MARKETS

Chapter markets financial/capital/money
Learning basic concepts!

What is a market?

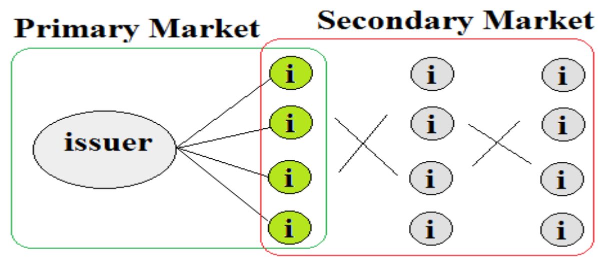
Market is a place where goods or services are exchanged between buyers and sellers (agents). There can be various types of markets.
To understand concept of market focus on three key things

1. What we are buying and selling (product)?
2. In exchange of what we are buying or selling (underlying instruments)
3. Who are participants in market (agents)?
   Example -Rice (product) sell by a farmer to rice mill (participants) in exchange of money (underlying instrument)

Types	Product	Agents	Instruments
Commodity markets	Buying & selling of commodities -rice, wheat, oil	Producers and consumers	Money (Rs, dollar etc)
Equity markets	Buying & selling of shares of companies	Shareholders, companies	Money
Capital markets	Buying & selling of Money for long terms	Companies , Govt, financial institutions, banks	Paper instruments, bond papers, shares,
Money markets	Buying & selling of Money for short terms	Banks, financial institutions, companies	Paper instruments, commercial papers
Forex markets	Buying & selling of foreign currencies	Central banks (RBI)	

Primary and secondary markets

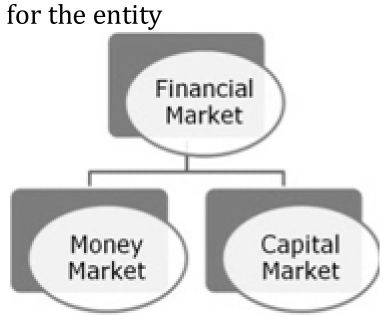
Every market can be classified on basis of instance of exchange of products. If agents exchanges a product very first instance it is known as **primary market**. If the same product is further exchanges between more agents, it is known as secondary markets. For example a company (say reliance) 1st time issues shares to public (IPO) it is known as primary market. Here agents are company & people who are buying shares. But if the same shares are further exchanged among people, it is known as secondary market.
See image below - imagine a company (issues) share to people (investors =i)
When very first time exchange of shares take place between a company and investors = Primary market
Next, if investors trade share between themselves (@ stock exchanges) = secondary market



Primary market	Secondary market
Fresh new public issue of securities for 1st time.	Trade between already issued securities
New funds are raised by borrowers	No new funds, provide liquidity for seller
User – govts, companies etc	Investors trade among themselves

Financial markets

Financial markets can either be a **Money Market** where extremely liquid financial instruments for <u>short terms</u> are traded or a **Capital Market** where buying and selling in securities are done to raise lo<u>ng term </u>funds for the entity



Capital Markets - Long Term Fund Raising

Capital Market where buying and selling in securities are done to raise lo<u>ng term </u>funds for the entity.
There are primarily two ways by which we can raise funds in capital markets. Let us understand with help of a rough example
Suppose a company want to raise funds. It has primarily two options. See below

How a company raise funds for business activities	
Issues Bonds (DEBT)	**Issues shares(EQUITY)**
A bond is a paper instrument in exchange of which a company raise funds from lenders on certain interest rate for fixed time period. On completion of this time (maturity) company return total amount Principal+interest Example - company writes on a piece of paper: "To whoever pays me Rs.1000, I'll pay annual 10% interest rate (Rs.100). And after 5 years, I'll also repay the	A share is a unit of ownership that a company gives to a shareholder in exchange of money received. Example - Company take money from people and in return offer people a partnership in company. This is called *Equity*

principle amount Rs.1000. No "ifs" and "buts".	
Company borrow money & paid fixed interest in return to investor. Even if a company losses, it will pay complete amount along with interest → fixed & definite return guaranteed	No fixedreturn guaranteed. Company borrow money & in return give a share of ownership in company. If a company losses, its share price may come down & no guarantee of returns in this case.

Derivatives

Prices of things constantly change and that is a risk for any business. Producer face low price risk while consumer faces high prices risk. For example take oil prices → oil prices almost crashed in last 2-3 years→ to meet such risks arising from market fluctuations, derivative instruments are designed.

Derivatives – financial **contract**whose value depends upon underlying assets. Assets can be equity, commodity, currency and simply indicators stock market index.

Why derivatives?

Different type of risks in financial markets – stock prices, interest rates, exchange rates etc. to reduce these risks

Type of derivatives

Forwards/ Futures –contract to buy or sell an asset at a predetermined prices and on a predetermined date.

Swaps – bank buys or sells the foreign currency simultaneously at the same rate but for different time periods. Ex- buy for 2 month forward and sell of 3 month forward. Allow better management of funds.

Options- contract hereby one party has option to buy or sell at predetermined prices on or before predetermined period

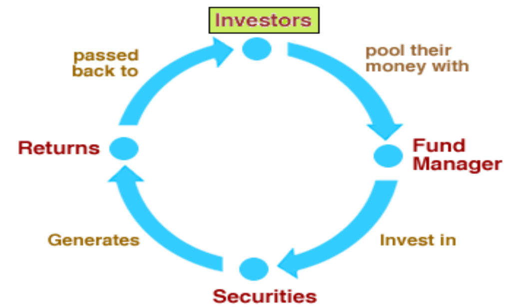
Mutual funds

Mutual funds are investment avenues that pool the money of several investors to invest in financial Instruments such as stocks, debentures etc. The profit earned on the investments is distributed among the investors on the basis of the units held by each of them. Due to a large pool of investors, the individual risk is spread. So individually you take on low risk.

The mutual funds in India are governed by Association of

Mutual Funds in India, the umbrella body for mutual funds, which is in turn governed by the Securities and Exchange Board of India.

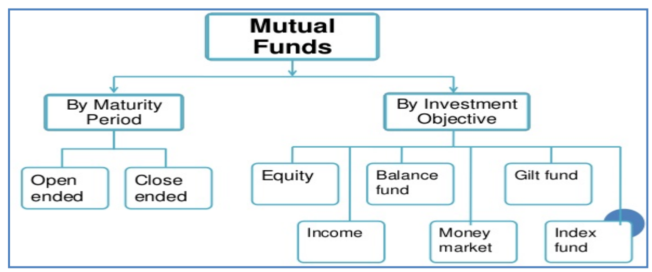
A diagrammatic representation to understand the Cycle"



Type of mutual funds

Open-end mutual funds which buy/sell back their shares from their investors at the end of every business day .

Closed-end funds generally issue shares to the public only once, when they are created through initial public offerings. After that investor can not sell his share to fund but can trade it only on stock market with other investors.



Dematerialization

Earlier Stock market trading involved too much paperwork complexities, since shares were held in the physical form.

Thus dematerialized account (**Demat Account**) came into existence, where your shares and securities are held in the electronic form instead of paper form.

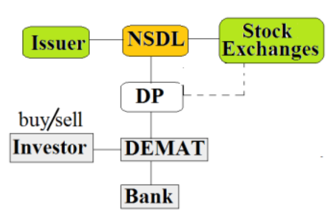
who open these accounts for the investors - Participants (DP) like banks, broking house, NBFC's, act as a link between the depositories and the investors

Depositories plays an important role as they are the ones who hold securities like shares, bonds.

NSDL - national securities depository limited - provide depository services where record & stock of shares/bonds maintained.

See image below - how demat a/c works.

Issuer is a company who issues shares - after that how these shares are traded- follow image

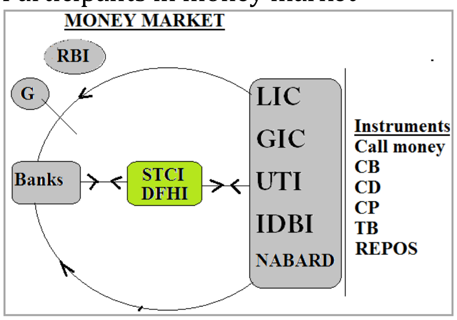


Money markets

"Money Market" refers to the market for short-term requirement and deployment of funds. Money market instruments are those instruments, which have a maturity period of less than one year.
The most active part of the money market is the market for overnight call and term money between banks and institutions and repo transactions. Money Market is regulated by RBI.

Why need of Money markets

There is always short term requirements or mismatches in cash flows for day to day requirements? To fullfill these requirements we need quick exchange of funds for short terms.
Participants -Commercial Banks, Mutual Funds, Corporate, Financial Institutions, Provident or Pension Funds and Insurance Companies can Trading companies, central banks.
Participants in money market



Instruments of money market

Call , Notice, term Money Market -borrowing or lending of funds for **1 day or a night**. If it is for **2 days and 14 days** it is known as Notice Money'. Term Money refers to borrowing/lending more than14 Days

Treasury Bill Market (T - Bills) : Short-term debt obligations of a national government that are issued to mature in three to twelve months. issued by RBI on behalf of Government of India. At present three types of treasury bills are issued through auctions, namely 91 day, 182 day and 364 day treasury bills.

Certificate Of Deposits (CDs) : It is issued against funds deposited at a bank. Minimum amount of a CD should be Rs.1 lakh and in multiples of Rs. 1 lakh thereafter. *CDs can be issued by* Scheduled commercial banks (excluding Regional Rural Banks and Local Area Banks) All-India Financial Institutions (FIs)The maturity period of CDs issued by banks should not be less than 7 days and notmore than one year, from the date of issue.

Commercial Papers (CP) : can be issued by listed company which have working capital of not less than Rs. 5 crores. They could be issued in multiple of Rs. 25 lakhs. The minimum size is Rs. 1 crore. CPs are issued at a discount to its face value and redeemed at its face value.

The Repo instruments- Repo is a repurchase agreement. It means selling a security under an agreement to repurchase it at a predetermined date and rate. Repo transactions are affected between banks and financial institutions and among bank themselves, RBI also undertake Repo.

Instrument	Issuer
Treasury Bills (T – Bills)	national **government**
Certificate Of Deposits (CDs)	Scheduled commercial **banks** (excluding Regional Rural Banks and Local AreaBanks) All-India Financial Institutions . min 1 lakh
Commercial Papers (CP)	**listed company.** Min 1 cr
Bankers Acceptance	**non-financial firm**, backed by a guarantee from the bank.
The Repo Market-	banks and financial institutions

Discount and Finance House of India (DFHI) –

In 1988, DFHI was set up by RBI. It is playing an important role in developing an active secondary market in Money Market Instruments. Similarly **STCI-** Securities Trading Corporation of **India** Limited

Comparison	Money Market	Capital Market
Meaning	A segment of the financial market where lending and borrowing of **short term** securities are done.	A section of financial market where **long term** securities are issued and traded.
Time Horizon	Within a year	More than a year
Financial instruments	Treasury Bills, Commercial Papers, Certificate of Deposit, Trade Credit etc (papers)	Shares, Debentures, Bonds, Retained Earnings, Asset Securitization, Euro Issues etc.
Risk Factor	Low	Comparatively High
Merit	Increases liquidity of funds in the economy.	Mobilization of Savings in the economy.
Return on Investment	Less	Comparatively High