



An introduction to capital market and its structure

Payal Saini

Lecturer on Extension Basis, Govt. PG College for Women, Rohtak, Haryana, India

Abstract

The organized market consists of investors, government institutions whereas unorganized sector consists of indigenous bankers and private Individual lenders. The financial market collectively refers to all those organizations and institutions which lend funds to business enterprise in organized sector. This paper views the meaning and nature of capital market. A broad range of area is covered such as meaning, objectives importance, role structure of capital market and their functions. A good capital market is an essential pre-requisite for industrial and commercial development of a country.

Keywords: market, capital market, stock exchange, primary market

Introduction

The capital market is a market for financial assets which have a long or indefinite maturity. It deals with long term securities which have a maturity period of above one year. A good capital market is an essential pre-requisite for industrial and commercial development of a country. Every business unit needs money to finance its activities. A business enterprise can raise capital from various sources such as short term and long term borrowings. In addition to business units, public corporations and governments are the other major borrowers of funds. The lenders of funds include the individual investors, banks and special industrial financial institutions. These borrowers and lenders are brought through the financial markets.

The capital market in India may be classified into two categories viz. organized and unorganized. The organized market consists of investors, government institutions whereas unorganized sector consists of indigenous bankers and private individual lenders.

The term 'financial market' collectively refers to all those organizations and institutions which lend funds to business enterprise and public authorities. It comprises two constituents

1. The Money Market
2. The Capital Market

The money market deals with the provision of short term credit. The capital market deals in the lending and borrowing of medium-term and long term credit. It is a market for dealing with financial assets and securities which have a maturity period of upto one year. The money market may be sub divided into four. They are:

- 1) Call money market
- 2) Commercial market
- 3) Treasury market
- 4) Short-term loan market

Importance of capital market

An efficient capital market is a pre-requisite of economic

development. An organized and well developed capital market operates in a free market economy.

1. Ensures balance between the flow of saving and flow of investment leading to capital formation.
2. Directs the flow of saving into most profitable channels and thereby ensures optimum utilization of financial resources.
3. The mobilization or concentration of national savings or economic development.
4. The mobilization and import of foreign capital and investment to augment the deficit in the required financial resources so as to maintain the expected rate of economic growth.
5. The capital market serves as an important source for the productive use of economy's savings.
6. It serves as an important source for technological upgradation in the industrial sector by utilizing the funds invested by people.
7. A healthy capital market consisting of expert intermediaries promotes stability in values of security representing capital funds.
8. It provides incentives to savings and facilitates capital formation by offering suitable rates of interest as the price of capital.
9. It facilitates increase in production and productivity in economy and enhances economic welfare of economy.

Role of capital market in India's industrial growth

1. Mobilisation of savings and acceleration of capital formation- In developing countries like India plagued with paucity of resources and increasing demand for investments by industrial organizations and governments, the importance of the capital market is self evident.
2. Promotion of Industrial growth- It stimulates industrial growth and economic development of the country by mobilizing funds for investment in the corporate securities.
3. Raising of long-term capital- The existence of stock

exchange enables companies to raise permanent capital and the investors cannot commit their funds for the permanent period. The stock exchange resolves this clash of interests by offering an opportunity to investors to buy and sell their securities.

4. Ready and continuous market- The stock exchange provides a central convenient place where buyers and sellers can easily sell and purchase securities.
5. Proper channelization of funds-An efficient capital market not only creates liquidity through its pricing mechanism but also functions to allocate resources to the most efficient industries.
6. Provision of a variety of services-The institutions functioning in the capital market provide a variety of services such as grant of long-term and medium term loans to enterprises to enable them to establish, expand and modernize business units.

Structure of the capital market

Broadly speaking the capital market can be divided into two classes:

- 1) The financial institutions
- 2) The security markets

The financial institutions e.g. IFCI, IDBI, EXIM Bank, SIDBI, LIC etc. provide long term and medium term loan facilities and the security market is divided into (i) the gilt edged market and (ii) the corporate securities market.

- 1) Gilt-edged Market - It is the market in government securities or the securities guaranteed (both principal and interest) by the government. Since the government cannot default on its payment obligations, the govt. securities are risk free and hence known as gilt-edged (which means of the best quality).

Important features of Gilt-edged market

- a) It is risk free market and returns are guaranteed.
- b) The government securities market consists of two parts – the new issue market represents the primary market where new securities i.e. shares of bonds that have never been previously issued, are offered.

The prime function of new issue market is to facilitate the transfer of funds from the willing investors, setting up new enterprises or going for expansion.

2) The secondary market / Stock exchange

Secondary capital market deals in the second-hand issued securities. Stock exchanges are secondary markets where buyers and sellers trade in already listed securities (shares, debentures) are traded. The main functions of stock exchange are:

- Help determining fair prices based on demand and supply forces and all-available information.
- Provide easy marketability and liquidity for investors.
- Enable investors to adjust portfolios of securities.

The secondary market may also include the over-the-counter (OTC) market and the derivatives market. In the stock market, share prices are determined by demand and supply forces, on

the other hand in the OTC market, prices are negotiated between buyers and sellers. The derivatives market deals in futures and options. In the futures market, securities or portfolios of securities are traded for future delivery and in case of options, the future delivery is conditional as the option buyer has a right to exercise or not to exercise the option.

Functions of stock exchanges

- Ensure liquidity of capital
- Continuous market for securities
- Evaluation of securities
- Provide easy marketability and liquidity for investors.
- Enable investors to adjust portfolios of securities.
- Mobilize savings
- Healthy speculation
- Mobility of funds
- Help capital formation

Factors contributing to the growth of capital market on India

1. Establishment of development banks and industrial financing institutions
2. Passing of capital issues(control) Act 1947 to regulate investment of different investor
3. Growth of underwriting business
4. Growing public confidence
5. Increasing awareness of investment opportunities.
6. Setting up of SEBI
7. Improvement in performance of mutual funds
8. Development of credit rating agencies.

Problems of Indian capital market

Problems of equity market

1. It was an association of brokers and imposed entry barriers, which led to increased cost of intermediation.
2. It was usual for brokers to charge the investors a much higher price from that actually traded at.
3. There was no price-time priority, so users of the market were not assured that a trade was executed at the best possible price.
4. A variety of manipulative practices prevailed no strict action could be taken against errant brokers
5. Retail investor's access market through chain-brokers who introduced market in the price and the investor thus had to pay a much higher price than the actual trade price.
6. A peculiar market practice called badla allowed brokers to carry position across settlement periods.

Problems of debt market

1. The lack of anonymity made it easier to form and enforce cartels which would indulge in a lot of manipulative practices.
2. There was a serious problem with the settlement of trades.
3. The problem of credit risk served to narrow the market down to a 'club market', a set of participant with homogeneous credit risk
4. The debt market relied on dealers who did not unbundle their intermediation price from the transaction price
5. High government borrowing at high interest rates.
6. Lack of transparency in public sector borrowings.

7. Low long term borrowing requirement.

References

1. Amarnath OM. Real Time Gross Settlement. PNB Staff Journal. 2005; 46(3):39.
2. Bhalla GS. ATMs, Internet Banking. Journal of CTDI. 2006; 6(8):20.
3. Dubey RK. Alternative Delivery Channels Integration for Competitive Edge. PNB Staff Journal. 2005; 46(3):40.
4. Kotler Philip. Marketing Management. Delhi: Pearson, 2005.
5. Passi Vikas. Cheque Truncation System- a step towards more efficient mode of payment. PNB Staff Journal. 2005; 46(3):48.