

FINANCIAL MARKETS

Financial Markets are a type of marketplace that provides a platform for the sale and purchase of financial products such as stocks, bonds, foreign exchange, derivatives, etc.

It serves as a link between the savers (who have surplus money) and borrowers (who need money). It transfers money or capital from surplus units to deficit units. Here investors are surplus units and business enterprises are deficit units. In this way, banks and financial markets bridge the gap between investors and borrowers.

**Functions of Financial Markets:**

The functions of financial markets are not limited to just providing an avenue for the sale and purchase of financial instruments. The Financial markets play a huge role in capital formation and the effective allocation of funds in the economy. Some of the major functions performed by financial markets are as follows:

* **Mobilization of savings and directing it towards the most effective use:** An Economy doesn’t grow if the savings are not put to productive use. Financial markets help to mobilize these savings from being idle with households, institutions, and banks to business enterprises requiring funds for investment in various projects. Thus we can say it is the function of financial markets to convert savings into investments.
* **Facilitates Discovery of Price of Securities:** like any other commodity price of securities also depends upon the demand and supply factors. When a security is listed on the financial market, it gets traded by buyers and sellers and the financial markets provide a mechanism for fixing the price of the security.
* **Providing Liquidity to the Financial Assets:** Financial Markets provide a platform whereone can buy or sell financial assets easily at any time. This brings liquidity to the financial assets. One can easily convert his/ her financial assets into cash.
* **Making Transaction cost economical:** It is easy to buy and sell financial securities in the financial market. Financial Markets provide complete information regarding the financial assets being traded on it about their price, availability, cost, etc. Thus investors and companies don’t need to spend any amount of money for getting such kind of information.

**Classification of Financial Markets:**

The financial markets are classified as follows:

* **By Nature Of Claim:**
* **Debt Market:** As the name suggests, this market deals with fixed claims debt instruments such as bonds, debentures, etc. Rate of return and period of maturity in fixed in the debt instruments.
* **Equity Market:** this market deals in residual claims- equity stocks. Stocks of companies are traded in this market.
* **By Timing Of delivery**:
* **Cash Market:**  In this kind of market claims are settled immediately between parties in real-time.
* **Futures Market:** in this kind of market commodities are delivered and claims are settled on a future date decided in present.
* **By Organizational Structure:**
* **Exchange-Traded Market:** These are centralized trading markets having standard procedures regulating their functioning.
* **Over-the-Counter Market:** It is a decentralized market without any standard procedure regulating its functioning. It involves a customized procedure. Traders can deal with each other without involving any broker in their transactions.
* **By Maturity Of Claim:**
* **Money Market:** this market deals with short securities or financial instruments of less than 1 year of maturity period. For example- treasury bills, commercial papers, certificates of deposits, etc. Because of less than 1 year of the maturity period, this market is highly liquid and involves low risk and low returns.
* **Capital Market**: This market deals with medium and long-term financial assets. This market is further divided into two categories as follows
1. **Primary Market**: In this market, new securities are sold for the very first time by the company directly to the investors. Securities in this market are issued by methods of Prospectus, Offer for Sale, Private Placement, Right issues, etc. The primary market directly contributes to capital formation.
2. **Secondary Market:** In this market previously issued or second-hand securities are traded. Securities are not issued to investors directly by the company. Instead, the investors sell and purchase securities from each other.

**Importance Of Financial Markets:**

Financial markets play a vital role in socio-economic growth and development by providing various benefits such as:

* Financial markets provide various fund seekers access to capital such as to business enterprises, governments, quasi-governmental organizations, etc.
* Provides opportunities to those people who have surplus funds with them and want to invest in profitable investment opportunities.
* Financial markets help in capital formation in the economy.
* It also helps in the effective allocation of funds in the economy by transferring the funds from surplus units to deficit units.
* Financial Markets create employment as many people are involved in its activities in different ways such as stoke brokers, underwriters, merchant bankers, depositories, custodians, etc.

**Conclusion:**

We can say that the financial markets play an immense role in the success and strengthening of an economy of a country. For economic development, a country needs capital and investments and with the help of the financial market, funds flow from surplus units to units facing a shortage. In this way, it helps in the capital formation and effective allocation of funds in the economy. Moreover, it provides investment opportunities in form of a wide range of lucrative financial instruments and also provides avenues where these instruments can be traded hassle-free.