BHARAT SCHOOL OF BANKING

Capital Market - Part I

While **Money Market** deals with **short-term** (up to **1 year**) funds, **Capital Market** deals with **medium** and **long term** (more than **1 year**) funds. It refers to all facilities and institutional arrangements for **borrowings** and **lending** medium and long term funds.

Borrowers - **private business corporations, PSUs, government,** etc.
Lenders - **individual, institutional investors, banks, financial institutions, government,** etc.

Capital Market

Capital market is the part of a **financial market**, where **companies** that need **capital** for its business purpose, issue **stocks** or **bonds** to the **investors** and raise money. **Investors** invest in **capital market** to earn profit from its **investment**.

They have **two** options for **investment** - either buy **equity (stock) instrument,** or **debt** (bonds, debentures) **instrument**. (Refer my previous post on **Equity & Debts**)

Primary and Secondary Market

Sometimes, a **company directly** approaches a **market** to get some **investment** and raise **capital**. For this purpose, they can work with **lead managers** or **merchant bankers**, who help them to raise money.
If **investors** directly provide money to the **company** (meaning, company raises capital directly from investors), then it means that the **trading** is in **Primary Market**.

After an **investor** has **shares** or **bonds** (whatever **instrument** he/she bought from the company in **Primary Market**), can **sell** his/her **shares/bonds** to other **investors**. All **consequent** buying or selling will be traded in the **Secondary Market** (meaning, investors doesn't buy instruments **directly** from the **company** in a Secondary market).

Issues in Primary Market

There are several type of **Issues** in a Primary market -

1. Initial Public Offering (IPO) - A company when **first time** wants to raise money from the **market**, **issues** shares to the general **public** (meaning, previously shares held only by the founding members, or the company itself). This **first time share issue** is known as **Initial Public Offering (IPO)**.
After IPO, the company becomes a **public company,** because the general **public** is also the **shareholder/stakeholder** of the company. It is now **listed** in one or more **stock markets** for trading in **Secondary Market**.

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2. Follow-On Public Offering (FPO) - After sometimes (after IPO), suppose, the company again wants to **issue** shares (shares held by company) to the **public**, then it will be known as **Follow-On Public Offering**. Note that this is done in **Primary Market** (investors buy directly from company), not in **Secondary market** (investors buy from other investors, or stock markets)

Confusion **-** Don't confuse **FPO** as **Secondary Market** offering. As I discussed earlier, that **Secondary market** deals only within the **investors**, not with the **company,** whereas, **IPO** and **FPO** work between the **company** and the **investor** (hence in **Primary Market**).

Company in need of capital, can raise money, by issuing **shares** to its **existing shareholders**, or to **non-shareholders.**

3. Rights Issue - If the company issues shares to **existing** shareholders in **per share basis**, then the **percentage stake** will not be **diluted.** This is known as **Rights Issue.**
For an example, suppose a company issues **1:3 Rights Issue @ Rs. 50/share**. It means an **existing shareholder** having **3 shares** already can **buy 1 new share** at **Rs. 50**. Note that the **percentage stake** is **not diluted**, because every **shareholder** again holds the **same percentage** of shares.

4. Preferential Issue - If the company issues shares to some other **selected (preferred)** people who is **not** an **existing shareholder,** then it will be known as **Preferential Issue**. Note that **percentage stake** is **diluted** here, because **new** person becomes **shareholder.**

Trade in Secondary Market

After the **IPO**, **investors** have the **securities** they bought, and the company has the **money/capital**. The company then **lists** the **securities** on one or more **Stock Exchanges** (like BSE, NSE, Nasdaq, etc).
Companies **apply** to the respective **stock exchanges** to get their **stocks listed,** after paying a **listing fee**. **Listing** facilitates the **subsequent** buying and selling of the **securities** through current and prospective **investors**. This enables **investors** to make **profits,** reduce **risks**, **invest** in **prospective** growth areas, and so on (and making a lot of **speculations**! **ups and downs** in stock market)

Note that in **Secondary** market, **investors** can **buy** and **sell** their **stocks** from and to **other investors**.

Some **Stock Exchanges -**
Bombay Stock Exchange (BSE), National Stock Exchange (NSE), New York Stock Exchange

(NYSE), NASDAQ, Japan Exchange Group, Euronext, London Stock Exchange, Hong Kong Stock Exchange, Deutsche Bourse, TMX Group, etc.