

## FINANCIAL MARKETS

- Financial Markets refers to the system consisting of financial institutions, financial instruments, regulatory bodies and organisations
- It facilitates flow of debt and equity capital
- Financial Institutions (Banks), Development financial Institutions (NABARD, SIDBI, IDBI etc.) and Non-Banking Financial Institutions form Financial Institutions.
- Financial Instruments are shares, bonds, debentures etc.
- There are two types of Capital Flow – Lending and Borrowing

Financial markets consist of two major segments: (1) Money Market: the market for short term funds; (2) Capital Market: the market for long and medium term funds.

## **MONEY MARKET**

- According to the RBI, "The money market is the centre for dealing mainly of short character, in monetary assets; it meets the short term requirements of borrowers and provides liquidity or cash to the lenders.
- It is a place where short term surplus investible funds at the disposal of financial and other institutions and individuals are bid by borrowers, again comprising institutions and individuals and also by the government."

### Functions of Money Market

- To maintain monetary equilibrium. It means to keep a balance between the demand for and supply of money for short term monetary transactions.
- 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.
- To provide help to Trade and Industry. Money market provides adequate finance to trade and industry. Similarly it also provides facility of discounting bills of exchange for trade and industry.
- To help in implementing Monetary Policy. It provides a mechanism for an effective implementation of the monetary policy.
- To help in Capital Formation. Money market makes available investment avenues for short term period. It helps in generating savings and investments in the economy.
- Money market provides non-inflationary sources of finance to government. It is possible by issuing treasury bills in order to raise short loans. However this does not leads to increases in the prices.

Money Market consists of all the organizations and institutions which deal or facilitate dealings in short term debt instruments. These institutions include RBI, commercial banks, cooperative banks, non-banking financial companies like LIC, GIG, UTI and special institutions like Discount and Finance House of India (DFHI). The important money market instruments or securities (financial assets) are as follows.

## **CAPITAL MARKET**

- The capital market is the market, for medium and long term funds. It consists of all the financial institutions, organizations and instruments which deal in lending and borrowing transaction of over one year maturity.

Money Market	Capital Market
Deals with short-term financial transaction. (upto 1 year) Net lenders are people. Firms borrow to invest money to buy raw materials. This is a short-term transaction. This is called working capital finance.	Deals with medium and long-term financial transaction. Medium → 1-5 yrs. Long Term → Over 5 years

Investing in new machinery, setting up factories is long-term.	
Working capital finance.	Promotes capital formation.
Works only with bonds. Example: Commercial papers, commercial bills, treasury bills, etc.	Deals with both bonds and equity. Example: Debentures, shares, etc.
Deals with high volume transactions.	Deals with all value transactions.
Only banks are there.	All FIs are there.
General public does not participate much in money market. Money market.	General public also participates significantly
Prime regulator is RBI.	Prime regulator is SEBI. IRDA, PFRDA (Pension Fund Regulatory Authority)

**Treasury Bills:** They are promissory notes issued by the RBI on behalf of the government as a short term liability and sold to banks and to the public. The maturity period ranges from 14 to 364 days. They are the negotiable instruments, i.e. they are freely transferable. No interest is paid on such bills but they are issued at a discount on their face value.

**Commercial Bills:** They are also called Trade Bills or Bills of Exchange. Commercial bills are drawn by one business firm to another in lieu of credit transaction. It is a written acknowledgement of debt by the maker directing to pay a specified sum of money to a particular person. They are short-term instruments generally issued for a period of 90 days. These are freely marketable. Banks provide working capital finance to firms by purchasing the commercial bills at a discount; this is called 'discounting of bills'.

**Commercial Paper (CP):** The CP was introduced in 1990 on the recommendation of the Vaghul Committee. A commercial paper is an unsecured promissory note issued by corporate with net worth of at least Rs 5 crore to the banks for short term loans. These are issued at discount on face value for a period of 14 days to 12 months. These are issued in multiples of Rs 1 lakh subject to a minimum of Rs 25 lakh.

**Certificate of Deposit (CD):** The CD was introduced in 1989 on the recommendation of the Vaghul Committee. These are issued by banks against deposits kept by individuals and institutions for a period of 15 days to 3 years. These are similar to Fixed Deposits but are negotiable and tradable. These are issued in multiples of Rs. 1 lakh subject to a minimum of Rs25 lakh.

**Discount and Finance House of India Ltd.:** DFHI was set up as a subsidiary of RBI in 1988 on the recommendation of the Vaghul Committee. Its objective is to stimulate activity in, the money market by providing liquidity to the money market instrument. It buys bills and short term securities from banks and financial institution thereby developing a secondary market in them. DFHI was set up as a subsidiary of RBI in 1988 on the recommendation of the Vaghul Committee. Its objective is to stimulate activity in, the money market by providing liquidity to the money market instrument. It buys bills and short term securities from banks and financial institution thereby developing a secondary market in them.

## CAPITAL MARKETS

Primary Market	Secondary Market
* It issues security for the first time. Example- Initial public offer and follow on public offer.	* Existing securities are bought and sold.
* Firms issue shares to public.	* One investor sells it to another investor.
* Price is fixed by the firms.	* Price is fixed on the basis of demand and supply.
* Firms raise money for long-term investment.	* Companies benefit from the secondary markets.
* There is no specific geographical location.	* There is no specific geographical location.
* SEBI is the regulator for this market.	* SEBI is the regulator for this market as well.

### GILT-EDGED MARKET

The Gilt-edged market refers to the market for government and semi government securities, backed by the RBI. The term gilt-edged means 'of the best quality'. It is known so because the government securities do not suffer from the risk of default and are highly liquid. The RBI is the sole supplier of such securities. These are demanded by commercial banks, insurance companies, provident funds and mutual funds.

The gilt-edged market may be divided into two parts- the Treasury bill market and the government bond market. Treasury bills are issued to meet short-term needs for funds of the government, while government bonds are issued to finance long-term developmental expenditure.

### Stock Exchange

- It is an organisation which facilitates buying and selling of shares of listed companies.
- Listed companies are those companies which are registered with stock exchange.
- Only old shares are bought and sold because it is a secondary market.
- Price is based on demand and supply.
- Shares are auctioned.
- Demand and supply of shares are constructed on the bidding of people.
- Demands are created by buyers.

### Major stock exchanges of India

#### Bombay Stock Exchange (BSE)

- Oldest stock exchange of India as well as Asia (established in 1875)
- Approximately 5000 companies are listed in BSE
- Important Indices
  - 1. Sensex (Based on 30 companies)
  - 2. BSE-100 (Based on 100 companies)
  - 3. BSE-200 (Based on 200 companies)
  - 4. Dollex (Based on dollar value of BSE-200 companies)

- 5. Bankex (Based on shares of banks only)
- 6. Reality index (Based on shares of real estate companies)

Sensex (Sensitive Index) - Most important index of BSE - Index of a stock exchange measures change in market capitalisation

Criteria for selection of 30 companies

- Based on shares of large companies
- Shares must be frequently bought and sold
- There should be atleast one leading company from each sector'