5.7 STRUCTURE OF CAPITAL MARKET

In the previous section, you have read about the money market which provides short term funds to investors for less than one year. However, business units and investors need funds for a longer duration also for undertaking business expansions or technology upgrading and in this regard they approach the capital market. A capital market is a market for long term securities or financial instruments having a maturity period of more than one year. Capital markets are important for channelising savings, capital formation and industrial growth. The structure of the capital market in India can be better understood with the help of Figure 5.4

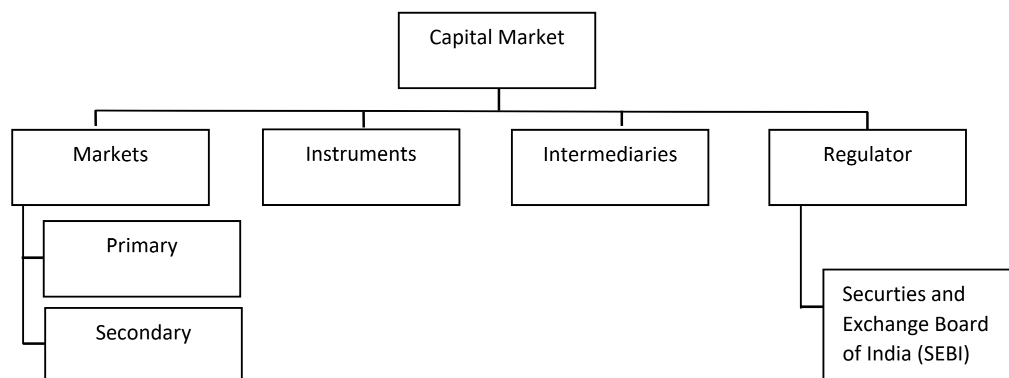

Figure 5.4: Structure of Capital Market in India

Capital markets comprised of two markets i) Primary Market and ii) Secondary Market. The primary market is also known as the New Issue Market (NIM) where the issuer of the securities (shares and bonds) sell the new securities to the investors directly without any intermediaries. Whenever the securities are offered for sale for the first time by the companies they are called Initial Public Offering (IPO). IPO is issued to raise capital for funding purpose. Both the companies and government raise funds by the sale of new stocks in the primary market.

The secondary market is also known as the stock market. It is a place where shares, bonds, options, etc which were sold earlier are sold and purchased. In India, you must have heard

about the Bombay Stock Exchange (BSE), National Stock Exchange (NSE) they are some of examples of stock exchanges. The secondary market can be either an auction market or Over-the-Counter. In the auction market, trading of securities is done through the stock exchange. In Over-the-Counter the trading is conducted without using the platform of stock exchange, it does not have any physical location and trading is done electronically.

Financial Instruments

Some of the major financial instruments used in capital markets are discussed below.

Shares

A share indicates a unit of ownership by the buyer of shares called shareholder/holers of the company. A shareholder has ownership in the company and has voting rights and shares the company profit or loss. The benefit which a shareholder receives out of company profit is called a dividend. Let us understand it with an example. Assume that there is a company know as XYZ limited and it needs funds (Rs 100 crore) for further expansion. For raising this fund the company will go to the public. This capital of Rs 100 crores is divided into 1,000,000 shares of Rs. 1000 per share. Now assume that there are two investors A and B and they want to invest in this company so they will buy some shares. Investor A buys 500 shares and investor B buys 800 shares so they are investing Rs 500000 and Rs 8000000 in this company and have become the shareholders and will share the profit or loss of the company in the proportion to their holdings. Further, shares are of two types namely equity shares and preference shares.

Bonds

Bonds are issued by state and central governments, companies and municipalities to raise money for a variety of projects and activities. They are debt instruments in which the entities borrow the funds for a defined period of time at a variable or fixed interest rate. It is fixed-income security and essentially a loan agreement between a bond issuer and an investor. The bondholders unlike shareholders do not have any ownership of the company or have voting rights.

Debentures

Debentures are also a type of debt instrument which is issued by companies for raising funds but they are not secured by physical assets or collateral. An investor buys debentures based on the reputations and the creditworthiness of the issuer. The interest rate on debentures is higher than that of bonds.

SENSEX also known as Sensitive Index (or S&P BSE Sensex Index) is a benchmark index of Bombay Stock Exchange. It is the market weighted stock of 30 companies.

Gilt Edge Market : The gilt-edged market refers to the market for Government and semi-government securities and is backed by the RBI. Government securties are called Gilt -edged means 'of the best quality' because they are highlighy liquid and risk free

Capital Market Intermediaries

There is a large number of intermediaries in the capital markets some of which are discussed below:

Merchant Bankers

Merchant Bankers are intermediaries between the investors and the company. They act as an advisor who advises the entrepreneurs from the stage of the conception of the project till the production begins. SEBI defines merchant bankers as "any person who is engaged in the business of issue management either by arranging for buying, selling or subscribing to securities or acting as manager, consultant or rendering corporate advisory services in relation to such issue management".

Underwriters

When a company decides to go public to raise funds all of its securities maybe not fully subscribed by the public, so there is a need for someone who can subscribe to those securities. This work is done by the underwriter he agrees with the issuer company that in the case of securities that are not subscribed then the underwriter would subscribe to the securities itself or by others the unsubscribed securities. He is paid a fee called 'underwriting commission' for this job. Underwriters can be both institutional (for example IDBI, UTI) or non-institutional. All underwriters need to be registered with SEBI.

Portfolio Managers or Portfolio Management Services (PMS)

A professional who enters into a contract with the client to advise or direct or undertake investment decisions on behalf of the client. Portfolio managers are of two types discretionary portfolio managers and non-discretionary portfolio managers. When the portfolio manager manages the funds of the client independently according to the needs of the client they are called discretionary portfolio managers. Whereas non-discretionary portfolio manager manages the funds following the directions of the client. Some of the examples of major **Portfolio Management Services** in India are Motilal Oswal PMS, Kotak PMS, ICICI Prudential PMS, etc.

Stock Brokers

A stockbroker is an individual or firm which is an intermediary between an investor and a securities exchange. The stockbroker trades in the stock exchange on the behalf of their clients. In return for their services, they are paid commissions of fees. They handle all the paperwork and maintain records of all transaction, manages their client's portfolio and advise the investors on formulating different investment strategies in the dynamic world of financial markets. All stockbrokers are registered with the SEBI.

Regulator of the Capital Market /SEBI

In India, the capital market is regulated by the Securities and Exchange Board of India (SEBI). SEBI was established in 1988 as a non -statutory body but with the passing of SEBI Act 1992, it was accorded statutory power. The major objectives of SEBI are to protect the interest of investors and development and regulation of stock exchange, to prevent deceitful malpractices and to regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc. SEBI performs various functions like registration of stock exchanges, mutual funds, underwriters, brokers and sub-brokers. Levys various fees and other charges promote investors educations, audit and inspection of stock exchanges and various intermediaries, prohibits unfair trade practices relating to the securities market and insider trading.

Activity 2

1. Conduct a field survey of your neighbourhood and assess the awareness level of the stock market.

   ____
   ____
   ____
   ____
   ____
   ____

2. Nowadays there is a trend of investment among common man in Mutual Funds through Systematic Investment Plan (SIP). Try to collect some information in your neighbourhood about the factors which affect individuals decision to invest in MF.

   ____
   ____
   ____
   ____
   ____
   ____

5.8 SUMMARY

This unit has given you detailed information about the financial system. Initially, you read about the importance of the financial system whereby it brings the suppliers and the borrowers of funds in the common platform. In the subsequent sections, the importance, functions and instruments of the money market were discussed. One of the major components of money markets is banks. In India, RBI is the apex bank and it formulates and regulates monetary policy. Monetary policy has two instruments namely quantitativeand qualitative. Quantitative instruments include various policy rates like CRR, Repo and Reverse repo rate, bank rate, etc. which aims at controlling the quantum of credit. Qualitative methods like moral suasion, direct action and others aim at directing the credit flow to a particular sector or to prohibit the credit flow. RBI uses both instruments but quantitative methods are more visible and easy to administer.

In the next section, you developed an understanding of banks and the various functions of the banks along with the structure of banking in India. The different categories of banks like the public sector, private sector, foreign banks were discussed in some details. In the last section, an understanding of the working of the capital market was highlighted with the emphasis on the meaning of capital market, its various instruments, intermediaries and SEBI.

5.9 KEY WORDS

Financial System: It consists of a set of institutions, instruments and markets which brings the savers and the investors to a common platform and provide the means by which savings are translated to investment.

Cash Reserve Ratio (CRR): It is the minimum amount that banks keep with RBI as a proportion of their Net Demand and Time Liabilities (NDTL).

Statutory Liquidity Ratio (SLR): It is the percentage of NDTL that banks have to mandatory maintain in safe and liquid assets like cash, gold or government securities.

Bonds: Bonds are issued by state and central governments, companies and municipalities to raise money for a variety of projects and activities.

5.10 SELF-ASSESSMENT QUESTIONS

1. Differentiate between money market and capital market.
2. Differentiate between shares and bonds.
3. What are the major functions of RBI?
4. Write about some of the instruments of the money market.
5. Write a note on SEBI.

5.11 REFERENCES/ FURTHER READINGS

1. Mishkin, Frederic. S. (2007) *Financial Markets and Institutions*. New Delhi, Pearson Education Ltd.
2. Khan, M. Y. (2007). *Indian Financial System*. New Delhi. Tata McGraw Hill.
3. Machiraju, H.R. (2006). *Indian Financial System*. New Delhi. Vikas Publication.
4. Bhole, L.M. (2008). *Financial Institutions and Markets*. New Delhi. Tata McGraw Hill.

ignou THE PEOPLE'S UNIVERSITY

ignou
THE PEOPLE'S
UNIVERSITY