UNIT -2

Meaning of Financial market?

A financial market is an organized system or environment in which individuals, businesses, and governments create, buy, and sell financial instruments such as stocks, bonds, currencies, commodities, and derivatives to mobilize savings, allocate capital, manage risk, and facilitate economic growth.
It provides mechanisms for price discovery, liquidity, and efficient transfer of funds between surplus and deficit units in the economy.

Financial market may be broadly classified as negotiable loan markets and open markets.

Functions of Financial markets?

1. Mobilization of Savings

Financial markets collect savings from individuals and institutions and channel them into productive investments.

2. Facilitation of Capital Formation

They help businesses and governments raise long-term and short-term funds by issuing shares, bonds, and other financial instruments.

3. Price Discovery

Financial markets determine the prices of financial assets through the forces of demand and supply. This helps in knowing the real value of securities.

4. Liquidity Provision

They provide a platform where financial assets can be quickly bought or sold, allowing investors to convert their investments into cash easily.

5. Risk Sharing and Diversification

Markets allow investors to spread or transfer risk through various instruments like derivatives, mutual funds, and insurance-related products.

7. Efficient Allocation of Resources

They direct funds to the most productive and profitable investment opportunities, improving overall economic efficiency.

8. Promoting Economic Growth

By enabling investment and capital formation, financial markets support business expansion, employment, and economic development.

Types of financial market?

1. Money market

2. Capital market.

Definition and features of money market?

The **money market** is a part of the financial market where **short-term funds** (with maturity of **one year or less**) are borrowed and lent.
It deals in **highly liquid, low-risk, short-term financial instruments**, helping businesses, banks, and governments meet their short-term financing needs and manage liquidity.

Features of Money Market

1. Short-Term Funds

Deals in short-term financial instruments such as Treasury Bills, Commercial Paper, Certificates of Deposit, and Call Money.

2. High Liquidity

Instruments can be easily converted into cash, ensuring quick availability of funds.

3. Low Risk

Since maturities are short and issuers are usually strong institutions, the risk of default is low.

4. No Physical Location

It is not confined to a particular building or exchange; transactions occur electronically among banks and financial institutions.

5. Large Volume Transactions

Deals mainly occur in bulk amounts, often between large institutions like banks, RBI, and corporations.

6. Use of Discount Instruments

Many money market instruments are issued at a discount and redeemed at face value (e.g., Treasury Bills).

7. Central Bank Participation

The central bank (like RBI) plays a major role in regulating and directing money market operations to control liquidity and interest rates.

8. Wholesale Market

Primarily meant for institutional investors; individual participation is limited.

Composition of money market?

Composition of the Money Market

The money market is made up of various sub-markets and instruments that deal with short-term funds. Its main components are:

1. Call Money Market

- Deals with overnight loans between banks.
- Used for maintaining short-term liquidity.

2. Treasury Bills (T-Bills) Market

- Short-term government securities issued by the central government.
- Maturities: 91-day, 182-day, 364-day.

3. Commercial Paper Market

- Unsecured, short-term promissory notes issued by corporates to meet working capital needs.

4. Certificates of Deposit Market

- Time deposits issued by commercial banks and some financial institutions.
- Tradable and used to raise short-term funds.

5. Acceptance Market / Bill Market

- Deals in commercial bills, bill of exchange, and banker's acceptance used for trade financing.

6. Repo and Reverse Repo Market

- Short-term agreements where securities are sold with a promise to repurchase.
- Widely used for liquidity management by banks and the central bank.

7. Money Market Mutual Funds (MMMFs)

- Funds that invest in short-term money market instruments, offering retail investors access to the money market.

8. Inter-Bank Market

- Market where banks lend to and borrow from each other for short periods.

9. Central Bank (RBI) Operations

- The RBI plays a crucial role through Open Market Operations (OMO), LAF, MSF, etc., to regulate liquidity and interest rates.

What is mean by treasury bills?

Treasury Bills, commonly known as T-Bills, are short-term government securities issued by the central government to meet temporary financial requirements and manage short-term liquidity in the economy. They are highly secure, negotiable, and short-maturity instruments—generally up to one year.
T-Bills are issued at a discount to their face value and redeemed at par, and the difference represents the investor's return. As they are backed by the government, they carry minimal risk, enjoy high liquidity, and play a crucial role in the money market and in the central bank's monetary policy operations.

Features of Treasury Bills

1. Short-term maturity

- Issued for one year or less.

2. Issued at a discount

- Sold below face value; redeemed at par.

3. Risk-free investment

- Backed fully by the government; near-zero default risk.

4. High liquidity

- Easily tradable in the money market.

5. No periodic interest

- Returns come from the difference between purchase price and face value (discount).

6. Eligible for banks

- Used by banks to maintain Statutory Liquidity Ratio (SLR).

7. Auction-based

- Issued through competitive and non-competitive bidding by RBI or central bank.

---

3. Importance of Treasury Bills

1. Tool for Government Borrowing

Helps the government meet short-term financial needs.

2. Supports Monetary Policy

Used by the central bank to control liquidity and interest rates through **Open Market Operations (OMO).**

3. Safe Investment Option

Attracts risk-averse investors like banks, mutual funds, and institutions.

4. Provides Benchmark Rates

T-Bill yields act as benchmarks for short-term interest rates in the economy.

5. Promotes Financial Stability

By offering a secure avenue for investment, T-Bills help stabilize the money market.

Difference between **Capital Market** and **Money Market**:

Basis	Capital Market	Money Market
Definition	Market for **long-term funds** (more than 1 year) for investment in shares, bonds, etc.	Market for **short-term funds** (up to 1 year) to meet liquidity needs.
Maturity	Long-term	Short-term
Instruments	Shares, debentures, bonds, preference shares, long-term loans	Treasury bills, commercial paper, certificates of deposit, call money
Purpose	Raises long-term capital for expansion and growth	Provides short-term working capital and liquidity management
Risk	Moderate to high risk (depending on the instrument)	Low risk; highly secure instruments
Return	Returns are generally higher (dividends, interest, capital gains)	Returns are lower; mainly from discount on face value or interest

Basis	Capital Market	Money Market
Participants	Corporations, investors, government, financial institutions	Banks, financial institutions, corporations, government
Liquidity	Less liquid; not easily converted into cash	Highly liquid; can be quickly converted into cash
Regulation	Regulated by **SEBI** (or respective securities authority)	Regulated by **RBI** (or central bank)
Nature	Long-term capital formation	Short-term liquidity management

New issue market (NIM)

The New Issue Market **is a segment of the capital market where** new securities (shares, debentures, bonds) are issued for the first time **by companies to raise long-term capital from the public.**
It is also called the Primary Market**.**

Definition of IPO:

An Initial Public Offering (IPO) is the process by which a private company offers its shares to the public for the first time in order to raise long-term capital. Through an IPO, a company transforms from a privately-held entity into a publicly-traded company whose shares are listed and traded on a stock exchange. The offering is conducted under the supervision of regulatory authorities (like SEBI in India) and usually involves underwriters or investment banks who assist in pricing, marketing, and guaranteeing the subscription of shares.

Key Features of IPO

1. First-time public issue – Shares are offered to the public for the very first time.
2. Fund-raising tool – Provides the company with long-term capital for expansion, debt repayment, acquisitions, or working capital.
3. Listing on stock exchanges – After the IPO, the company's shares are listed, making them tradable in the secondary market.
4. Regulatory compliance – The company must issue a prospectus, disclose financial and business information, and follow rules set by the regulatory authority.
5. Underwriting – Investment banks or financial institutions often act as underwriters to ensure the issue is fully subscribed.
6. Public participation – Offers investors (both retail and institutional) an opportunity to own a part of the company.
7. Price determination – Share price is decided through methods like book building or fixed price issue.

Importance of IPO

- Provides a source of long-term funds to companies.
- Enables the public to invest in the company and benefit from its growth.
- Increases transparency and credibility of the company due to regulatory oversight.
- Helps in corporate expansion, diversification, and debt reduction.
-