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# ROLE OF FINANCIAL MARKETS IN INDUSTRIAL DEVELOPMENT

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***Abstract***

*In the recent times the financial system becomes increasingly important either as a facilitator of economic growth. The significant role of the financial sector in supporting an efficient allocation of resources and economic growth. But it has not been so well recognized that as economies are developing, the financial system becomes increasingly important either as a facilitator of economic growth or as an inhibitor. In the financial market, the securities in trade is money which could be raised through multiple instruments, under well governed rules and regulations, carefully administered and controlled by different institutions or market operators and regulators. In fact the rate of economic growth of any nation is linked with the performance of its financial market and specifically its capital markets efficiency and growth. While considering the importance of role of financial market in economic growth of any nation, this is a descriptive paper and focuses on capital markets, types and its functions, role, advantages, disadvantages, recent trends and developments related to financial systems.*

***Keywords: Capital Market, Economic Growth, Financial Market.***

## Introduction

A capital market is a financial market in which long-term debt or equity -backed securities are bought and sold, in contrast to a money transfer where short-term debt is bought and sold. Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. Financial Regulators like Security Exchange Board of India (SEBI), Bank of England (BoE) and the U.S. Security and Exchange Commission (SEC) oversee capital markets to protect investors against fraud, among other duties. Generally, the personal savings of an entrepreneur along with contributions from friends and relatives are the source of fund to start new or to expand existing business. This may not be feasible in case of large projects as the required contribution from the entrepreneur (promoter) would be very large even after availing term loan; the promoter may not be able to bring his / her share (equity capital).Thus availability of capital can be a major constraint in setting up or expanding business on a large scale However, instead of depending upon a limited pool of savings of a small circle of friends and relatives, the promoter has the option of raising money from the public across the country by selling (issuing) shares of the company. For this purpose, the promoter can invite investment to his or her venture by issuing offer document which gives full details about track record, the company, the nature of the project, the business model, the expected profitability etc.

Businesses can raise funds through various ways and many sources through the financial markets. A financial market helps mobilize funds between savers [households] and investors business. The work of allocation is done by two intermediaries which can be banks or financial markets. A Financial Market is referred to space, where selling and buying of financial assets and securities take place. It allocates limited resources in the nation's economy. It serves as an agent between the investors and collector by mobilizing capital between them. In a financial market, the stock market allows investors to purchase and trade publicly companies share. The issue of new stocks is first offered in the primary stock market, and stock securities trading happen in the secondary market.

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**Reviews of Literature**

**Shanmuga Sundaram** is of the view that stock scam is the volatility in the share price movements without relevance to the performance of the company. During the period March-August 2001, there have been a number of stock scams in the capital market. After analyzing these scams, SEBI had reported the involvement of brokers, promoters, bankers, etc. this paper is an attempt to find out the reasons for the scams and suggest necessary action to prevent them. It also outlines the various steps taken by SEBI in this regard such as the introduction of margin trading and rolling settlement, ban on badla trading and introduction of derivative trading viz. future and options. A few recommendations are made for consideration by SEBI, government and RBI to avoid or minimize the stock scam.

**Nalini Prava Tripathy** noted that the rapid development of the capital market and financial liberation has brought a profound change in the perception of entrants in the capital market. The large sum of Foreign Direct Investment in the country is an obvious outcome of India's commitment to the process of most attractive investment markets, the world over. The GDR issues of Indian companies received an overwhelming response abroad. Thus, in this article, an attempt has been made to determine the relationship between movement of GDR price and domestic price to encourage Indian companies to integrate with global market. It also highlights the significance of the difference of variance in average GDR price and average domestic price to tap the international capital market with greater confidence.

**Sur, D., & Bhunia, A. (2015)** examined the influence of selected macroeconomic variables in terms of international crude oil price, exchange rates, domestic gold price, real interest rates, and wholesale price index on stock market indices (Sensex and Nifty) of India. With the help of time series, monthly data was collected from Reserve Bank of India database; BSE and NSE database, investing.com and yahoo, finance database for the period July 1997 to July 2015 with the application of financial econometrics. It was found that Sensex and Nifty reactions to shocks on crude oil prices, exchanges rates, real interest rates, and wholesale prices indices were positive while a negative shock from Sensex and Nifty to real interest was noticed.

**Objectives of the Study**

- To study the overview of the Capital and financial markets
- To know the challenges faced by the capital markets

**Research Methodology**

This paper is based on secondary data. The data has been collected from internet, research articles, newspapers and magazines and broacher etc.

Capital markets structure is made of primary and secondary markets.

- Primary markets consist of companies that issue securities and investors who purchase those securities directly from the issuing company. These securities are called Initial Public Offerings (IPO). Whenever a company goes public it sells its stocks and bonds to large scales institutional investors like hedge funds and mutual funds.
- Secondary markets are places where the trade of already issued certificates between investors are overseen by regulatory bodies. Issuing companies play no part in the secondary market. Examples of secondary markets are New York Stock Exchange (NYSE), London Stock Exchange (LSE), and Bombay Stock Exchange (BSE).

**Functions of financial markets**

- ✓ It mobilizes savings by trading it in the most productive methods.

- ✓ It assists in deciding the securities price by interaction with the investors and depending on the demand and supply in the market.
- ✓ It gives liquidity to bartered assets.
- ✓ Less time-consuming and cost-effective as parties don't have to spend extra time and money to find potential clients to deal with securities. It also decreases cost by giving valuable information about the securities traded in the financial market.

**Types of Financial Markets**

- **Over the Counter (OTC) Market –** They manage public stock exchange, which is not listed on the NASDAQ, American Stock Exchange, and New York Stock Exchange. The OTC market dealing with companies are usually small companies that can be traded in cheap and has less regulation.
- **Bond Market –** A financial market is a place where investors loan money on bond as security for a set if time at a predefined rate of interest. Bonds are issued by corporations, states, municipalities, and federal governments across the world.
- **Money Markets –** They trade high liquid and short maturities, and lending of securities that matures in less than a year.
- **Derivatives Market –**They trades securities that determine its value from its primary asset. The derivative contract value is regulated by the market price of the primary item — the derivatives market securities, including futures, options, contracts-for-difference, forward contracts, and swaps.
- **Forex Market –** It is a financial market where investors trade in currencies. In the entire world, this is the most liquid financial market.

**Key Roles of Financial Markets**

- Allocation of Capital
- Facilitating for Investment
- Providing liquidity
- Price discovery
- Risk Management
- Promoting Economic Growth
- To provide market for equity
- To facilitate financial exchange of goods and services
- To allocate funds for productive uses

**Types of Financial Markets**

| Primary Market | Secondary Market |
|---|---|
| It issues security for the first time. Example- Initial public offer and follow on public offer. | Existing securities are bought and sold. |
| Firms issue shares to the public. | One investor sells it to another investor. |
| Price is fixed by the firms. | Price is fixed based on demand and supply. |
| Firms raise money for long-term investments. | Companies benefit from the secondary markets. |
| There is no specific geographical location. | There is no specific geographical location. |
| Security & Exchange Board of India (SEBI) is the regulator for this market. | SEBI is the regulator of this market as well. |

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**An efficient financial market can serve the following purposes:**

- Supporting investors managing their capital for different time horizons with financial products.
- It provides a source of capital for businesses depending on short-term or long-term financing requirements for both private as well as the government.
- Minimizing risks by some strategies such as hedging or diversification.
- Act as a mirror reflecting the economic conditions of the country/states.

**Differences between Capital Market and Money Market**

| Capital Market | Money Market |
|---|---|
| It deals with short-term financial transactions. (up to 1 year) | It deals with medium and long-term financial transactions. Medium 1-5 yrs. |
| Net lenders are people. | |
| Firms borrow to invest money to buy raw materials. This is a short-term transaction. | Long Term Over 5 years |
| This is called working capital finance. | Promotes capital formation. |
| Working capital finance. | Deals with both bonds and equity. Example: Debentures, shares, etc. |
| Works only with bonds. Example: Commercial papers, commercial bills, treasury bills, etc. | The general public also participates significantly |
| The general public does not participate much in the Money market. | RBI is the regulator of the Money Market in India |
| The Prime regulator is RBI. | The common Instruments of money market are call money, treasure bill, commercial bill. |

**Different types of financial Instruments**

- Cash Instruments
- Derivative Instruments
- Foreign Exchange Instruments

**Significance of Financial Markets in the economy**

Capital markets are financial markets that bring buyers and sellers together to trade stocks, bonds, currencies, and other financial assets. Capital markets include the stock market and the bond market. They help people with ideas become entrepreneurs and help small businesses grow into big companies. Businesses need capital to grow and to expand their respective business thus, where the financial market plays a critical role in the buildup of capital and the production of goods and services providing access to capital. In a well-developed and efficient market, the transaction costs are always lower with efficient transfer of funds; it can be mean also a lower cost of financing and a safe return on investment. In developing countries, which have limited financial market, the poor legal system, transparency may make it more costly to raise capital and may lower the return on savings or investments Vis a Vis the risk. A good financial market helps in the creation of wealth and provides a link between savings and investment that meet the short-term and long-term financial needs of both the household and corporate sector through efficient mobilization and allocation of surplus. Macroeconomic factors mentioned such as growth, inflation, business cycles, etc have a strong impact on the financial markets. Financial structures fund businesses and companies, contributing to job growth and, in turn, growing economic development and trade. Increased trade leads to increased competition, such as sales and marketing that increase jobs in these sectors further. Whether it is primary, secondary and tertiary sectors all need capital for growth, and the need for capital is balanced by the financial system.

**Functions of Capital Markets**

- Capital markets bring together those requiring capital and those having excess capital.
- Capital markets aim to achieve better efficiency in transactions.
- It helps in economic growth
- It ensures there is the continuous availability of funds
- By ensuring the movement and productive utilization of capital, it helps in boosting the national income.
- Minimizes transaction costs and information costs.
- Makes trading of securities easier for companies and investors.
- It offers insurance against market risk.

**Capital market – Advantages**

- Money moves between people who need capital and who have the capital.
- There is more efficiency in the transactions.
- Securities like shares help in earning dividend income.
- With the passage of time, the growth in value of investments is high.
- The interest rates provided by securities like Bonds are higher than interest rates given by banks.
- Can avail tax benefits by investing in stock markets.
- Scope for a wide range of investments.
- Securities of capital markets can be used as collateral for getting loans from banks.

**Challenges faced by the Capital Markets in India**

- Limited information and regulatory oversight. Private companies have limited regulatory oversight because they have few investors.
- Social, political, economical problems.
- No trading history. Financial markets are full of risks. ...
- Disruptive business model.
- Lack of large project experience.
- The bottom line.

**Conclusions**

Stock markets can be volatile, and the reasons behind stocks rise and fall can be complex. Stock prices are affected by many factors like macroeconomic factors, institutional factors, and other factors that influence stock prices directly or indirectly. The empirical literature shows that macroeconomic variables such as inflation rate, exchange rate, money supply, industrial production, the wholesale price index, GNP, FDI, and GDP are important and have a positive impact on stock market development. Macroeconomic instability can adversely affect the development of the stock market. Moreover, institutional factors such as institutional quality, financial liberalization policies, political risk, law and order, and bureaucratic quality play major roles in the development of stock markets. Financial indicators are a neutral tool for evaluating the company's performance. Investors are always searching for that one golden key measurement that can be obtained by looking at a company's financial statements. Although, investors should analyze these four main areas of financial health that should be examined are liquidity, solvency, profitability, and operating efficiency. Among the four, the best measurement of a company's health is the level of its profitability. However, no single metric

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