INTRODUCTION TO FINANCIAL MARKETS

Definition

Functions

Types

Instruments

CONCEPT OF FINANCIAL MARKET

- A market operates by bringing together, many buyers and sellers thereby making it easier for them to be able to locate each other.

- A financial market helps to bring together, those who have money (lenders/buyers of financial instruments) and those who need money (borrowers/sellers of financial instruments).

- Financial markets is used to identify markets where funds can be raised.

- Without financial markets, borrowers will find it difficult to locate lenders

Definition

- Any system/structure that makes it possible to trade in different kinds of financial securities.
- Markets where financial instruments like debt, debentures, equities are traded.
- Market where government, companies and individual investors can have the opportunity to trade in financial securities.
- Financial security/instrument is the receipt which the borrower issues to the lender as a promise of evidence to pay back the capital.

Types of Financial Markets

- There are two types of financial markets
- 1. Money market
- It is a market where short-term financial securities are bought and sold.
- Only funds that are needed for a short period of time can be raised from this market.
- The funds raised from this market can only be used for a maximum period of one year or less.

Functions of Financial Markets

1. promote economic growth by making money available to different sectors
2. platform for effective implementation of monetary policy
3. Stabilize demand and supply of money for short time transactions
4. Avenues for short term investments
5. Generates savings and investments in the economy

Money Market Instruments

1. Treasury Bills: instruments used by government to borrow funds for a short time and are usually issued by the Central Bank.
2. Repurchase Agreements: both parties agree to sell and repurchase the same security. The seller agrees to sell to the buyer and later buy the same security back from the buyer
3. Certificate of Deposit: a promissory note issued by a bank which gives the bearer the right to receive interest.
4. Banker's Acceptance: a promise by the buyer to pay the seller and the buyer's bank will stand as a guarantor.

Types of Financial Markets

- 2. Capital Markets
- Markets where financial securities that have life span of more than one year are bought and sold
- Market for medium and long-term financial securities

Types of Capital Markets

- Capital markets are divided into two:
- 1. Primary Market: where newly issued financial securities are bought and sold.
- Transactions in the primary market are usually between the company issuing the security and investors buying
- 2. Secondary Market: where already existing financial securities are bought and sold.
- Transactions in the secondary markets are usually between investor who have already bought such securities but who wishes to resell and other investors.
- The company that issued the financial securities do not get involved in the secondary markets

Types of Secondary Markets Instruments

- 1. Shares/Equities
- An equity share, normally known as ordinary share is a part ownership where each member is a fractional owner and initiates the maximum entrepreneurial liability related to a trading concern.
- 2. Debt/Debenture
- A debenture is a type of debt instrument issued by companies to raise capital.
- It is not secured by physical assets or collateral. Debentures promise to pay interest and principal to the debenture holders.
- Companies issue debentures to investors, and these investors become creditors of the company.