

## Quadrant II - Notes

**Paper Code: ECS 104**

**Module Name: INTRODUCTION TO FINANCIAL MARKET**

**Module No: 01**

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### **MEANING**

- The term 'market' usually brings to mind a geographical place where people exchange goods and services.
- Generally speaking, there is no specific place or location to indicate a financial market.
- Whenever a financial transaction takes place, it is deemed to have taken place in the financial market.
- In other words, financial market is any market place where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. For e.g. stock of exchange or currency exchange.
- Financial market can be found in every nation in the world.
- A financial market is a transmission mechanism between investors-lenders and borrowers-users through which transfer of funds is facilitated.
- It consists of individual investors, financial institutions and credit instruments like bills of exchange, promissory notes, treasury bills, shares, debentures, bonds, etc.

### **FUNCTIONS OF FINANCIAL MARKETS**

#### **1. Mobilization of savings and channelising them into the most productive uses:**

- Facilitates transfer of savings from the savers to the investors.
- Financial markets help people to invest their savings in various financial instruments and earn income and capital appreciation.
- Facilitate mobilization of savings of people and their channelisation into the most productive uses.

## **2. Facilitate Price Discovery:**

- Price of anything depends upon the demand and supply factors.
- Demand and supply of financial assets and securities in financial markets help in deciding the prices of various financial securities; where business firms represent the demand and the households represent the supply.

## **3. Provide liquidity to financial assets:**

- Financial markets provide liquidity to financial instruments by providing a ready market for the sale and purchase of financial assets.
- Whenever the investors want, they can invest their savings into long term investments and whenever they want, they can sell the investments/instruments and convert them into cash.

## **4. Reduce the cost of transactions:**

- By providing valuable information to buyers and sellers of financial assets, it helps to save time, effort and money that would have been spent by them to find each other.
- Also investors can buy/sell securities through brokers who charge a nominal commission for their services. This way financial markets facilitate transactions at a very low cost.

## **MONEY MARKET AND CAPITAL MARKET**

- The main organized financial markets in India are the money market and the capital market.
- The first one is a market for short term securities while the second is a market for long term securities, i.e. securities having a maturity period of one year or more.

## **Money Market**

- Money market- financial institutions dealing in short-term funds which provides an outlet to lenders and a source of supply of funds to borrowers.
- The short period varies from a day to a few months i.e less than one year.
- Market for low risk, unsecured and short term debt instruments that are highly liquid are traded every day.
- Demand for short-term funds comes from Government, business concerns and private individuals.
- The main instruments of money market are treasury bills, commercial papers, commercial bills, certificate of deposits and call money.

## **Capital Market**

- Capital market is the market for medium and long term funds.
- The demand for long-term funds comes mainly from industry, trade, agriculture and government.
- The supply of funds comes largely from individual savers, corporate savings, banks, insurance companies, specialized financial institutions and government.
- Capital Market is a place where different financial instruments are traded between different entities.
- On one side, there are entities that have abundant capital, much more than they require and on the other side, there are entities who need capital for various purposes.
- Examples: stock market, bond market, currency and foreign exchange markets.

Examples of capital market includes:

1. Stock Market: A stock market, equity market or share market is the aggregation of buyers and sellers of stocks, which represent ownership claims on businesses

2. Bond Market: The bond market is a financial market where participants can issue new debt, known as the primary market, or buy and sell debt securities
3. Currency and Foreign Exchange Markets: The foreign exchange market is a global decentralized or over-the-counter market for the trading of currencies. This market determines foreign exchange rates for every currency.