Capital Market (PUN019)

A **capital market** is a financial market in which long-term debt (over a year) or equity-backed securities are bought and sold,[1] in contrast to a money market where short-term debt is bought and sold. Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.[a] Financial regulators like Securities and Exchange Board of India (SEBI), Bank of England (BoE) and the U.S. Securities and Exchange Commission (SEC) oversee capital markets to protect investors against fraud, among other duties. Transactions on capital markets are generally managed by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. As an example, in the United States, any American citizen with an internet connection can create an account with Treasury Direct and use it to buy bonds in the primary market, though sales to individuals form only a tiny fraction of the total volume of bonds sold. Various private companies provide browser-based platforms that allow individuals to buy shares and sometimes even bonds in the secondary markets. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments. Physically, the systems are hosted all over the world, though they tend to be concentrated in financial centers like London, New York, and Hong Kong. A capital market can be either a primary market or a secondary market. In a primary market, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary market, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises. A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors). A business needs two types of funding to succeed. These are generally short-term working capital requirements and long-term fixed capital requirements. To meet short-term or working capital needs, companies take out loans and issue promissory notes and other securities on the money market. On the other hand, companies raise long-term funds or fixed capital by issuing shares, bonds, or debentures on the capital market. Capital markets are marketplaces for buying and selling bonds, stocks, currencies and other financial assets. They assist entrepreneurs and help small businesses grow into big ones. Additionally, they provide opportunities for regular people to invest and save for their future. Capital markets are key engines of economic growth and wealth creation in any economy. Learn more about capital market meaning, its types, and functions in this blog. A capital market is a platform for channeling savings and investments among suppliers and those in need. An entity with a surplus fund can transfer it to another that needs capital for its business purpose through this platform. Typically, suppliers include banks and investors who offer capital for lending or investing. Businesses, governments, and individuals seek capital in this market. A capital market aims to improve transaction efficiency by bringing together suppliers and investors and facilitating their share exchange. A capital market is a broad term for the physical and online spaces where financial instruments are traded. Stock markets, bond markets, and currency markets (forex) are all types of capital markets. They facilitate the sale and purchase of equity shares, debentures, preference shares, zero-coupon bonds, and debt instruments.

Capital Market: After discussing the capital market definition, let’s find out how the capital market works, capital markets assist economies by providing a platform for raising funds to operate businesses, develop projects, or enhance wealth. Capital markets function according to the circular flow of money theory. Typically, capital markets are used for selling financial products such as stocks and bonds. Stocks, or ownership shares of a company, are equities. A bond is an interest-bearing IOU, as are other debt securities. A firm, for example, borrows money from households or individuals for business operations. Individuals or households invest money in a company's shares or bonds in the capital markets. In exchange for their investment, investors gain profits and goods. The capital market consists of finance suppliers and buyers, as well as trading instruments and mechanisms. Regulatory bodies are also present.

Primary Markets: Primary capital markets are where companies first sell new stock or bonds publicly. Also known as the 'New Issues Market', it is a place where businesses and governments seek out new financing. The new money is converted into debt or shares of the company. Debt or stocks are locked in until they are sold on a secondary market, repurchased by the company, or mature, primary capital markets trade two major financial instruments: equities (stocks) and debt.

Initial Public Offering (IPO): is the process of introducing new equities to the market. It's simply the process of selling part of a company to the public for capital. Bonds, on the other hand, are a bit more complicated. Underwriters act as intermediaries in the issuance of bonds. If Company A wants to issue INR 10 crore in bonds, it goes to the underwriter. These bonds are then issued and sold by the underwriter to investors. In this instance, the underwriter is responsible for ensuring that Company A gets the capital it needs. A bond underwriter buys bonds from Company A and then sells them on the market - typically at a higher price. The underwriter then takes on the risk, but Company A receives the entire loan.

Secondary Market: Investors trade old debt or stocks on the secondary capital market. It differs from the primary market because the debt has already been issued here. Investors trade stock in the secondary capital markets through exchanges such as the Bombay Stock Exchange, the Calcutta Stock Exchange, and the New York Stock Exchange. A stock exchange also allows people to sell the old stock if they no longer want it, which results in the 'liquidation' of these stocks. Thus, the seller now has cash rather than an asset. Unlike stocks, bonds are typically held for a longer period - usually until they expire. However, those who hold bonds but need cash quickly can rely on the secondary market. Investors use the secondary market to obtain cash, either to invest in another stock or for personal consumption. It involves liquidating assets so that other things can be purchased.

Elements of a Capital Market:

- Market sources of funds include individual investors, financial institutions, insurance companies, commercial banks, businesses, and retirement funds.
- Investors invest money intending to make capital gains as their investments grow over time. They also receive dividends, interest, and ownership rights.
- Fund-seekers include companies, entrepreneurs, governments, etc. For example, to fund the economy and development projects, the government issues bonds and deposits.
- These markets usually trade long-term investments such as stocks, bonds, debentures, and government securities. Moreover, hybrid securities like convertible debentures and preference shares are available.
- The market is primarily operated by stock exchanges. Brokerage firms, investment banks, and venture capitalists are other intermediaries.
- The regulatory bodies are responsible for monitoring and eliminating any illegal activities in the capital market. Securities and Exchange Commission, for example, oversees stock exchange operations.

Functions of Capital Market:

- **Links Borrowers and Investors:** Capital markets serve as an intermediary between people with excess funds and those in need of funds.
- **Capital Formation:** The capital market plays an important role in capital formation. By timely providing sufficient funds, it meets the financial needs of different sectors of the economy.
- **Regulate Security Prices:** It contributes to securities' stability and systematic pricing. The system monitors whole processes and ensures that no unproductive or speculative activities occur. A standard or minimum interest rate is charged to the borrower. As a result, the economy's security prices stabilize.
- **Provides Opportunities to Investors:** The capital markets have enough financial instruments to meet any investor's needs, regardless of the risk level. Capital markets also provide investors with the opportunity to increase their capital yields. The interest rate on most savings accounts is extremely low compared to the rate on equities. Therefore, investors can earn a higher rate of return on the capital market, though some risks are involved as well.
- **Minimizes Transaction Cost and Time:** Long-term securities are traded on the capital market. The whole trading process is simplified and reduced in cost and time. A system and program automate every aspect of the trading process, thus speeding up the entire process.
- **Capital Liquidity:** The financial markets allow people to invest their money. In exchange, they receive ownership of a stock or bond. Bond certificates cannot be used to purchase a car, food, or other assets, so they may need to be liquidated. Investors can sell their assets for liquid funds to a third party on the capital markets.

Thank You…