

Unit-I

Lecture-3

Capital Market

It is financial market where long-term securities having maturity period of more than one year are traded. Capital market are meant for financing the long-term investments. Various securities traded in capital market are bonds, stocks, debentures etc. New York stock exchange, National stock exchange and Bombay stock exchange are some of the capital market. This market is further classified into three categories like primary market, secondary market and derivative market.

FUNCTIONS OF CAPITAL MARKET

The major functions performed by a capital/ security market are:

1. Helps in capital formation.

The capital market plays an important role in mobilisation of savings and channel them into productive investments for the development of commerce and industry. As such, the capital market helps in capital formation and economic growth of the country.

2. Act as link between savers and investors.

The capital market acts as an important link between savers and investors. The savers are lenders of funds while investors are borrowers of funds. The savers who do not spend all their income are called "Surplus units" and the borrowers are known as "deficit units. The capital market is the transmission mechanism between surplus units and deficit units. It is a conduit through which surplus unity lend their surplus funds to deficit units.

3. Helps in increasing national income.

Funds come into the capital market from individuals and financial intermediaries and are used by commerce, industry and government. It thus facilitates the transfer of funds to be used more productively and profitability to increases the national income.

4. Facilitates buying and selling.

Surplus units buy securities with their surplus funds and deficit wits ells securities to raise the funds they need. Funds flow from lenders to borrowers either directly or indirectly through financial institutions such as banks, unit trusts, mutual funds, etc. The borrowers issue primary securities which are purchased by lenders either directly or indirectly through financial institutions.

5. Channelizes funds from unproductive to productive resources.

The capital market provides a market mechanism for those who have savings and to those who need funds for productive investments. It divers resources from wasteful and unproductive channels such as gold, jewellery, real estate, conspicuous consumption, etc, to productive investments

6. Minimises speculative activities.

It does so by providing capital to the needy at reasonable interest rates and helps in minimising speculative activities.

7. Brings stability in value of stocks.

A well - developed capital market comprising expert banking and non - banking intermediaries brings stability in the value of stocks and securities.

8. Promotes economic growth. The capital market encourages economic growth. The various institutions which operate in the capital market give quantities and qualitative direction to the flow of funds and bring rational allocation of resources. They do so by converting financial assets into productive physical assets. This leads to the development of commerce and industry through the private and public sector, thereby inducing economic growth.

 **Primary Market / New Issue Market**

Primary market is a market for new issues or new financial claims. Hence, it is also called New Issue market. The primary market deals with those securities which are issued to the public for the first time.

In the primary market, borrowers exchange new financial securities for long term funds. Thus, primary market facilitates capital formation. There are three ways by which a company may raise capital in a primary market.

FEATURES OF PRIMARY MARKETS

(i) This is the market for new long term equity capital. The primary market is the market where the securities are sold for the first time. Therefore it is also called the new issue market (NIM).

(ii) In a primary issue, the securities are issued by the company directly to investors.

(iii) The company receives the money and issues new security certificates to the investors

(iv) Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.

(v) The primary market performs the crucial function of facilitating capital formation in the economy.

(vi) The new issue market does not include certain other sources of new long term external

finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital,

this is known as " going public. "