

UNIT 8- Capital Market Instruments with Examples - Explained



Introduction

It refers to the market for funds with a **maturity of 1 year and above** (term funds). Both the government and private sector participate in this market for investment purposes. A capital market can be a **primary market or secondary market**. In Primary markets, new stocks and bonds are issued & in secondary markets, existing securities are bought and sold among investors.

Capital Market Instruments

G-secs

- **Tradable instruments** issued by the central government or state governments.
- They are both short term (T- bills) and long term (Dated bonds or Govt bonds)
- Do not carry any risk of default and are hence called '**risk-free gilt-edged securities**'.
- GoI also issues savings instruments (savings bonds, NSCs or special securities (power bonds, oil bonds) but they are not fully tradable.
- Dated govt securities are long-term and carry a fixed or floating coupon rate which is payable at fixed time periods. The maturity of these securities can be up to **30 years**.
- Dated security can be issued to any person, firm, corporates, state govt's and trusts.
- Foreign companies owned by NRIs and FIIs registered with SEBI can also invest in them.
- **Floating Rate Bonds** carry variable interest rates with fixed percentage pegged to some benchmark rate.
- **Capital Indexed Bonds** carry a fixed interest rate over wholesale price index or consumer price index.
- **Inflation Indexed Bonds** carry interest rates linked to inflation rates (observed from WPI earlier, now CPI) so that real return is positive from investments.
- Lately, RBI has allowed sovereign wealth funds, endowment funds, insurance and pension funds & foreign central banks (Federal Reserve etc) to invest in G-secs if they are registered with SEBI.

Mutual Funds

- Mutual funds raise money from the public, pool them and invest in stock market.
- They are regulated by SEBI.
- Structure of a mutual fund is as follows:
 - **Sponsor** - the person who alone or in association with another organisation establishes a mutual fund.
 - **Trust** - It is registered as a trust according to provisions of Indian Trust Act, 1882 (for private trusts)
 - **Trustee** - a corporate body which safeguards the interests of unit holders
 - **Custodian** - A bank or a financial institution registered with SEBI which holds and safeguards the securities owned within a mutual fund. E.g. SBI is the custodian of SBI mutual fund.

Hedge Funds

- A **pooled investment** which is professionally administered by a firm.
- They invest in diverse markets and use various investment styles.
- They are comparatively **more risk** prone, aim at **faster returns** and generally avoid regulatory oversight.
- Available only to certain investors and **can't be** sold to general public.
- They are a form of Alternate Investment Funds (AIFs).

Alternative Investment Funds (AIFs)

- Newly created investment vehicle where investments are pooled in from real estate, hedge funds and private equity. Capital can be pooled from both Indian and foreign investors.
- Regulated by SEBI.
- It **excludes** mutual funds, employee stock option and family trusts.

Venture Capital

- Money provided by **financial institutions** for investment in rapidly growing companies.
- They manage the new firms alongside investing, as per terms.
- It's an important source of raising capital for **start-up** companies.

Angel Investors

- An **individual** who provides capital for a business starts up.
- Usually, the investment is in exchange for convertible debt or ownership equity.
- They invest their **own money**, unlike venture capitalist who invests public money.
- AIs can register themselves as AIFs as per SEBI.
- Minimum investment should be Rs **25 lacs**.

Chit Funds

- An arrangement that a group of people arrive at to contribute money in a manner at periodic intervals into a kitty.
- A member can withdraw that money through a lucky draw, auction or other agreed ways.
- Usually popular in Rural India, Tier2 and Tier3 cities due to under penetration of banking services.
- Chit funds are established under **Central chit funds act, 1982**.
- An office "**Registrar of Chit funds**" in every state monitors their operations.

Exchange Traded Funds (ETFs)

- These are index funds listed and traded on stock exchanges.
- They comprise of a **basket of stocks** that has a composite index and the value of that depends on underlying stocks.
- The major benefit is that you can invest in a **diverse portfolio** with the simplicity of trading a single stock.
- ETFs are increasingly becoming a popular investment option throughout the globe

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