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Financial Market

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ABSTRACT

A financial market is a market in which people and entities can trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds, and commodities include precious metals or agricultural goods.

There are both general markets (where many commodities are traded) and specialized markets (where only one commodity is traded). Markets work by placing many interested buyers and sellers, including households, firms, and government agencies, in one "place", thus making it easier for them to find each other. An economy which relies primarily on interactions between buyers and sellers to allocate resources is known as a market economy in contrast either to a command economy or to a non-market economy such as a gift economy.

In finance, financial markets facilitate:

- *The raising of capital (in the capital markets)*
- *The transfer of risk (in the derivatives markets)*
- *Price discovery*
- *Global transactions with integration of financial markets*
- *The transfer of liquidity (in the money markets)*
- *International trade (in the currency markets)*

KEYWORDS :

DEFINITION
In economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them. The term “market” is sometimes used for what are more strictly *exchanges*, organizations that facilitate the trade in financial securities, e.g., a stock exchange or commodity exchange. This may be a physical location (like the NYSE, BSE, and NSE) or an electronic system (like NASDAQ). Much trading of stocks takes place on an exchange; still, corporate actions (merger, spinoff) are outside an exchange, while any two companies or people, for whatever reason, may agree to sell stock from the one to the other without using an exchange. Trading of currencies and bonds is largely on a bilateral basis, although some bonds trade on a stock exchange, and people are building electronic systems for these as well, similar to stock exchanges. Financial markets can be domestic or they can be international.

TYPES OF FINANCIAL MARKETS
Within the financial sector, the term “financial markets” is often used to refer just to the markets that are used to raise finance: for long term finance, the Capital markets; for short term finance, the Money markets. Another common use of the term is as a catchall for all the markets in the financial sector, as per examples in the breakdown below.

Capital markets which consist of:
- Stock markets, which provide financing through the issuance of shares or common stock, and enable the subsequent trading thereof.
- Bond markets, which provide financing through the issuance of bonds, and enable the subsequent trading thereof.
- Commodity markets, which facilitate the trading of commodities.
- Money markets, which provide short term debt financing and investment.
- Derivatives markets, which provide instruments for the management of financial risk.
- Futures markets, which provide standardized forward contracts for trading products at some future date; see also forward market.
- Insurance markets, which facilitate the redistribution of various risks.
- Foreign exchange markets, which facilitate the trading of foreign exchange.

The capital markets may also be divided into primary markets and secondary markets. Newly formed (issued) securities are bought or sold in primary markets, such as during initial public offerings. Secondary markets allow investors to buy and sell existing securities. The transactions in primary markets exist between issuers and investors, while in secondary market transactions exist among investors.

RAISING CAPITAL
Financial markets attract funds from investors and channel them to corporations they thus allow corporations to finance their operations and achieve growth. Money markets allow firms to borrow funds on a short term basis, while capital markets allow corporations to gain long-term funding to support expansion.

Without financial markets, borrowers would have difficulty finding lenders themselves. Intermediaries such as banks, Investment Banks, and Boutique Investment Banks can help in this process. Banks take deposits from those who have money to save. They can then lend money from this pool of deposited money to those who seek to borrow. Banks popularly lend money in the form of loans and mortgages.

LENDERS
Lenders who have enough money to lend or to give someone money from own pocket at the condition of getting back the principal amount or with some interest or charge, is the Lender Individuals & Doubles.

Many individuals are not aware that they are lenders, but almost everybody does lend money in many ways. A person lends money when he or she:

- puts money in a savings account at a bank;
- contributes to a pension plan;
- pays premiums to an insurance company;
- invests in government bonds; or
- Invests in company shares.

COMPANIES
Companies tend to be borrowers of capital. When companies have surplus cash that is not needed for a short period of time, they may seek to make money from their cash surplus by lending it via short term markets called money markets.

There are a few companies that have very strong cash flows. These companies tend to be lenders rather than borrowers. Such companies may decide to return cash to surplus (e.g. via a share buyback.) Alternatively, they may seek to make more money on their cash by lending it (e.g. investing in bonds and stocks).

BORROWERS
- Individuals borrow money via bankers' loans for short term needs or longer term mortgages to help finance a house purchase.
- Companies borrow money to aid short term or long term cash flows. They also borrow to fund modernization or future business expansion.
- Public Corporations typically include nationalized industries. These may include the postal services, railway companies and utility companies.
- Borrowers having similar needs can form into a group of borrowers. They can also take an organizational form like Mutual Funds.

DERIVATIVE PRODUCTS
In the financial markets, stock prices, bond prices, currency rates, interest rates and dividends go up and down, creating risk. Derivative products are financial products which are used to control risk or paradoxically exploit risk. It is also called financial economics.

Derivative products or instruments help the issuers to gain an unusual profit from issuing the instruments. For using the help of these products a contract has to be made. Derivative contracts are mainly 3 types

- Future Contracts
- Forward Contracts
- Option Contracts.

CURRENCY MARKETS
The most obvious buyers and sellers of currency are importers and exporters of goods. While this may have been true in the distant past, when international trade created the demand for currency markets, importers and exporters now represent only 1/32 of foreign exchange dealing, according to the Bank for International Settlements.

The picture of foreign currency transactions today shows:

- Banks/Institutions
- Speculators
- Government spending (for example, military bases abroad)
- Importers/Exporters
- Tourists

FINANCIAL MARKET SLANG
- Poison pill, when a company issues more shares to prevent being bought out by another company, thereby increasing the number of outstanding shares to be bought by the hostile company making the bid to establish majority.
- Quant, a quantitative analyst with a PhD (and above) level of training in mathematics and statistical methods.
- Rocket scientist, a financial consultant at the zenith of mathematical and computer programming skill.
- White Knight, a friendly party in a takeover bid. Used to describe a party that buys the shares of one organization to help prevent against a hostile takeover of that organization by another party.
- Smurfing, a deliberate structuring of payments or transactions to conceal it from regulators or other parties, a type of money laundering that is often illegal.
- Spread, the difference between the highest bid and the lowest offer.

FUNCTIONS OF FINANCIAL MARKETS
Intermediary Functions
The intermediary functions of financial markets include the following:

Transfer of Resources
Financial markets facilitate the transfer of real economic resources from lenders to ultimate borrowers.

Enhancing income
Financial markets allow lenders to earn interest or dividend on their surplus invisible funds, thus contributing to the enhancement of the individual and the national income.

Productive usage
Financial markets allow for the productive use of the funds borrowed. The enhancing income leads the gross national production.

Capital Formation
Financial markets provide a channel through which new savings flow to aid capital formation of a country.

Price determination
Financial markets allow for the determination of price of the traded financial assets through the interaction of buyers and sellers. They provide a sign for the allocation of funds in the economy based on the demand and supply through the mechanism called price discovery process.

Sale Mechanism
Financial markets provide a mechanism for selling of a financial asset by an investor so as to offer the benefit of marketability and liquidity of such assets.

Information
The activities of the participants in the financial market result in the generation and the consequent dissemination of information to the various segments of the market, so as to reduce the cost of transaction of financial assets.

FINANCIAL FUNCTIONS
- Providing the borrower with funds so as to enable them to carry out their investment plans.
- Providing the lenders with earning assets so as to enable them to earn wealth by deploying the assets in production debentures.
- Providing liquidity in the market so as to facilitate trading of funds.
- It provides liquidity to commercial bank
- It facilitate credit creation
- It promotes savings
- It promotes investment
- It facilitates balance economic growth
- It improves trading floors

CONSTITUENTS OF FINANCIAL MARKET BASED ON MARKET LEVELS
Primary market
Primary market is a market for new issues or new financial claims. Hence it's also called new issue market. The primary market deals with those securities which are issued to the public for the first time.

Secondary market
It's a market for secondary sale of securities. In other words, securities which have already passed through the new issue market are traded in this market. Generally, such securities are quoted in the stock exchange and it provides a continuous and regular market for buying and selling of securities.

BASED ON SECURITY TYPES

Money market

Money market is a market for dealing with financial assets and securities which have a maturity period of up to one year. In other words, it's a market for purely short term funds.

Capital market

A capital market is a market for financial assets which have a long or indefinite maturity. Generally it deals with long term securities which have a maturity period of above one year. Capital market may be further divided into:

(a) Industrial securities market
(b) Govt. securities market and
(c) Long term loans market.

Equity markets

A market where ownership of securities are issued and subscribed is known as equity market. An example of a secondary equity market for shares is the Bombay stock exchange.

Debt market

The market where funds are borrowed and lent is known as debt market. Arrangements are made in such a way that the borrowers agree to pay the lender the original amount of the loan plus some specified amount of interest.

DERIVATIVE MARKETS

Financial service market

A market that comprises participants such as commercial banks that provide various financial services like ATM. Credit cards. Credit rating, stock broking etc. is known as financial service market.

Depository markets

A depository market consist of depository institutions that accept deposit from individuals and firms and uses these funds to participate in the debt market, by giving loans or purchasing other debt instruments such as treasure bills.

Non-Depository market

Non-depository market carries out various functions in financial markets ranging from financial intermediary to selling, insurance etc. The various constituencies in non-depositary markets are mutual funds, insurance companies, pension funds, brokerage firms etc.

NOTES

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