Financial Systems

- It is a system that **allows the exchange of funds** between lenders, investors, and borrowers.
- It operates at national, global, and firm-specific levels.
- Money and credit are used as media of exchange in this system.
- It serve as a **medium of known value** for which goods and services can be exchanged as an alternative to barter system.
- A modern financial system may include banks (operated by the government or private sector), financial markets, financial instruments and financial services.
- It allows funds to be allocated, invested, or moved between economic sectors.

Functions of the Financial System:

1. Link between savers and investors
2. Allocation of risk
3. Price-related information available
4. Reduce cost of transaction and borrowing
5. Financial expansion and development

Financial Market

- The term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them.
- The term market is sometimes used for what are more strictly exchanges, organizations that facilitate the trade in financial securities, e.g., a stock exchange or commodity exchange.
- A financial market is a market in which people trade financial securities and commodities at low transaction costs and at prices that reflect supply and demand.
- Securities include stocks and bonds, and commodities include precious metals or agricultural products.

Functions of the Financial Markets:

1. Creation and allocation of credit and liquidity
2. Utilisation of savings
3. Balanced economic growth
4. Provide financial convenience

PRIMARY MARKET
OR
NEW ISSUE MARKET

- Market where new securities i.e. shares and bonds first time issued.
- Both the new companies and the existing ones can issue securities in this market to raise capital.
- In this market transactions are made between an issuer and the investors.
- This market is directly regulated by SEBI.
- The process of selling new issues to investors is called underwriting.
- In the case of a new stock issue, this sale is called as an Initial Public Offer (IPO).

Functions of Primary Market:

1. **Origination:**

- It simply means **origin of the new issue.**
- It is the **work which begins before an issue is actually floated** in the market.
- The following things is being determined before origin of issue i.e.

a. Time of floating the new issue.
b. Type of issue
c. Price

2. **Underwriting:**

- It is a **kind of guarantee undertaken by an institution or firm of brokers** ensuring the marketability of an issue.
- It is a method in which the **guarantor promise to the issuing company that he/she would purchase certain specific shares if the public not invested in it.**

- The following **organisations who give guarantee** are:

a. LIC
b. GIC
c. Development Banks (IDBI, ICICI, etc.)
d. Brokers, etc.

3. **Distribution:**

- It involves the function of **sale of shares and debentures** to the investors.
- It is performed by **brokers and agents**.
- Brokers can **maintain regular list of clients** and directly contact for purchase and sale of securities.

Methods of Floating New Issues
OR
Methods to Raise Equity Capital in the Primary Market

1. **Public issue:**

- When a company **raises funds by issuing its shares, debentures and bonds to the public**, it is called as a public issue.

2. **Initial Public Offer (IPO):**

- When a company makes a public issue for the first time and gets its shares listed on stock exchange, the public issue is called as initial public offer (**IPO**).

3. **Follow-on public offer (FPO)**:

- When a **listed company makes additional public issue on running projects to raise capital**, it is called follow-on offer (**FPO**).

4. Offer for sale:

- Institutional investors like **venture funds, private equity funds** etc., invest in **unlisted company when it is very small or at an early stage.**
- When the company becomes large, these **investors sell their shares to the public, through issue of offer document and the company's shares are listed in stock exchange.** This is called as **offer for sale.**

5. Private Placement:

- It is the **sale of securities to a relatively small number of select investors for raising capital.**
- Investors involved in private placements are usually **large banks, mutual funds, insurance companies and pension funds**.
- Private placement is the **opposite of a public issue**, in which securities are made available for sale on the open market.

6. <u>Rights Issue:</u>

- When a company raises funds from its existing shareholders by issuing them new shares / debentures, it is called as **rights issue**.
- The offer document for a rights issue is called as the **Letter of Offer.**
- The issue is open for 30-60 days.

7. <u>Bonus Issue:</u>

- The company issues new shares to its existing shareholders.
- Shareholders need not pay any money to the company for receiving the new shares.

SECONDARY MARKET
OR
STOCK EXCHANGE

- A stock exchange is an exchange where stockbrokers and traders can buy and/or sell stocks (also called shares), bonds and other securities.
- It is a market place where listed securities buy and sell for investment or speculation.
- It is an organised and regulated market for various securities issued by corporate sector and other institutions.

- It is a privately organised market which are used to facilitate trading of securities.
- It is as ready market where buyers and sellers are always available to buy and sell the securities.
- The securities of corporations, trusts, Government, municipal corporations, etc. are allowed to deal at stock exchange.
- It is a market wholly governed and regulated by SEBI.

Functions of Secondary Market:

1. **Ensure Liquidity of Capital:**

- It provides a place where securities are converted into cash.
- It is a market where buyers and sellers are always available and those who need hard cash can sell their securities.

2. **Contributes to Economic Growth:**

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

3. **Spreading of Ownership culture:**

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

4. **Providing Scope for Speculation:**

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

5. **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.

6. 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.

7. 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.