Unit 21. Financial Market : Money Market and Capital Market

Fund Raising By Business Units

Business units have to raise short-term as well as long-term funds to meet their working and fixed capital requirements from time to time. From where would they get funds from? Ans : From investors or lenders. Surplus money flows from the investors or lenders to the businessmen for the purpose of production or sale of goods and services. So, we find two different groups, one who invest money or lend money and the others, who borrow or use the money.

Financial Market

Financial market is the market that facilitates transfer of funds between investors/ lenders and borrowers/ users. Financial market may be defined as 'a transmission mechanism between investors (or lenders) and the borrowers (or users) through which transfer of funds is facilitated'. It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network for trading the various financial assets and credit instruments. It deals in financial instruments (like bills of exchange, shares, debentures, bonds, etc).

Main functions of financial market

Let us now see the main functions of financial market.
(a) It provides facilities for interaction between the investors and the borrowers.
(b) It provides pricing information resulting from the interaction between buyers and sellers in the market when they trade the financial assets.
(c) It provides security to dealings in financial assets.
(d) It ensures liquidity by providing a mechanism for an investor to sell the financial assets.
(e) It ensures low cost of transactions and information.

Classification of Financial Market

A financial market consists of two major segments: (a) Money Market; and (b) Capital Market. While the money market deals in short-term credit, the capital market handles the medium term and long-term credit.

Financial Market Classification

A. **Money Market.**
   i. Call Money.
   ii. Treasury Bill.
   iii. Commercial Paper.
   iv. Certificate of Deposit.
   v. Trade bill.

B. **Capital Market.**
   i. Securities Market
      a. Primary Market : IPOs, Book Building, Private Placements.
      b. Secondary Market : Equity Market, Debt Market, Commodity Market, Futures and Options Market. (Secondary Market can be basically divided into two – spot market and forward market. Forward market has two divisions – futures and options/derivatives. Again, there are two types of options – put option and call option.)
   ii. Non-Securities Market
      a. Mutual Funds.
      b. Fixed Deposits, Savings Deposits, Post Office savings.
      c. Insurance.

Money Market

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is upto one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for **credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc.** These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement.
The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

Capital Market

Capital Market is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various ***securities such as shares, debentures, bonds, etc***. The securities market has two different segments namely primary and secondary market.

Primary Market vs Secondary Market : The primary market consists of arrangements for procurement of long-term funds by companies by fresh issue of shares and debentures. *The secondary market or stock exchange* provides a ready market for existing long term securities. Stock exchange is the secondary market, which provides a place for regular sale and purchase of different types of securities like shares, debentures, bonds & government securities. It is an organised market where all transactions are regulated by the rules and laws of the concerned stock exchanges.

Secondary Markets or Stock Exchanges : The functions of a stock exchanges are to provide ready and continuous market for securities, information about prices and sales, safety to dealings and investment, helps mobilisation of savings and capital formation. It acts as a barometer of economic and business conditions and helps in better allocation of funds. Stock exchanges provide many benefits to companies, investors and the society as a whole. But they also suffer from limitations like exclusive speculation and fluctuation in prices due to rumours and unpredictable events. There are 21 stock exchanges in India presently, including BSE, NSE and OTCEI. Stock Exchanges are regulated by the Securities Contracts (Regulation) Act and by SEBI. SEBI has initiated a number of reforms in the primary and secondary market to regulate the stock market. Documentary and procedural requirements for listing and trading have been made stricter and foolproof to protect investors' interest.

The secondary market has further two components. First, the ***spot market*** where securities are traded for immediate delivery and payment. The other is ***forward market*** where the securities are traded for future delivery and payment. This forward market is further divided into **Futures** and **Options Market (Derivatives Markets)**. In futures Market the securities are traded for conditional future delivery whereas in option market, two types of options are traded. A put option gives right but not an obligation to the owner to sell a security to the writer of the option at a predetermined price before a certain date, while a call option gives right but not an obligation to the buyer to purchase a security from the writer of the option at a particular price before a certain date.

Money Market and Capital Market : A comparison

Point of Distinction	Money Market	Capital Market
1. Time period / Term	Deals in short-term funds.	Long term funds.
2. Instrument Dealt In	Deals in securities like treasury bills, commercial paper, bills of exchange, certificate of deposits etc.	Deals in securities like shares, debentures, bonds and government securities.
3. Participants	Commercial banks, NBFS, chit funds etc.	Stock brokers, under writers, mutual funds, individual investors, financial institutions
4. Regulatory body	RBI	SEBI