Financial markets

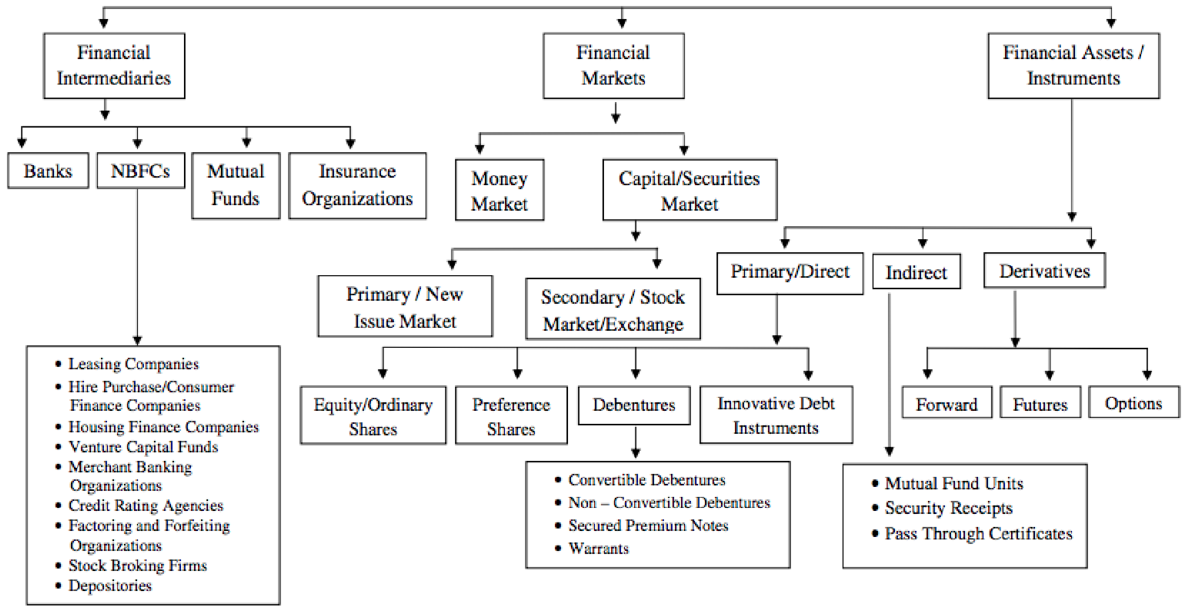
The **financial market in India** at present is more advanced than many other sectors as it became organized as early as the 19th century with the securities exchanges in Mumbai, Ahmedabad and Kolkata. ... The regulatory body for the Indian capital**markets** was the SEBI (Securities and Exchange Board of **India**).

Indian Financial System's Structure

There are three main components of the system (briefly explained in the below image)

1. Financial Intermediaries
2. Financial Markets
3. Financial Instruments/Assets/Securities

Classification of financial system



Financial markets attract funds from investors and channel them to corporations—they thus allow corporations to finance their operations and achieve growth. Money markets allow firms to borrow funds on a short term basis, while capital markets allow corporations to gain long-term funding to support expansion (known as maturity transformation).

Without financial markets, borrowers would have difficulty finding lenders themselves. Intermediaries such as banks, Investment Banks, and Boutique Investment Banks can help in this process. Banks take deposits from those who have money to save. They can then lend money from this pool of deposited money to those who seek to borrow. Banks popularly lend money in the form of loans and mortgages.

More complex transactions than a simple bank deposit require markets where lenders and their agents can meet borrowers and their agents, and where existing borrowing or lending commitments can be sold on to other parties. A good example of a financial market is a stock exchange. A company can raise money by selling shares to investors and its existing shares can be bought or sold.

A **financial system** is a network of financial institutions, financial markets, financial instruments and financial services to facilitate the transfer of funds. The system consists of savers, intermediaries, instruments and the ultimate user of funds. The level of economic growth largely depends upon and is facilitated by the state of financial system prevailing in the economy. Efficient financial system and sustainable economic growth are corollary. The financial system mobilizes the savings and channelizes them into the productive activity and thus influences the pace of economic development. Economic growth is hampered for want of effective financial system. Broadly speaking, financial system deals with three inter-related and interdependent variables, i.e., money, credit and finance.

The financial system provides channels to transfer funds from individual and groups who have saved money to individuals and group who want to borrow money. Saver (refer to the lender) are suppliers of funds to borrowers in return with promises of repayment of even more funds in the future. Borrowers are demanders of funds for consumer durables, house, or business plant and equipment, promising to repay borrower funds based on their expectation of having higher incomes in the future. These promises are financial liabilities for the borrower-that is, both a source of funds and a claim against the borrower's future income.

Main Functions of Financial System

The functions of financial system can be enumerated as follows:

- Financial system works as an effective conduit for optimum allocation of financial resources in an economy.
- It helps in establishing a link between the savers and the investors.
- Financial system allows 'asset-liability transformation'. Banks create claims (liabilities) against themselves when they accept deposits from customers but also create assets when they provide loans to clients.
- Economic resources (i.e., funds) are transferred from one party to another through financial system.
- The financial system ensures the efficient functioning of the payment mechanism in an economy. All transactions between the buyers and sellers of goods and services are effected smoothly because of financial system.
- Financial system helps in risk transformation by diversification, as in case of mutual funds.
- Financial system enhances liquidity of financial claims.
- Financial system helps price discovery of financial assets resulting from the interaction of buyers and sellers. For example, the prices of securities are determined by demand and supply forces in the capital market.
- Financial system helps reducing the cost of transactions.

Services Provided by the Financial System

1. **Risk Sharing:** Financial system provides risk sharing by allowing savers to hold many assets. It also means financial system enables individuals to transfer risk. Financial markets can create instruments to transfer risk from savers to borrowers who do not like uncertainty in returns or payments to savers or investors who are willing to bear risk. The ability of the financial system to provide risk sharing makes savers more willing to buy borrowers' IOUs. This willingness, in turn, increases borrowers' ability to raise funds in the financial system.

2. **Liquidity:** The second service that financial system provides for savers and borrowers is liquidity, which is the ease with which an asset can be exchanges for money to purchase other assets or exchanges for goods and services. Most of the savers view the liquidity as a benefit. If an individual need their assets for their own consumption and investment, they can just exchange it. Liquid assets allow an individual or firm to respond quickly to new opportunities or unexpected events. Bonds, stocks, or checking accounts are created by financial assets, which have more liquid than cars, machinery and real estate.
3. **Information:** The third service of financial system is collection and communication of information or we can say that it is the facts about borrowers an expectations about returns on financial assets. The first informational role the financial system plays is to gather information. That includes finding out about prospective borrowers and what they will do with borrowed funds. Another problem that exists in most transactions is asymmetric information. This means that borrowers posses information about their opportunities or activities that they don't disclose to lenders pr creditors and can take advantage of this information. The second informational role that financial system plays is communication of information. Financial markets do that job by incorporating information into the prices of stocks, bonds, and other financial assets. Savers and borrowers receive the benefits of information from the financial system by looking at asset returns. As long as financial market participants are informed, the information works its way into asset returns and prices.

Importance of Financial Markets

There are many things that financial markets make possible, including the following:

- Financial markets provide a place where participants like investors and debtors, regardless of their size, will receive fair and proper treatment.
- They provide individuals, companies, and government organizations with access to capital.
- Financial markets help lower the unemployment rate because of the many job opportunities it offers

What Is a Primary Market?

A primary market issues new securities on an exchange for companies, governments and other groups to obtain financing through debt-based or equity-based securities. Primary markets are facilitated by underwriting groupsconsisting of investment banks that set a beginning price range for a given security and oversee its sale to investors.

Role and functions of primary market are: ↓

1. Origination
2. Underwriting
3. Distribution

Features and functions of primary market are discussed below. ↓

1. Origination

In primary market, origination means to investigate, evaluate and procedure new project proposals. It initiates before an issue is present in the market. It is done with the help of merchant bankers.

The merchant bankers can be ↓

- banks,
- financial institutions,
- private investment firms, etc.

In primary market, the preliminary investigation involves a detailed study of economic, financial, legal, technical aspects to ensure the soundness of the project. The second function is performed by sponsoring institutions. They provide advisory service.

Advisory service includes: ↓

- Types of issue,
- Thug,
- Pricing,
- Methods of issue, etc.

2. Underwriting

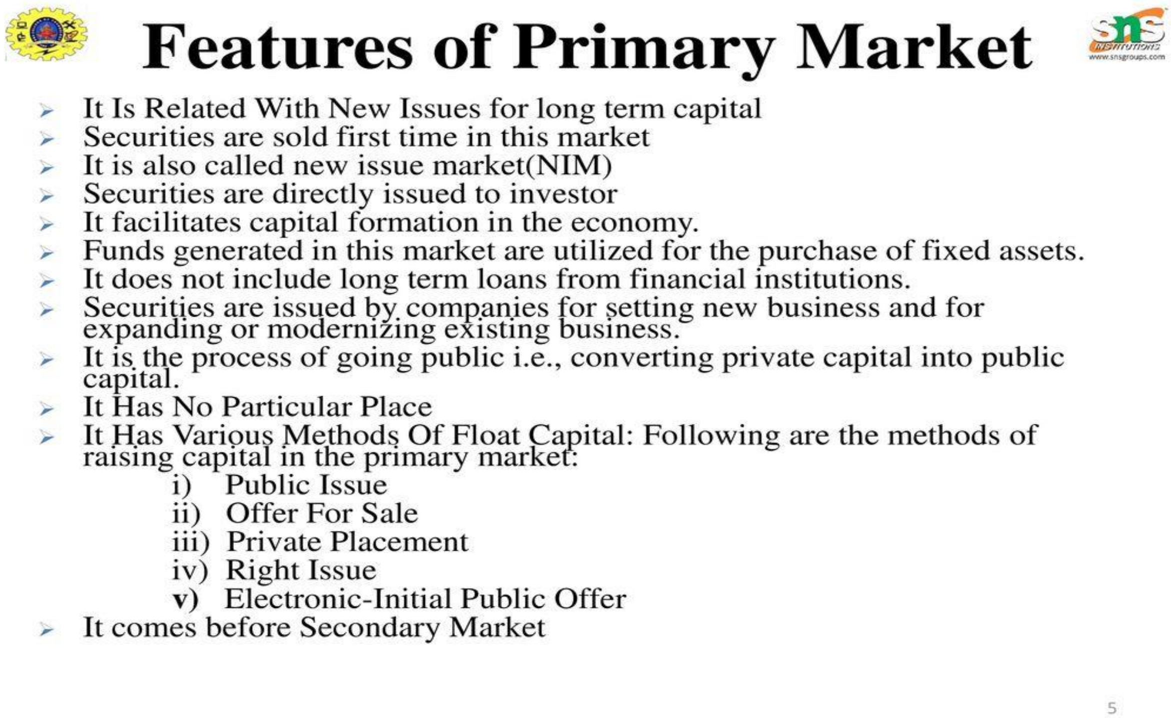
In primary market, to ensure success of new issue, there is a need for underwriting firms. The company needs to appoint underwriters. They can be banks or financial institutions or specialized underwriting firms.

In primary market, underwriting can be done by a single underwriter or by a group of underwriters. Minimum subscription is guaranteed by underwriters. If the issue is completely subscribed, no liability would be left for the underwriters. If by chance any part of the issue remains unsold, afterwards the underwriter has no option, rather than buying all the unsubscribed shares.

3. Distribution

In primary market, the success of any grand new issue is hinges on the issue is being subscribed by the people. The sale of the securities to the supreme or highest investors is termed as distribution.

Distribution Job is given to brokers and dealers. The brokers or agents maintain direct contact with the supreme investors



PLAYERS IN THE PRIMARY MARKET

Some important players in the primary market are:

Merchant Bankers

When a company approaches the public for funds, merchant bankers manage the process of public issue. They perform in the capacity of issue managers, lead managers and co-managers.

Registrars

Next to merchant bankers are registrars to the issue who collect the applications, money and allocate shares to subscribers in consultation with the stock exchange. They issue allotment letters, share certificates, etc., within the schedules prescribed by the regulatory authority. Apart from these, they are also responsible for fulfilling the listing requirements and to see that the stocks are listed on the stock exchange.

Underwriters and Brokers

Underwriters subscribe to a certain amount of capital in the issue. They have to fill the gap, if any, due to the failure of subscription as planned. Brokers place the new issue in the market through their wide network and through sub-brokers.

Collecting and Coordinating Bankers

Collecting bankers collect the money in the form of cash, cheques, etc., for the subscriptions and the coordinating bankers correlate the collection information on subscriptions and convey the same to the underwriters and merchant bankers. A collecting banker may double up as coordinating bankers too.

Other Agencies

Other agencies like printers, advertisers and mailing agencies are also involved for providing publicity to the new issue.

Primary market instruments

1. **Equity shares**
2. **Preference shares**
3. **Debentures**
4. **Foreign currency convertible bonds**
5. **Participatory notes**
6. **Depository receipts**
7. **Commercial papers**
8. **Certificate of deposits**
9. **Treasury bills**
10. **Repo and revere repo**

1. Public Issue or Initial Public Offer (IPO):

Under this method, the company issues a prospectus to the public inviting offers for subscription. The investors who are interested in the securities apply for the securities they are willing to buy. Advertisements are also issued in the leading newspapers. Under the Company Act it is obligatory for a public limited company to issue a prospectus or file a statement in lieu of prospectus with the Registrar of Companies.

Once subscriptions are received, the company makes allotment of securities keeping in view the prescribed requirements. The prospectus must be drafted and issued in accordance with the provisions of the Companies Act and the guidelines of SEBI. Otherwise it may lead to civil and criminal liabilities.

Public issue or direct selling of securities is the most common method of selling new issues of securities. This method enables a company to raise funds from a large number of investors widely scattered throughout the country. This method ensures a wider distribution of securities thereby leading to diffusion of ownership and avoids concentration of economic power in a few hands.

However, this method is quite cumbersome involving a large number of administrative problems. Moreover, this method does not guarantee the raising of adequate funds unless the issue is underwritten. In short, this method is suitable for reputed companies which want to raise large capital and can bear the large costs of a public issue.

2. Private Placement:

In this method, the issuing company sells its securities privately to one or more institutional brokers who in turn sell them to their clients and associates. This method is quite convenient and economical. Moreover, the company gets the money quickly and there is no risk of non-receipt of minimum subscription.

Private placement, however suffers from certain drawbacks. The financial institution may insist on a huge discount or other conditions for private purchase of securities. Secondly, it may not sell the securities in the market but keep them with it.

This deprives the public a chance to purchase securities of a flourishing company and there may be concentration of the company's ownership in a few hands. Private placement is very suitable for small issues particularly during depression.

3. Offer for Sale:

Under this method, the issuing company allots or agrees to allot the security to an issue house at an agreed price. The issue house or financial institution publishes a document called an ‘offer for sale’. It offers to the public shares or debentures for sale at higher price. Application form is attached to the offer document. After receiving applications, the issue house renounces the allotment in favour of the applicants who become direct allottees of the shares or debentures.

This method saves the company from the cost and trouble of selling securities directly to the investing public. It ensures that the whole issue is sold and stamp duty payable on transfer of shares is saved. But the entire premium received is retained by the offerer and not the issuing company.

4. Sale through Intermediaries:

n this method, a company appoints intermediaries like stock brokers, commercial banks and financial institutions to assist in finding market for the new securities on a commission basis. The company supplies blank application forms to each intermediary who affixes his seal on them and distributes the among prospective investors. Each intermediary gets commission on the amount of security applications bearing his seal. However, intermediaries do not guarantee the sale of securities.

This method is useful when a company has already offered 49 per cent of issue to the general public which is essential for listing of securities. The pace of sale of securities may be very slow and there is uncertainty about the sale of whole lot of securities offered through intermediaries. But this method saves the administrative problems and expenses involved in direct selling of securities to the public.

- Buyback of shares

A buyback, also known as a share repurchase, is when a company buys its own outstanding shares to reduce the number of shares available on the open market. Companies buy back shares for a number of reasons, such as to increase the value of remaining shares available by reducing the supply or to prevent other shareholders from taking a controlling stake.

Understanding Buybacks
A buyback allows companies to invest in themselves. Reducing the number of shares outstanding on the market increases the proportion of shares owned by investors. A company may feel its shares are undervalued and do a buyback to provide investors with a return. And because the company is bullish on its current operations, a buyback also boosts the proportion of earnings that a share is allocated. This will raise the stock price if the same price-to-earnings (P/E) ratio is maintained.

The share repurchase reduces the number of existing shares, making each worth a greater percentage of the corporation. The stock's EPS thus increases while the price-to-earnings ratio (P/E) decreases or the stock price increases. A share repurchase demonstrates to investors that the business has sufficient cash set aside for emergencies and a low probability of economic troubles.

Another reason for a buyback is for compensation purposes. Companies often award their employees and management with stock rewards and stock options. To make due on rewards and options, companies buy back shares and issue them to employees and management. This helps avoid the dilution of existing shareholders.

Because share buybacks are carried out using a firm's retained earnings, the net economic effect to investors would be the same as if those retained earnings were paid out as shareholder dividends.
How Companies Perform a Buyback
Buybacks are carried out in two ways:

1. Shareholders might be presented with a tender offer, where they have the option to submit, or tender, all or a portion of their shares within a given time frame at a premium to the current market price. This premium compensates investors for tendering their shares rather than holding onto them.
2. Companies buy back shares on the open market over an extended period of time and may even have an outlined share repurchase program that purchases shares at certain times or at regular intervals.

A company can fund its buyback by taking on debt, with cash on hand or with its cash flow from operations.

An expanded share buyback is an increase in a company's existing share repurchase plan. An expanded share buyback accelerates a company's share repurchase plan and leads to a faster contraction of its share float. The market impact of an expanded share buyback depends on its magnitude. A large, expanded buyback is likely to cause the share price to rise.

The buyback ratio considers the buyback dollars spent over the past year, divided by its market capitalization at the beginning of the buyback period. The buyback ratio enables a comparison of the potential impact of repurchases across different companies. It is also a good indicator of a company's ability to return value to its shareholders since companies that engage in regular buybacks have historically outperformed the broad market.

- **Preferential allotment**

- Preferential allotment is a process in which shares are alloted to a specific group of people or companies which are interested in it on preferential basis. Company which allots shares states that whenever it will pay dividend, preference shares holders will be paid first.This can be done by any company which is listed on exchange and all rules and regulations stated by SEBI are to be followed to do so. Traders often refer experts advise on **mcx tips** and more as they looking for consistent earnings from market. A company may decide to raise funds from public in order to meet different financial requirements. If they will go for issuing shares to public on large scale it will consume a lot of time and is complicated as well. Among all methods of raising funds this one is most convenient as less paper work is required.
- **Why company go for preferential allotment of shares**
- When a company wants to raise funds it can do so by issuing new shares to public or bulk allotment of shares. The main reason behind preferential allotment of shares is to facilitates shareholders who are unable to buy large chunk of shares from market as it is too costly or unfeasible for them. But these shareholders do not get any voting rights and they are paid only when company earns profit.
- **Benefits of preference shareholders**
- 1) No brokerage costs is incurred and preferential shareholders get paid first when company earns profit and after them other share holders are paid.
- 2) If any company has not paid dividend in present year then shareholders has right to claim this dividend in the next years.
- 3) Capital of preference shareholders is always safe. If in case company fails or gets bankrupt then preference shareholders will be paid first among all.
- Along with these advantages it has some drawbacks as well. No voting rights are issued here and it is risky than bonds. Also when company gets bankrupts they are paid after NCD (Non Convertible Debentures).
- Some companies start performing well after preference allotment of shares. The reason behind this may be that they have used raised funds in an efficient manner. And if some well informed veteran investors have invested in them then definitely it will drive the growth of business. As per needs a trader may decide whether he wants to go for preference shares or common shares. Also they can take guidance from some **financial advisory services**
providers to take optimum decisions while trading in stock market. They assists with useful experts recommendations after carefully understanding present market conditions. Though extra cost is involved to get such experts recommendations but it helps traders in improving their trade results.

- **Further public offer**

- **What is Follow On Public Offer (FPO)**
- A follow-on public offer (FPO) is the issuance of shares to investors by a public company that is currently listed on a stock market exchange. An FPO is a stock issue of additional shares made by a company that is already publicly listed and has gone through the IPO process. FPOs are popular methods for companies to raise additional equity capital in capital markets through an issue of stock.

Money market

Money market instruments are securities that provide businesses, banks, and the government with large amounts of low-cost capital for a short time. The period is overnight, a few days, weeks, or even months, but always less than a year. ... **Money market instruments** allow managers to get **cash** quickly when they need it.

Money market instruments

- Certificate of deposit – Time deposit, commonly offered to consumers by banks, thrift institutions, and credit unions.
- Repurchase agreements – Short-term loans—normally for less than one week and frequently for one day—arranged by selling securities to an investor with an agreement to repurchase them at a fixed price on a fixed date.
- Commercial paper – Short term instruments promissory notes issued by company at discount to face value and redeemed at face value
- Eurodollar deposit – Deposits made in U.S. dollars at a bank or bank branch located outside the United States.
- Federal agency short-term securities – In the U.S., short-term securities issued by government sponsored enterprises such as the Farm Credit System, the Federal Home Loan Banks and the Federal National Mortgage Association. Money markets is heavily used function.
- Federal funds – In the U.S., interest-bearing deposits held by banks and other depository institutions at the Federal Reserve; these are immediately available funds that institutions borrow or lend, usually on an overnight basis. They are lent for the federal funds rate.
- Municipal notes – In the U.S., short-term notes issued by municipalities in anticipation of tax receipts or other revenues
- Treasury bills – Short-term debt obligations of a national government that are issued to mature in three to twelve months
- Money funds – Pooled short-maturity, high-quality investments that buy money market securities on behalf of retail or institutional investors
- Foreign exchange swaps – Exchanging a set of currencies in spot date and the reversal of the exchange of currencies at a predetermined time in the future
- Short-lived mortgage- and asset-backed securities

Functions Of Money Market

Features of Money Market:

Summarized below are some of the important features of a developed money market:

- It has an organized banking system.
- It consists of several sub-markets that deal with different types of credit instruments.
- A developed money market consists of near- money assets of various types like bills of exchange, treasury bills and bonds.
- It also has access to financial sources from within the country as well as from foreign investments.

- The money market securities are considered to be highly liquid and are fixed income securities that have a shorter maturity term.
- Issuers of the money market instruments have good credit ratings. Therefore, it is obvious that the money market instruments are safe for investment purposes.
- One of the main features of money market instruments is that they are issued at a discounted price to face value.

Instruments of the Money Market:

Bill of exchange/ commercial bills:

A bill of exchange is a written unconditional order by one party to another, to pay a specified amount of money either immediately or on a fixed date. A bill of exchange is a document used in international trade to pay for goods and services. It is signed by the person promising to pay and given to the person receiving the payment. A bill of exchange can be compared to a promissory note.

Treasury Bills:

Treasury bills are short term borrowing instruments issued by the Government of India. These are the oldest money market instruments that are still in use. The treasury bills do not pay any interest, but are available at a discount to face value at the time of the issue. Treasury bills can be classified in two ways i.e. based on maturity and based on type. These are the safest instruments as they are backed by a government guarantee. The rate of return, also known as risk-free rate, is low for Treasury bills like T-364, T-182 and so on, as compared to all other instruments.

Commercial Papers:

Commercial Paper is an unsecured money market instrument, issued in the form of a promissory note. It was introduced in India in 1990 with the objective of enabling corporate borrowers diversify their sources of short-term borrowings and to provide an additional investment instrument to investors. Commercial paper is a money-market security issued (sold) by large corporations to obtain funds to meet short-term debt obligations (for example, payroll), and is backed only by an issuing bank or company's promise to pay the face value on the maturity date specified on the note.

Certificate of Deposit:

A certificate of deposit is a savings instrument that is similar to a fixed deposit. Unlike fixed deposit, certificate of deposit cannot be withdrawn before maturity. These deposits have a fixed maturity date and a specified rate of interest.

The certificate of deposit was introduced in the Indian market in the year 1989 to increase the options among money market instruments. Certificates of deposit are issued by scheduled commercial banks and some select financial institutions in India and are monitored by the RBI. The RBI issues guidelines for certificate of deposit from time to time.

Banker's Acceptance:

A banker's acceptance is a document that promises future payment that is guaranteed by the commercial bank. It is considered to be a very safe investment option and is widely used in foreign trade. Banker's acceptance are time drafts which are accepted and guaranteed by the bank and drawn on a deposit at the bank. The maturity period of banker's acceptance can range from 30 to 180 days.

Repurchase Agreements:

These are known as Repo or reverse Repo. They are loans of short duration which are agreed by buyers and sellers for the purpose of trading. However, the transactions are carried out between institutions approved by the Reserve Bank of India.

Functions of Money Market:

A money market plays an important role in the allocation of resources in the economy by performing the following important functions.

Provides Funds:

The money market provides short term funds for borrowing at a lower rate of interest. The private and the public institutions can borrow money from the money market to finance capital requirements and fund business growth through the system of finance bills and commercial paper. The government can also borrow funds from the money market by issuing treasury bills.

Therefore, money market issues money market instruments like commercial papers, treasury bills and so on and helps in the development of trade, industry and commerce within and outside India. The money market plays an important role in financing domestic and international trade.

Use of Surplus Funds:

The money market provides a platform where the banks and other lending institutions can lend excess money for a short period of time and earn profits. This fulfils the main objectives of the commercial banks i.e. to earn income from reserves as well as maintain liquidity to meet the cash required for daily transactions. The institutions that can lend funds in money market not only include commercial banks and other financial institutions, but also comprises of non-financial business corporations, central, state and local governments.

No Need to Borrow From Banks:

A developed money market helps commercial banks become self-sufficient. The existence of an established money market increases the options of borrowing money at lower interest rates and helps commercial banks and the central bank.

However, if there is a shortage of cash in the commercial banks and central banks, they can call in some of their loans from the money market. Most of the commercial banks like SBI, Union Bank, BOI and others prefer to recall their loans.

Helps Government:

The money market instruments help the government raise money for financing government projects for public welfare and infrastructure development. The government can borrow short term funds by issuing treasury bills at low interest rates. On the other hand, if the government were to issue paper money or borrow from the central bank, it would lead to inflation in the economy.

Helps in Monetary Policy:

A properly functioning money market helps the central bank successfully implement monetary policies. Though the central bank can function and influence the banking system in the absence of a money market, the existence of a developed money market helps in the efficient functioning and increases the effectiveness of the central banks. The money market helps the central banks in the following ways:

1. Short-run interest rates serve as an indicator of the monetary and banking conditions in the country and, in this way, guide the central bank to adopt an appropriate banking policy.

2. Sensitive and integrated money markets help the central bank secure quick and widespread influence on the sub-markets, thus facilitating effective policy implementation.

Helps in Financial Mobility:

The money market helps in financial mobility by enabling easy transfer of funds from one sector to the other. Financial mobility is essential for the development of industry and commerce in the economy.

Promotes Liquidity and Safety:

This is one of the most important functions of money market, as it provides safety and liquidity of funds. It also encourages savings and investments. These investment instruments have shorter maturity which means they can readily be converted to cash. The money market instruments are issued by entities with good credit score which makes them safe investment options. Check free credit score on IndianMoney.com.

Equilibrium Between Demand and Supply of Funds:

The money market creates a balance between the demand and supply of loanable funds. The money market helps in allocating savings into investment channels. A money market helps in mobilizing savings and make better use, by allowing them to be invested through the money market. It helps savers channelize funds, thus leading to productive use of money in the economy.

Economy in Use of Cash:

As the money market deals in near-money assets and not proper money, it helps in economizing the use of cash. It provides a convenient and safe way of transferring funds from one place to another, thereby immensely helping commerce and industry in India.

MONEY MARKET VS. CAPITAL MARKET		
	MONEY MARKETS	CAPITAL MARKETS
1. Duration	It is for short term funds.(1 yr or less)	It is for long term funds.(more than 1 year)
2. Nature of Funds	Supplies funds for Working Capital Requirements	Supplies funds for fixed capital requirement
3. Instruments	Instruments are T-bill, Commercial Papers, Certificates of Deposit, etc	Instruments are shares, debentures, bonds etc.
4. Amount of Instrument	Each single instrument is of large amount.	Each single instrument is of small amount.
5. Institutions	Central banks, commercial banks, acceptance houses, nonbank financial institutions, bill brokers, etc.	Stock exchanges, commercial banks and nonbank institutions, such as insurance companies, mortgage banks, building societies, etc.
6. Risk	Less due to smaller maturity. In short term, probability of default is less.	Risk is higher.
7. Transactions	Transactions are on over phone and no formal place.	Transactions are at formal place. Eg stock market.
8. Broker	Transaction without the help of broker.	Transaction have to be conducted with the help of broker.
9. Basic Role	Liquidity adjustment.	Putting capital to work, preferably to long-term, secure and productive employment.
10. Relation with Central Bank	Closely and directly linked with central bank of the country.	The capital market feels central bank's influence, but mainly indirectly and through the money market.
11. Market Regulation	Commercial banks are closely regulated.	The institutions are not much regulated. *www.financeNmoney.in*

Secondary market

The **secondary market** is where investors buy and sell securities they already own. It is what most people typically think of as the "stock **market**," though stocks are also sold on the primary **market** when they are first issued.

Understanding Secondary Market

Though stocks are one of the most commonly traded securities, there are also other types of secondary markets. For example, investment banks and corporate and individual investors buy and sell mutual funds and bonds on secondary markets. Entities such as Fannie Mae and Freddie Mac also purchase mortgages on a secondary market.

Transactions that occur on the secondary market are termed secondary simply because they are one step removed from the transaction that originally created the securities in question. For example, a financial institution writes a mortgage for a consumer, creating the mortgage security. The bank can then sell it to Fannie Mae on the secondary market in a secondary transaction.

Some of the Important Functions of Stock Exchange/Secondary Market are listed below:

1. Economic Barometer:

A stock exchange is a reliable barometer to measure the economic condition of a country.

Every major change in country and economy is reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. Stock exchange is also known as a pulse of economy or economic mirror which reflects the economic conditions of a country.

2. Pricing of Securities:

The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The valuation of securities is useful for investors, government and creditors. The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.

3. Safety of Transactions:

In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

4. Contributes to Economic Growth:

In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

5. Spreading of Equity Cult:

Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

6. Providing Scope for Speculation:

To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

7. Liquidity:

The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.

8. Better Allocation of Capital:

The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor’s fund to profitable channels.

9. Promotes the Habits of Savings and Investment:

The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

Difference Between Primary Market and Secondary Market

Purchasing Method or Primary and Secondary Market

The primary market for financial instruments is a direct market where companies offer their shares to the members of the public for consideration.

The buyers and sellers interact with one another offering the chance to negotiate for the shares on offer, especially in the auction markets where the highest bidder is assumed to have won the purchasing battle.

The secondary market is an indirect financial platform where prospective buyers purchase shares from others investors. In the secondary market, the original owner of the shares (company) is not involved in the transfer of the units of ownership.

Financing/Beneficiary for Primary and Secondary Market

The main purpose of the primary market is to provide finances to organizations so that they can expand their operations or boost their current activities. Companies offer their shares for a subscription to prospective buyers and investors in return for money, which is essential in funding the events of the company.

On the other hand, secondary market does not offer finances to the company. This is because the shares are traded between prospective investors who have speculative motives. The secondary market involves the exchange of shares from one investor to the other.

The organization is the final beneficiary of the primary market because it will gain all the proceeds, which are acquired after the sale of financial instruments. In the secondary market, the investors are the beneficiary after the transfer of ownership.

Parties Involved in Primary and Secondary Market

The primary market involves direct contact between the company and the investor. The company offers shares to the investor who considers them for purchase concerning the associated profits and the cost of the shares.

The secondary market involves different investors exchanging the financial instruments. The company is not involved because this is an indirect market, which involves investors only.

Price of Financial Instruments for Primary and Secondary Market

In the primary market, the price of the financial instruments is usually fixed. Companies sell their shares in an open market where other members of the public are aware of the prevailing prices. Besides, the price of the shares in an initial public offer is communicated through the print and other media platforms.

However, the participants do not know the price of shares and other products. The price of the financial instruments keeps on fluctuating and is mostly depends on demand and supply aspects. Therefore, the more the products, the lower the prices and the vice versa.

Organization

The primary trade of financial instruments is usually not rooted in any specific place or geographical position. This means that buyers can buy their shares at any place, especially the organizational premises.

The secondary market has physical existence, which means that this form of trade is rooted in a specific place. This explains why there is the existence of the stock exchange offices and halls where investors sell their units of ownership to other investors.

Agents/Intermediaries for Primary and Secondary Market

In the primary markets, underwriters are the intermediaries between the company and the investors who are willing to purchase units of ownership in the company. Some of the common underwriting agencies include banks and insurance companies among others.

Brokers form the intermediaries in the secondary market. Brokers are responsible for assessing the risks and profits associated with a specific financial instrument after which they purchase the promising shares on behalf of the buyer.

Number of Transactions involved in Primary and Secondary Market

In the primary market, a financial instrument is sold once. The enterprise is tasked with the obligation of selling the share to the investor for profit at a fixed rate upon which the investor possesses the full rights to the unit.

The investor is entitled to all the benefits associated with the ownership of the instrument including dividends and resale rights.

On the other hand, a unit of ownership can be sold several times with each transaction involving the exchange of rights and benefits. This is because the secondary market consists of the sale of shares and other financial instruments between investors at a profit.

PRIMARY MARKET
VERSUS
SECONDARY MARKET

Purchasing Method	Direct	Indirect
Beneficiary	Company	Investor
Price of Products	Fixed	Fluctuating
Parties Involved	Company and Investor	Investors
Market Organization	No Specific Place	Has a Specific Place
Agents/ Intermediaries	Underwriters	Brokers
Number of Transactions	Single	Multiple

Summary of Primary and Secondary Market

- The fundamental difference between primary and secondary market is the, in primary market involves the sale of shares by the company to the investor while secondary market consists in selling stock between investors.
- Other notable differences between primary and secondary differences between primary and secondary market include purchasing methods, beneficiaries, number of transactions, intermediaries, market organization, and parties involved among Others