

FINANCIAL MARKET

1. What are Financial Markets?

Financial markets are structured systems or platforms that enable the creation, exchange, and trading of financial assets such as money, shares, bonds, debentures, derivatives, and currencies between different participants in an economy. They act as a bridge between surplus units (savers and investors) and deficit units (businesses, governments, and institutions that need funds), thereby facilitating the mobilization of savings and efficient allocation of capital. Financial markets provide essential functions such as liquidity (easy conversion of assets into cash), price discovery (determination of fair market value through demand and supply), capital formation, and risk management through instruments like insurance and derivatives. By supporting investment, production, trade, and infrastructure development, financial markets play a central role in promoting economic growth, financial stability, and overall development of the economy.

2. Types of Financial Markets

Financial markets can be classified into different types based on the nature of instruments traded, maturity period of funds, nature of claims, and the stage of issue of securities. This classification helps in understanding how funds flow within the economy and how different segments of the financial system perform specialized functions. Each type of financial market serves a specific purpose—such as meeting short-term fund requirements, providing long-term capital, facilitating investment, managing risk, and enabling international trade and finance. Broadly, financial markets are divided into various categories such as money market, capital market, primary market, secondary market, foreign exchange market, and derivative market, each playing a distinct and complementary role in the efficient functioning of the financial system. Let's have a look one by one:

✓ Capital Market

Capital market is a segment of the financial market that deals with the mobilisation and allocation of long-term funds (generally for a period of more than one year) for productive purposes in the economy. It provides a platform through which companies, governments, and institutions raise long-term capital for business expansion, infrastructure development, industrial growth, and economic development by issuing financial instruments such as equity shares, preference shares, debentures, bonds, and government securities. At the same time, it offers investors opportunities to invest their savings and earn returns in the form of dividends, interest, and capital appreciation. The capital market plays a crucial role in capital formation, economic growth, employment generation, and development of industries. It is broadly divided into –

- **Primary market** (where new securities are issued)

Primary market is a segment of the capital market where new securities are issued for the first time directly by companies, governments, or institutions to raise fresh capital. It acts as the channel through which savings of investors are converted into long-term productive investments. In the primary market, funds flow directly from investors to the issuers, helping businesses finance expansion, new projects, diversification, and infrastructure development. Securities in the primary market are issued through methods such as Initial Public Offerings (IPOs) (first-time issue of shares by a company to the public), Follow-on Public Offerings (FPOs) (additional issue of shares by an already listed company), rights issues (offer of new shares to existing shareholders in proportion to their holdings), bonus issues (issue of free shares to existing shareholders from company reserves), private placements (issue of securities to a selected group of investors instead of the public), and preferential allotments (issue of shares to specific investors at a predetermined price). The primary market is the main source of fresh funds for the

corporate and public sector.

- **Secondary market** (where existing securities are traded)

The secondary market is the segment of the financial market where already issued securities such as shares, debentures, bonds, and other financial instruments are bought and sold among investors through recognized stock exchanges and over-the-counter platforms. In this market, the issuing company does not receive funds directly, as transactions take place between existing holders of securities and new buyers. The secondary market provides liquidity and marketability to financial instruments, allowing investors to easily convert their investments into cash.

- ✓ **Money Market**

The money market is a specialized segment of the financial market that deals in short-term funds and highly liquid financial instruments with a maturity period of one year or less, and it serves as the backbone of short-term finance in an economy. It provides a platform for banks, financial institutions, corporates, governments, and other participants to manage their short-term liquidity needs, working capital requirements, and temporary surplus funds. The money market ensures the smooth flow of short-term credit through instruments such as treasury bills, commercial bills, commercial paper, certificates of deposit, call money, and repo and reverse repo agreements, which are characterized by high safety, low risk, and high liquidity. This market plays a crucial role in maintaining stability in the banking system, balancing demand and supply of short-term funds.

- ✓ **Derivative Market**

The derivatives market is a type of financial market where people trade special contracts instead of actual goods or shares. The value of these contracts depends on something else, like the price of a share, commodity, currency, or index. These contracts are used mainly to protect against future losses or to make profit from price changes. For example, a farmer may use derivatives to lock the price of crops in advance, or an investor may use them to protect their investment from falling prices. Common derivative contracts include futures, options, forwards, and swaps. In simple words, the derivatives market helps people manage risk, plan safely for the future, and deal with price uncertainty in business and investment.

- ✓ **Over the Counter Market**

The over-the-counter (OTC) market is a type of market where buying and selling of financial instruments happens directly between two parties, without using a formal stock exchange like NSE or BSE. There is no central physical place or trading floor; instead, trading happens through banks, brokers, dealers, phones, and online networks. This market is commonly used for instruments like bonds, derivatives, currencies, and some shares. Suppose a company wants to borrow money for a short period and directly makes a deal with a financial institution to issue commercial paper at a fixed interest rate, without listing it on any stock exchange. This direct transaction between the company and the institution happens in the over-the-counter (OTC) market.

- ✓ **Foreign Exchange Market**

The foreign exchange market is the market where currencies of different countries are bought and sold. It is used when people, companies, or governments need to exchange one country's money for another country's money for purposes like trade, travel, study abroad, investment, or international business. This market works through banks, financial institutions, and online trading platforms, and not through a single physical location. Example: If an Indian student is going to the USA for studies, their family will exchange Indian rupees (₹) for US dollars (\$)

through a bank or forex service. This exchange of currencies happens in the foreign exchange market.

✓ **Commodity Market**

The commodity market is a market where physical goods (commodities) like gold, silver, oil, wheat, rice, cotton, sugar, coffee, and other raw materials are bought and sold. These goods are used in daily life and in industries for production. People trade in commodities either in actual form (physical delivery) or through contracts based on future prices. Farmers, producers, companies, and traders use this market to fix prices in advance, reduce risk, and earn profit from price changes.

Example: A jewellery maker buys gold from the market for making ornaments, and a farmer sells wheat in the market after harvest. Both of these activities happen in the commodity market.

✓ **Cryptocurrency Market**

The cryptocurrency market is a digital market where online money called cryptocurrencies like Bitcoin, Ethereum, and other digital coins are bought and sold. These are not physical currencies like rupees or dollars and are not controlled by any single government or central bank. Trading happens through online platforms and mobile apps, using internet and digital wallets. People buy cryptocurrencies for investment, trading, and digital payments. Prices change quickly because of demand, supply, and market news. Example: If a person buys Bitcoin using Indian rupees through a crypto app and later sells it when the price increases, this buying and selling happens in the cryptocurrency market.

3. **What is a Stock Market?**

✓ **Introduction**

The stock market is an important part of the financial system that provides a platform for the buying and selling of shares and other securities, enabling companies to raise capital and investors to invest their savings in productive economic activities. Through organized stock exchanges and regulated trading systems, the stock market ensures transparency, price discovery, and liquidity, allowing securities to be easily converted into cash.

✓ **Instruments traded in stock market**

The stock market facilitates the trading of a wide variety of financial instruments that serve different investment, financing, and risk management needs of investors and companies. These instruments include equity shares, which represent ownership in a company and provide returns through dividends and capital appreciation; preference shares, which offer fixed dividends with limited ownership rights; and debt instruments such as bonds, debentures, and government securities, which provide fixed income and capital safety. The market also trades mutual fund units, allowing investors to invest indirectly in diversified portfolios managed by professionals, and derivative instruments such as futures and options, which are used for hedging risk and managing price volatility. In addition, exchange-traded funds (ETFs), index funds, and other structured financial products are traded to meet modern investment needs. Together, these instruments provide investors with multiple options based on risk appetite, return expectations, investment horizon, and financial goals, making the stock market a diversified and dynamic investment platform.

✓ **Indian stock market structure**

The Indian stock market structure is a well-organized and regulated system designed to ensure transparent,

efficient, and secure trading of securities in the country. It is primarily organized around recognized stock exchanges such as the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), which provide electronic trading platforms for buying and selling securities. The market operates through a structured network of intermediaries including stock brokers, sub-brokers, merchant bankers, portfolio managers, investment advisors, custodians, and depository participants, who facilitate smooth market functioning. The depository system, consisting of NSDL and CDSL, enables dematerialization of securities and electronic transfer of ownership, while clearing corporations handle clearing, settlement, and risk management of trades. The entire system is regulated and supervised by the Securities and Exchange Board of India (SEBI), which ensures investor protection, market integrity, and fair-trading practices. Supporting institutions such as the Reserve Bank of India (RBI), clearing banks, and settlement agencies further strengthen the operational framework. This integrated structure ensures transparency, liquidity, investor confidence, efficient capital mobilization, and stability in the Indian stock market system.

4. How Stock Market Works?

✓ Companies go public

Companies go public through a formal and regulated process known as an Initial Public Offering (IPO), in which a private company offers its shares to the general public for the first time. The process begins with the company appointing intermediaries such as merchant bankers, investment bankers, legal advisors, auditors, and registrars to manage the issue. The company then prepares a prospectus containing detailed information about its business, financial performance, risks, objectives, and share offering, which is approved by the regulatory authority. After regulatory approval, the company decides the issue price and number of shares to be offered through methods such as fixed price issues or book building. The shares are then offered to the public through stock exchanges, investors apply for shares, and allotment is made based on demand. Finally, the shares are listed on the stock exchange, enabling public trading.

✓ Investors buy & sell stocks

Once companies go public and their shares are listed on the stock exchange, investors participate in the market by buying and selling these shares through recognized trading platforms and registered brokers. Investors use trading and demat accounts to place orders electronically, and transactions take place in the secondary market where ownership of shares is transferred from one investor to another. Through this continuous buying and selling process, investors aim to earn returns in the form of dividends and capital appreciation, while the market provides liquidity, price discovery, and smooth circulation of capital, thereby keeping the stock market active, dynamic, and functional.

✓ Prices are set by supply & demand

As investors actively buy and sell shares in the stock market, the prices of stocks are continuously determined by the forces of supply and demand. When more investors want to buy a particular share than sell it, demand increases and the price rises, whereas when more investors want to sell than buy, supply increases and the price falls. These price movements reflect various factors such as company performance, financial results, economic conditions, industry trends, news, and investor expectations. This demand–supply mechanism ensures fair price discovery, meaning that share prices represent the collective judgement of the market. In this way, the interaction

of buyers and sellers naturally decides the value of stocks, making pricing dynamic, transparent, and market-driven.

✓ **Stock exchange match buyers & sellers**

As prices are determined by supply and demand, stock exchanges play a crucial role by providing a centralized electronic platform that automatically matches buyers and sellers of shares. When investors place buy and sell orders through brokers or online trading systems, these orders enter the exchange's trading system, where they are matched based on price priority and time priority. This automated matching process ensures fairness, speed, transparency, and accuracy in transactions. By efficiently connecting buyers and sellers, stock exchanges enable smooth trading, continuous price discovery, and uninterrupted market activity, making the stock market an organized, reliable, and well-functioning system.

✓ **Investors make and lose money**

As buyers and sellers are matched on the stock exchange and prices move based on supply and demand, investors may make profits or face losses depending on market movements. When an investor buys a share at a lower price and sells it later at a higher price, they earn a capital gain, but if the share price falls after purchase and is sold at a lower price, the investor incurs a loss. In addition, investors may also earn income through dividends when companies distribute profits. These gains and losses are influenced by factors such as company performance, market conditions, economic changes, and investor decisions. This possibility of profit and loss makes the stock market both an opportunity for wealth creation and a space that involves risk, requiring informed decision-making and financial discipline.

✓ **Regulations keep it fair**

To ensure that this entire process of company participation, investor trading, price discovery, profit and loss, and market operations remains fair and trustworthy, the stock market is governed by strict regulations and regulatory authorities. Regulatory bodies such as SEBI in India monitor market activities, control malpractices, prevent fraud, insider trading, and market manipulation, and ensure transparency and ethical conduct. Rules related to disclosures, listing requirements, trading practices, and investor protection are enforced to create a safe and disciplined market environment. These regulations protect investors' interests, maintain market integrity, and build public confidence, ensuring that the stock market functions as a fair, stable, and reliable system for all participants.

5. SEBI – Watchdog of Indian Stock Market

The Securities and Exchange Board of India (SEBI) is the apex regulatory authority of the Indian securities market, responsible for regulating, supervising, and developing the stock market and related financial markets in the country. It was established to protect the interests of investors, ensure fair and transparent market practices, and promote the healthy growth of the securities market. By regulating stock exchanges, listed companies, and market intermediaries, and by framing rules, guidelines, and policies, SEBI plays a central role in maintaining discipline, integrity, and stability in the Indian financial system.

Functions of SEBI:

✓ **Insider Trading**

Preventing insider trading is one of the key regulatory functions of SEBI to ensure fairness and transparency in the securities market. Insider trading refers to the practice of buying or selling securities by individuals who possess unpublished price-sensitive information about a company, such as financial results, mergers, acquisitions, or major business decisions, before this information is made public. SEBI frames strict rules and regulations to prohibit such practices, monitors trading activities, investigates suspicious transactions, and takes legal action against individuals and entities involved in insider trading. By preventing misuse of confidential information, SEBI ensures equal access

to information for all investors, protects small investors from unfair disadvantages, and maintains trust, integrity, and ethical standards in the stock market system.

✓ **Regulating Intermediaries**

Regulating market intermediaries is an important function of SEBI to ensure the orderly and efficient functioning of the securities market. SEBI registers, supervises, and monitors various intermediaries such as stock brokers, sub-brokers, merchant bankers, mutual funds, portfolio managers, investment advisors, registrars, depository participants, and other financial service providers. It frames rules, codes of conduct, and operational guidelines for their activities and ensures compliance through inspections, audits, and regulatory actions. By regulating intermediaries, SEBI ensures ethical behaviour, professional standards, transparency, and accountability in market operations, protects investors from malpractices, and maintains discipline and stability in the securities market ecosystem.

✓ **Approving IPOs**

Approving Initial Public Offerings (IPOs) is an important regulatory function of SEBI to ensure transparency, investor protection, and fair capital raising in the securities market. Before a company can issue shares to the public, SEBI examines and approves the prospectus and disclosure documents to ensure that all necessary financial, legal, and business information is properly disclosed to investors. SEBI verifies that the company has complied with regulatory norms, listing requirements, and disclosure standards, and that investors are provided with accurate, complete, and truthful information for informed decision-making. By regulating and approving IPOs, SEBI prevents misleading information, protects investors from fraudulent issues, and ensures that public fund mobilization takes place in a transparent, fair, and legally compliant manner.

✓ **Promoting Investor Awareness**

Promoting investor awareness is a vital function of SEBI aimed at educating investors and protecting them from financial frauds, mis-selling, and market manipulation. SEBI conducts awareness programmes, financial literacy campaigns, workshops, seminars, digital initiatives, and educational drives to help investors understand basic investment concepts, market risks, rights and responsibilities, and safe investment practices. It also provides guidelines, educational content, and information platforms to improve financial knowledge among retail investors. By promoting investor education, SEBI empowers investors to make informed financial decisions, reduces vulnerability to exploitation, and strengthens investor confidence, thereby contributing to a more transparent, responsible, and stable securities market.

6. Careers in Stock Market

✓ **Equity Research Analyst**

Studies companies and markets to give investment recommendations

✓ **Stock Broker**

Executes buy and sell orders for clients on stock exchanges

✓ **Portfolio Management**

Manages investment portfolios for individuals and institutions

✓ **Trader**

Buys and sells securities for short-term profit

✓ **Investment Banker**

Helps companies raise capital and manage IPOs, mergers, and acquisitions

✓ **Wealth Manager**

Manages and grows the wealth of high-net-worth individuals by providing personalized investment planning, portfolio management, tax planning, and long-term financial strategies

✓ **Quantitative Analyst**

Uses mathematics, statistics, programming, and data analysis to build financial models, trading algorithms, and risk management systems for investment and trading decisions

✓ **Financial Journalist**

Covers stock markets, companies, economic trends, and financial news through articles, reports, TV shows, digital media, and analysis, helping the public understand market movements and financial developments

7.Functions of Financial Markets

✓ **Mobilization of Savings**

Mobilization of savings is one of the most important functions of financial markets, as it involves collecting scattered savings from individuals, households, and institutions and channelizing them into productive investment activities. Financial markets provide a wide range of financial instruments such as bank deposits, shares, bonds, mutual funds, insurance products, pension schemes, and other investment options that encourage people to save their money instead of keeping it idle. By offering different levels of risk, return, liquidity, and investment horizons, financial markets attract savings from various sections of society and convert them into capital for businesses, industries, infrastructure projects, and government development programmers. This process not only increases the availability of funds for economic activities but also promotes financial inclusion, capital formation, and long-term economic growth by ensuring that savings are effectively transformed into productive investments that contribute to national development.

✓ **Economic Indicator**

Financial markets act as an important economic indicator by reflecting the overall health, performance, and future direction of the economy through movements in prices, indices, and market trends. Changes in stock prices, bond yields, interest rates, trading volumes, and market indices often signal investor confidence, business performance, economic growth, inflation expectations, and financial stability. A rising market generally indicates economic expansion, strong corporate performance, and positive investor sentiment, while a falling market may indicate economic slowdown, uncertainty, or financial stress. Policymakers, governments, businesses, and investors use market trends and indicators as signals for economic planning, policy formulation, investment decisions, and strategic planning. In this way, financial markets function as a mirror of economic conditions, providing valuable insights into the present and future state of the economy.

✓ **Price Discovery**

Price discovery is a key function of financial markets, referring to the process through which the prices of financial instruments such as stocks, bonds, commodities, and derivatives are determined based on the interaction of demand and supply. In well-functioning markets, the collective buying and selling decisions of investors reflect the perceived value of assets, taking into account factors like company performance, economic conditions, interest rates, inflation, and market expectations. This process ensures that prices are transparent, market-driven, and fair, providing investors and businesses with accurate information for making financial and investment decisions. Effective price discovery also helps in efficient allocation of resources, as funds are directed toward assets and sectors that are valued higher by the market, ultimately contributing to economic growth and stability.

✓ **Support to Government**

Financial markets provide crucial support to the government by facilitating the raising of funds for public expenditure, infrastructure development, and welfare programs through instruments such as government securities, bonds, treasury bills, and other debt instruments. By issuing these securities in the primary market, the government can

borrow funds from investors, including banks, financial institutions, and the general public, to meet fiscal requirements without relying solely on taxation. The secondary market ensures liquidity and tradability of these instruments, making government borrowing more efficient and attractive to investors. Additionally, financial markets help the government in implementing monetary and fiscal policies, managing public debt, and regulating interest rates, thereby supporting macroeconomic stability and the smooth functioning of the economy.

✓ Foreign Investment Flows

Financial markets play a key role in attracting and facilitating foreign investment flows into the economy, including Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). By providing transparent, liquid, and regulated platforms such as stock exchanges and bond markets, financial markets enable foreign investors to invest in domestic companies, government securities, and financial instruments with confidence. These inflows bring additional capital, technology, expertise, and global market access, helping domestic businesses expand and modernise. Moreover, foreign investment flows contribute to exchange rate stability, increased liquidity, and enhanced market depth, while signalling international confidence in the country's economic prospects. Effective management and regulation of these flows by financial markets ensure that foreign capital is mobilised efficiently and supports sustainable economic growth.

