Basics of Markets

Financial Market

- **Financial market** is a mechanism that allows people to buy and sell (trade) financial securities (such as stocks and bonds),commodities (such as precious metals or agricultural goods), and other fungible items of value at low transaction costs.
- financial markets facilitate:
  - The raising of capital (in the capital markets)
  - The transfer of risk (in the derivatives markets)
  - International trade (in the currency markets)

Types of Financial Market

- **Capital markets**
  - Stock markets
  - Bond markets
- **Commodity markets:** Trading of commodities.
- **Money markets:** Short term debt financing and investment
- **Derivatives markets**: Instruments for the management of financial risk
- **Insurance markets:** Redistribution of various risks
- **Foreign exchange markets:** Trading of foreign exchange

- Asset Classes
- Capital Market
- Primary Markets
- Secondary Markets
- Primary & Secondary Markets: Difference

Asset Classes

Capital Market

Primary Markets

Secondary Markets

Primary & Secondary Markets: Difference

Asset Classes

- Asset: Anything tangible or intangible that is capable of being owned or controlled to produce value and that is held to have positive economic value
- Type of Asset Classes

➢ Equity	--Interest Rate
➢ Bonds	-- Art
➢ Currency	-- Weather
➢ Commodity	-- Real Estate

Equity

- **Shareholders' equity** represents the remaining interest in assets of a company, spread among individual shareholders of common or preferred stock
  - stockholders' equity
  - shareholders' funds

Bonds

- **Bond** is a debt security in which
  - Authorized issuer owes the holders a debt and
  - Is obliged to pay interest (the coupon) and/or
  - To repay the principal at a later date,
  - At termed maturity.
- A bond is a formal contract to repay borrowed money with interest at fixed interval
- Issued by government and corporate
- Absorbed by Banks, Hedge Funds, MFs etc

Interest Rate Futures

- An **interest rate future** is a financial derivative (a futures contract) with an interest-bearing instrument as the underlying asset.
- Interest rate futures are used to hedge against the risk of that interest rates will move in an adverse direction, causing a cost to the company.

Commodity

- A **commodity** is a good for which there is demand, but which is supplied without qualitative differentiation across a market.
- Commodities are substances that come out of the earth and maintain roughly a universal price.
- Fungible, i.e. equivalent no matter who produces it.
- Types
  - Agricultural
  - Metals
  - Energy

Asset Classes

Capital Market

Primary Markets

Secondary Markets

Primary & Secondary Markets: Difference

Capital Market

- A market for securities (debt or equity), where business enterprises (companies) and governments can raise long-term funds.
- Money is provided for periods longer than a year
- Raising of short-term funds takes place on other markets (e.g., the money market).
- Classified as :

  Primary markets and **Secondary markets**

Asset Classes

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Primary & Secondary Markets: Difference

Primary Market

- Deals with the issuance of new securities
- Process of selling new issues to investors is called **Underwriting**
- New stock issue is called **Initial public offering (IPO)**
- Converts a “*Pvt ltd*” firm to a “*Public ltd*” firm

Primary Market : Features

- Market for new long term equity capital
- Also called the **New Issue Market (NIM)**
- In a primary issue, the securities are issued by the company directly to investors
- The company receives the money and issues new security certificates to the investors
- Accelerates the process of capital formation in a country's economy

Primary Market : Features

- Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business
- Securities are issued on an exchange basis
- The underwriters, that is, the investment banks, play an important role in this market: they set the initial price range for a particular share and then supervise the selling of that share

Primary Market : Features

- Does not include certain other sources of new long term external finance, such as loans from financial institutions
- Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as ***"going public"***
- The financial assets sold can only be redeemed by the original holder

Primary Market: Methods of Issuing Securities

- **Initial public offering**

  When an unlisted company makes either a

  fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public

- **A follow on public offering (Further Issue)**

  When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document

Primary Market: Methods of Issuing Securities

- **Rights issue** (for existing companies)

  When a listed company which proposes to issue fresh securities to its existing shareholders as on a record date

- **Preferential issue**

  An issue of shares or of convertible securities by listed companies to a select group of persons which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital

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Secondary Market

- Previously issued securities and financial instruments such as stock, bonds, options, and futures are bought and sold
- Securities are sold by and transferred from one investor or speculator to another
- Comprises of equity markets and the debt markets

Secondary Market : Role

- Provides an efficient platform for trading of investor's securities
- For the management of the company, Secondary equity markets serve as a monitoring and control conduit that guides management decisions by:
    1. Facilitating value-enhancing control activities
    2. Enabling implementation of incentive-based management performance
    3. Aggregating information (via price discovery)

Secondary Market : Features

- All the securities are first created in the primary market and then, they enter into the secondary market
- In the **Stock Exchange** where shares are daily traded, all the stocks belong to the secondary market
- Important role to play behind the developments of an efficient capital market

Secondary Market : Importance

- For example, In a traditional partnership, a partner can not access the other partner's investment but only his or her investment in that partnership, even on an emergency basis
- If he or she may breaks the ownership of equity into parts and sell his or her respective proportion to another investor
- This kind of trading is facilitated only by the secondary market

Secondary Market : Products

- The main financial products/instruments dealt in the Secondary market may be divided broadly into Shares and Bonds
- Shares are risky investments and offer higher returns at the cost of higher risks
- Bonds are low-risky investments and offer lower returns at the cost of lower risks

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Difference

- **Primary market** - Securities are offered to public for subscription for the purpose of raising capital or fund. It is a allotment/lottery market.
- **Secondary market** - An equity trading venue in which already existing/pre-issued securities are traded among investors. Secondary market could be either auction or dealer market. While stock exchange is the part of an auction market, Over-the-Counter (OTC) is a part of the dealer market.