Understanding Capital Markets

Neeraj Marathe

13/02/2021
Introduction

• Let us say you want to start a business. You will put in some of your own money, borrow some from banks etc. But beyond a certain size, where will you get more money from?

• Capital market: A place where people & organisations in need of long term capital are brought together with people & organisations will to provide this long term capital

• The capital market is composed of 2 segments; the primary market (street name: IPO market) and the secondary market (street name: share market)

• There are 2 main type of securities in the capital market; shares and bonds
Role of capital market in the economy

- Savings mobilization
- Enhancement of income
- Productive use of income
- Capital formation
- Price determination and discovery
- Sale mechanism to investors
- Better information dissemination
Primary Market

- In the primary market, fresh financial instruments are created and sold to investors.
- The company gets the money to grow and become bigger, and the investors get the financial instrument (like shares).
- Now why would an investor buy the shares? (at Rs.20 in the present case)
I love the company. I will pay Rs.23/share for it.

I got the shares at Rs.20.

Me too! Will sell at Rs.25.

I will pay Rs.22/share.

A platform
Secondary Market

• In the secondary market, investors buy and sell shares among themselves. Where did these shares come from?

• But how will these investor buyers-sellers find each other? That is where the platform comes in; the stock exchange

• Investors get money when they sell shares they own to other investors. The company gets nothing

• So, if Infosys stock price goes from Rs.800/share to Rs.1300/share, does Infosys get richer?
The Stock Market – how we began

• Video of BSE
• https://www.youtube.com/watch?v=VfW-jmQvv8I
The Stock Market – where we are today

- Physical share certificates have been converted into electronic form (technically known as dematerialisation of shares; demat)
- Just like your money is stored in your savings bank account, your electronic shares are stored in a demat account
- The physical ring has been replaced by computer systems (saving many from getting a black eye!)
- You place your buy/sell orders online and can see their status etc online
- Technological advancements are continuously changing the way our markets function. Algo trading, for example
- So how does one start?
The Actual Infrastructure

Stock Exchange
Mainframe Computer

Brokers

Satellite
The characters in the mad-house

Retail Investors
HNI Investors
Mutual Funds
Insurance Companies
Foreign Investors
Portfolio Managers
How is it important for you?

• Finance / non-finance student; it doesn’t matter. You will be exposed to the ‘stock market’ in a variety of ways in life

• Having a basic understanding of how it works is a must

• More importantly, having an idea of how to avoid the big blunders is a must

• Some important points to remember
  • There is no guarantee (practically and legally)
  • If it’s too good to be true, it’s surely not true
  • All stock market stories will always end with you going ‘wooooow’
  • Survivorship bias
  • Perverse incentives everywhere
  • Mutual funds are the best, indirect way to invest in stocks