximise total profit, the firm must equate Marginal Revenue in each market to the Marginal Cost:

$$MR_1 = MR_2 = MC$$

- Step 1: Equate MR_1 and MR_2 to find the relationship between Q_1 and Q_2**

$$200 - 10Q_1 = 160 - 10Q_2$$

$$40 = 10Q_1 - 10Q_2$$

$$Q_1 = Q_2 + 4$$

- Step 2: Substitute Q_1 into the MC function and equate it to MR_2**

$$MC = 20 + 5(Q_2 + 4) + 5Q_2$$

$$MC = 20 + 5Q_2 + 20 + 5Q_2$$

$$MC = 40 + 10Q_2$$

- Step 3: Solve for Q_2**

$$160 - 10Q_2 = 40 + 10Q_2$$

$$120 = 20Q_2$$

$$Q_2 = 6 \text{ (i.e. 6,000 subscriptions for Independent Developers)}$$

- Step 4: Solve for Q_1**

$$Q_1 = 6 + 4$$

$$Q_1 = 10 \text{ (i.e. 10,000 subscriptions for Corporate Enterprises)}$$

[2.5]

iii) Profit-Maximising Prices and Total Profit

- Market 1 Price**

$$P_1 = 200 - 5(10) = 150$$

- Market 2 Price**

$$P_2 = 160 - 5(6) = 130$$

- Calculate Total Profit ($\pi = TR - TC$):**

- Total Output**

$$Q = 10 + 6 = 16$$

$$TR = (150 \times 10) + (130 \times 6) = 1500 + 780 = 2280$$

$$TC = 100 + 20(16) + 2.5(16^2) = 100 + 320 + 2.5(256) = 1060$$

$$\text{Profit} = 2280 - 1060 = 1220 \text{ (i.e. 1,220,000)}$$

[1.5]

iv) Point Price Elasticity of Demand (Market 1)

- Formula**

$$PED = \frac{dQ_1}{dP_1} \times \frac{P_1}{Q_1}$$

From $P_1 = 200 - 5Q_1$:

$$Q_1 = 40 - 0.2P_1$$

$$\frac{dQ_1}{dP_1} = -0.2$$

$$PED = -0.2 \times \frac{150}{10} = -0.2 \times 15 = -3$$

[0.5]

[6 Marks]

Solution 18 :

i)

1. The source of scarcity is Neha's limited time (strictly capped at 30 hours per week)
2. This forces an economic choice because she cannot produce unlimited quantities of both services. To produce more of one good, she must actively trade off and allocate time away from the other.

[1]

ii)

- a) Moving from 1 database (Alternative B) to 2 databases (Alternative C), her web page production falls from 46 to 38. The opportunity cost is exactly 8 web pages.
- b) The opportunity cost increases from 4, to 8, to 14, to 24 web pages. It illustrates the Law of Increasing Opportunity Cost which happens because her resources, skills, or mental energy are not perfectly adaptable to both tasks equally.

[1]

iii)

Alternative B: $5000 \times 1 + 500 \times 46 = 28,000$

Alternative C: $5000 \times 2 + 500 \times 38 = 29,000$

Alternative D: $5000 \times 3 + 500 \times 24 = 27,000$

To maximize her revenue, Neha should choose Alternative C (producing 2 databases and 38 web pages), which yields the highest possible revenue of 29,000

[2]

[4 Marks]

Solution 19:

i) Economies of Scale / Scope

- **Purchasing / Commercial:** Negotiating significant bulk-buy discounts from aircraft manufacturers (e.g., Boeing/Airbus) or aviation fuel suppliers due to the massive volume required for the doubled fleet.
- **Technical (Indivisibility):** Spreading the massive fixed costs of indivisible capital—such as multi-million-dollar advanced flight simulators or new hangar diagnostic equipment—across a much larger pool of newly trained pilots and aircraft.
- **Financial:** Securing lower interest rates on corporate loans to build the new maintenance hangars, because a drastically larger airline with more physical assets is perceived as a lower credit risk by major commercial banks.
- **Managerial / Specialisation:** Cost-justifying the employment of highly specialized staff, such as aviation tax experts or fleet-routing data scientists, whose salaries are now spread over a much larger volume of passenger flights.
- **Economies of Scope:** Utilizing the newly acquired maintenance hangars and overhauled ground crew to service third-party aircraft or launch a cargo freight division, sharing the overhead costs across different revenue streams.

[2]

ii) Diseconomies of Scale

- **Managerial Coordination Limits:** The extreme logistical difficulty of synchronizing flight schedules and maintenance rosters across a doubled network, meaning a delay at one new hub cascades into costly, massive network-wide disruptions.
- **Alienation / Labour Relations:** Newly recruited cabin crew and pilots feeling like insignificant numbers within a massive corporate training machine, leading to diminished customer service quality, strikes, or costly high staff turnover.
- **Communication / Bureaucracy:** The necessity of adding multiple layers of middle management to oversee the expanded hubs, resulting in a sluggish corporate response to localized competitor price cuts or sudden route disruptions.
- **Physical Infrastructure Bottlenecks (Technical):** The physical capacity of the new maintenance hangars becoming overwhelmed by the doubled fleet size, resulting in aircraft waiting in queues for routine servicing and increasing costly non-flying ground time.
- **External Diseconomies:** SkyRoute's massive expansion significantly exacerbating air traffic congestion and runway bottlenecks at their Mumbai base, forcing their planes into fuel-wasting holding patterns.

[2]

[4 Marks]

Solution 20:

- i)
- An increase in the quantity of labour available, driven by demographic changes like population growth or higher workforce participation rates.
 - Improvements in the quality of human capital through better education, specialized training, and enhanced healthcare systems.
 - Increases in the stock of physical capital via higher levels of domestic or foreign investment in machinery, factories, and equipment.
 - Technological advancements and research and development (R&D) that shift the production possibility frontier outward by creating more efficient production methods.
 - The discovery, extraction, or more efficient utilization of natural resources and raw materials.
 - Improvements in the geographical and occupational mobility of labour and other factors of production, ensuring resources move to their most productive uses.
 - An increase in entrepreneurial activity and innovation that efficiently combines other factors of production to generate higher output.

[3]

- ii)
- A lack of political stability or the presence of ongoing conflict, which drastically deters both domestic and foreign long-term investment.
 - Weak legal frameworks and poor enforcement of property rights, leaving investors and innovators vulnerable to expropriation, fraud, or theft.
 - High levels of systemic corruption and excessive government bureaucracy that act as unofficial taxes on enterprise and slow down business formation.
 - Underdeveloped, heavily regulated, or unstable financial systems that fail to efficiently channel household savings into productive commercial investments.
 - Inadequate public infrastructure, such as unreliable electricity grids or poor transport networks, leading to prohibitively high logistical and operational costs.
 - Protectionist trade policies or closed economic structures that restrict competition and limit the inflow of foreign direct investment (FDI) and crucial technology transfers.
 - High burdens of sovereign debt that crowd out private investment and force governments to cut back on growth-enhancing public spending.

[3]

[6 Marks]

Solution 21 :

i) Set $Q_d = Q_s$
 $12000 - 15P = -3000 + 10P$
 $15000 = 25P$
 $P = 600$ (i.e. INR 600,000)

Substitute P back into either equation:

$$Q = 12000 - 15(600)$$

$$Q = 3000 \text{ batteries}$$

[1]

ii) New equations

- New Demand:
 $Q_d = 13000 - 15P$
- New Supply
 $Q_s = -3500 + 10P$

Set New $Q_d = Q_s$
 $13000 - 15P = -3500 + 10P$
 $16500 = 25P$
 $P = 660$ (i.e. INR 660,000)

$$Q = 13000 - 15(660)$$

$$Q = 3100 \text{ batteries}$$

[2]

iii)

$$PED = \frac{dQ}{dP} \times \frac{P}{Q}$$

From the new demand equation $Q_d = 13000 - 15P$, the derivative is:

$$\frac{dQ}{dP} = -15$$

At the new equilibrium ($P = 660$ $Q = 3100$):

$$PED = -15 \times \left(\frac{660}{3100} \right) = -3.19$$

Interpretation: Since the absolute value $|-3.19| > 1$, demand is elastic at this price point. This means a % change in price will lead to a larger % change in quantity demanded.

[2]**[5 marks]**

Solution 22:

- Tariffs prevent foreign firms from predatory dumping of steel below marginal production costs.
- Protection avoids immediate structural unemployment for steelworkers possessing highly specific, immobile skill sets.
- Trade barriers give Cortovia's declining steel mills vital time to restructure or phase out.
- Maintaining domestic steel production is strategically vital for Cortovia's military and national infrastructure.
- Saving mills prevents a severe negative multiplier effect from devastating allied regional supply chains.
- Restricting bulk steel imports reduces expenditure, directly improving Cortovia's current account balance deficit.
- Protection allows nascent, specialized green steel production in Cortovia to reach economies of scale.
- Quotas protect local steelworkers from unfair competition against nations exploiting cheap, unregulated labor.
- Tariffs prevent domestic production from moving to countries with weaker environmental and emissions regulations.
- Cortovia can use steel tariffs strategically as a bargaining tool against unfair foreign policies.
- Imposing tariffs on imported steel generates significant tax revenue for Cortovia's national government budget.
- Diverting consumption to domestic steel stimulates internal aggregate demand during an economic downturn.
- Maintaining a domestic steel sector diversifies Cortovia's economy, reducing vulnerability to global shocks.
- Protection prevents widening income inequality by saving vital blue-collar manufacturing jobs in Cortovia.
- Restricting imports preserves specialized metallurgical knowledge and essential human capital from permanent loss.

[5 marks]**Solution 23:****Benefits to the Firm (AeroSat)**

- Economies of Scale: Accessing the global satellite market significantly increases AeroSat's production volume, lowering its long-run average costs.
- Lower Input Costs: Importing specialized components (e.g., optical sensors) tariff-free directly reduces AeroSat's marginal cost of production.
- Efficiency: Exposure to foreign aerospace competitors forces AeroSat's management to eliminate organizational slack and operate more efficiently to survive.
- Dynamic Efficiency: Competing globally exposes AeroSat to international R&D, accelerating technological transfer and innovation in satellite design.
- Risk Diversification: AeroSat's revenue is no longer solely dependent on the domestic Meridian telecom sector, reducing its vulnerability to local economic shocks.

Benefits to the Country (Meridia)

- Comparative Advantage: Meridia can reallocate domestic resources to specialize in high-value aerospace manufacturing, increasing the country's total economic output.
- Export-Led Growth: Exporting high-value LEO satellites acts as a significant injection into Meridia's circular flow, driving GDP growth via the multiplier effect.
- Balance of Payments: Selling high-priced satellites internationally will improve the trade balance within Meridia's current account.
- Employment Generation: Expanding production to meet global demand increases the derived demand for labor, creating high-skilled jobs for Meridian aerospace engineers.
- Domestic Welfare: Meridian telecommunications firms and consumers gain access to cheaper, higher-quality, or more varied foreign satellite services due to the removal of import barriers.

[4 marks]

Solution 24:

i)

- Provides clear direction and transparency to financial markets regarding the central bank's primary objective.
- Successfully anchors the long-term inflation expectations of consumers and businesses.
- Reduces the likelihood of a wage-price spiral by anchoring inflation expectations and strengthening policy credibility, so workers and trade unions are less likely to seek large nominal wage increases to protect real incomes, employers are less willing to grant inflationary pay settlements, firms are less likely to raise prices in response to expected or actual labour-cost increases, and temporary inflation is less likely to become embedded in wage bargaining, price-setting behaviour, and future inflation expectations.
- Holds the central bank strictly accountable for its performance, as the target is a measurable metric.
- Helps prevent the time-inconsistency problem or political manipulation of monetary policy for short-term electoral gains.
- Promotes domestic and foreign direct investment by reducing uncertainty regarding the future purchasing power of the currency.
- Easier to communicate to the general public compared to complex, multi-variable economic mandates. [3]

ii)

- The Taylor Rule suggests that a central bank should set its short-term nominal interest rate rather than relying on strict discretion.
- It dictates adjusting the base interest rate in response to two main factors: the inflation gap and the output gap.
- The inflation gap represents the difference between actual current inflation and the target inflation rate.
- The output gap represents the difference between actual real GDP and potential GDP.
- Unlike a rigid inflation target, the Taylor Rule explicitly balances the dual mandates of price stability and economic growth/unemployment stabilization.
- If inflation rises above the target, the rule mandates a disproportionate increase in nominal interest rates to ensure real interest rates rise and cool the economy.
- If the economy enters a recession resulting in a negative output gap, the rule systematically advises lowering interest rates to stimulate aggregate demand.
- It provides a systematic, predictable, rule-based approach that can adapt to supply shocks better than a simple inflation target.

Mathematically, the Taylor Rule expresses the target short-term nominal interest rate as:

$$i_t = r^* + \pi_t + 0.5(\pi_t - \pi^*) + 0.5(y_t)$$

where,

- i_t = The target nominal interest rate
- r^* = The assumed natural or equilibrium real interest rate
- π_t = The current actual rate of inflation
- π^* = The central bank's target rate of inflation
- y_t = The output gap, which is the percentage deviation of actual real GDP from potential GDP

[3]
[6 Marks]

Solution 25:

1. The number of firms in the industry

The fewer the number of competing firms in the market, the greater the market power of an individual firm.

In markets with very few firms (e.g., monopoly or oligopoly), a firm faces less competition and has a greater ability to influence market prices.

2. The freedom of entry and exit (Barriers to entry)

A firm's market power is stronger when there are high barriers preventing new firms from entering the industry.

High sunk costs, patents, or regulatory restrictions deter potential entrants, allowing existing firms to maintain higher prices without the threat of new competition undercutting them.

3. The nature of the product

A firm enjoys greater market power if its product is highly differentiated from those of its competitors.

When a product has unique features, strong branding, or no close substitutes, consumers become brand loyal and are less likely to switch to rivals if the firm raises its price.

4. The shape of the firm's demand curve

The less elastic (steeper) the demand curve faced by the firm, the greater its market power.

If demand is price inelastic, a firm can increase its price without suffering a proportionately large decrease in the quantity demanded, giving it significant control over pricing.

[4 Marks]

Solution 26:

- Central banks are essential for controlling the money supply and implementing monetary policy to achieve macroeconomic stability.
- A primary mandate for most central banks is maintaining price stability, conventionally managed by adjusting base interest rates to influence aggregate demand.
- During periods of high inflation, a central bank would typically raise interest rates to increase the cost of borrowing and cool down economic activity.
- Central banks serve a crucial microeconomic role by actively regulating and supervising individual commercial banks to prevent excessive risk-taking.
- They enforce minimum capital adequacy requirements, ensuring banks hold sufficient equity buffers to absorb unexpected loan losses.
- They mandate statutory reserve and liquidity ratios to ensure banks maintain enough liquid assets to meet daily depositor withdrawals.
- They conduct regular stress tests on specific financial institutions to evaluate their resilience against hypothetical economic shocks.
- They oversee and secure the payment, clearing, and settlement systems to guarantee smooth daily transactions between institutions.
- They often coordinate with or manage deposit insurance schemes to maintain consumer confidence and prevent retail bank runs.
- They act as the "lender of last resort," providing emergency liquidity to solvent but illiquid commercial banks to prevent bank runs and systemic financial contagion.
- A critical policy conflict arises because aggressively raising interest rates to fight inflation directly reduces the market value of existing assets (such as government bonds) held by commercial banks.
- This monetary tightening can inadvertently trigger or exacerbate a severe liquidity crisis and threaten the solvency of the commercial banking sector.
- Conversely, if the central bank injects massive emergency liquidity to rescue struggling banks, it risks expanding the broader money supply and further fueling inflationary pressures.
- This dilemma is worsened when dealing with supply-side (cost-push) inflation, as demand-side monetary tools like rate hikes are relatively ineffective at solving root supply chain issues.
- A failure by the central bank to intervene during a banking crisis would destroy the credit multiplier effect, freezing lending to households and businesses entirely.
- Central banks are therefore crucial because they must delicately balance these conflicting objectives to prevent the economy from falling into stagflation or a complete financial collapse.
- To resolve this, central banks often must decouple their tools, utilizing targeted liquidity facilities or macro-prudential regulations for financial stability while using general interest rates for inflation.

[5 Marks]

Solution 27:**i)**

- VidyutGrid operates as a natural monopoly because supplying the entire Rajasthan-Maharashtra transmission demand via a single entity yields a significantly lower average cost than splitting the market among multiple grid companies.
- The firm's cost structure involves massive fixed infrastructure costs (₹85,000 crores) combined with very low marginal costs for transmitting each additional megawatt-hour of electricity.
- As a result, VidyutGrid experiences continuous economies of scale over the entire range of the market's transmission demand.
- This inherent cost structure creates a prohibitive barrier to entry, as any new competitor would face astronomical duplication costs without sufficient market share to achieve the incumbent's competitively low average costs.
- Furthermore, this natural barrier is reinforced by a legal barrier to entry, as the 30-year exclusive government concession explicitly prevents competitors from entering the market and building redundant lines along this route.

[2]

ii) Allocative Efficiency

- Allocative efficiency occurs where price equals marginal cost ($P = MC$), meaning resources are distributed optimally according to consumer preferences.
- As a profit-maximizing monopolist, VidyutGrid Corp will produce where marginal revenue equals marginal cost ($MR = MC$).
- Because the demand curve slopes downward, the price charged (average revenue) will be greater than the marginal revenue ($P > MR$).
- Therefore, at the profit-maximizing output level, $P > MC$, meaning the transmission fees will be higher and the volume of electricity transmitted will be lower than the socially optimal level.
- Consequently, VidyutGrid Corp will be allocatively inefficient.

Productive Efficiency

- Productive efficiency occurs when a firm produces at the lowest possible average cost (the minimum point on the average cost curve).
- VidyutGrid Corp faces downward-sloping average cost curves due to continuous economies of scale (as a natural monopoly).
- It will restrict output to maximize profit ($MR = MC$), which means it will not expand output to the point where average costs are minimized.
- Furthermore, protected by government legislation (the 30-year concession) and high barriers to entry, it faces no competitive pressure.
- This lack of competition may lead to X-inefficiency (organizational slack), where costs are higher than necessary due to a lack of incentive to control them.
- Therefore, VidyutGrid Corp is highly unlikely to be productively efficient.

[4]

[6 Marks]

Solution 28:

- A reduction in corporate taxes increases the after-tax profits and retained earnings of electrical wiring manufacturers.
- This raises the expected net return on new capital projects, shifting the marginal efficiency of capital curve outward.
- Firms will have greater internal liquidity to finance new extrusion machinery, upgrade wire-drawing technologies, or build new manufacturing facilities.

- Increased capital investment leads to an expansion in production capacity and an outward shift in the industry's long-run supply curve.
- The highly favourable tax environment may also attract foreign direct investment or joint ventures into the domestic building materials sector.
- However, investment might not increase if overall business confidence remains low due to a broader slowdown or high interest rates in the real estate market.
- Firms may choose to use the financial windfall from tax cuts to increase dividend payouts or conduct share buybacks instead of investing in physical capital.
- The sector may face structural supply-side bottlenecks, such as global price volatility or shortages in raw copper and insulation polymers, limiting actual output expansion despite the availability of funds.
- The resulting reduction in government tax revenue creates an opportunity cost for public finances.
- This could lead to reduced government spending on large-scale public infrastructure projects (which are major consumers of electrical wiring), ultimately constraining long-term demand in the sector.

[4 Marks]

Solution 29:**Aggregation and Intermediation**

- The financial sector acts as an intermediary by channeling funds from surplus units (domestic households) to deficit units (Aura Grid).
- It pools or aggregates small individual savings from millions of households into the large-scale capital amounts required for Aura Grid's offshore wind farms.

Maturity Transformation

- The financial sector resolves the maturity mismatch between the two parties through maturity transformation.
- Households require short-term liquidity (short maturity), whereas Aura Grid requires funds locked in for years to complete construction (long maturity).
- Financial institutions (like commercial banks or mutual funds) borrow "short" from households and lend "long" to Aura Grid, maintaining sufficient cash reserves to meet household withdrawal demands.

Risk Transformation and Diversification

- Financial intermediaries perform risk transformation by converting the high-risk profile of the wind farm project into a lower-risk profile for retail investors.
- Households have a low risk tolerance, while an individual infrastructure project carries high idiosyncratic risk.
- Intermediaries absorb this by diversifying household funds across multiple firms, sectors, and asset classes, thus shielding individual households from the failure of a single project like Aura Grid.

Overcoming Information Asymmetry (Screening and Monitoring)

- The financial sector provides an information function to bridge the knowledge gap between the parties.
- Households lack the technical expertise and resources to accurately assess the technological and financial viability of offshore wind farms.
- Financial institutions utilize specialized analysts to screen Aura Grid's proposals, assess their creditworthiness, and continuously monitor the project's progress on behalf of the households.

Liquidity Provision

- The financial sector creates secondary markets (e.g., stock or bond markets) that provide liquidity to the system.
- If Aura Grid issues long-term bonds or equities, financial markets allow initial investors to sell their assets quickly without demanding the underlying capital back from Aura Grid.

[5 Marks]
