Capital Market: Financial Market

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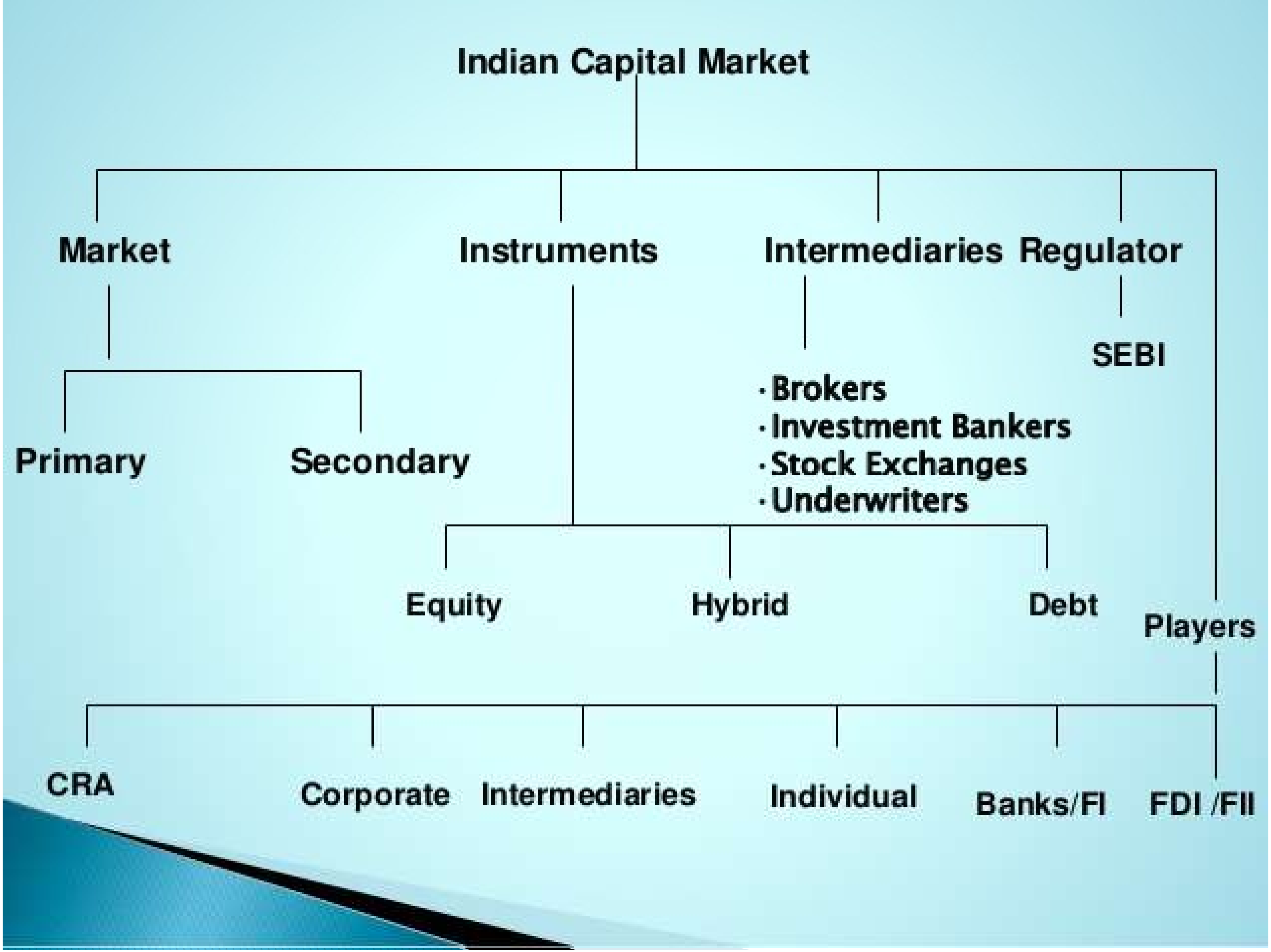
Indian Capital Market
Market
Instruments
Intermediaries
Regulator
Primary
Secondary
SEBI
· Brokers
· Investment Bankers
· Stock Exchanges
· Underwriters
Equity
Hybrid
Debt
Players
CRA
Corporate
Intermediaries
Individual
Banks/FI
FDI /FII

CAPITAL MARKET INSTRUMENTS

It includes;

- Equity instruments (common stocks)
- Debt instruments
- Insurance instruments.
- Hybrid instruments
- Derivatives

EQUITY INSTRUMENTS

- **Equity** is used in accounting in several ways. Often the word equity is used when referring to an ownership interest in a business. Examples include stockholders' equity or owner's equity
- In the capital market equity is used as a source of finance (capital)
- When the company wants to raise funds it can issue common stock or preference shares.

EQUITY INSTRUMENTS

- The main types of equity are :
- Common stock: A security that represents ownership in a corporation.
- When the company issue common stock they gives shareholder to own some part of company ownership.
- Holders of common stock exercise control by electing a board of director and voting on corporate policy.
- In the event of liquidation, common stockholder have rights to a company's assets only after bondholder, preferred shareholders and other debtholders have been paid in full.

COMMON STOCKS

- If the company goes bankrupt, the common stockholders will not receive their money until the creditors and preferred shareholders have received their respective share of the leftover assets.
- This makes common stock riskier than debt or preferred shares. The upside to common shares is that they usually outperform bonds and preferred shares in the long run.

PREFERENCE SHARES

- The holder of preference share also own some percentage of the company but cannot participate in anything to the company.
- Holder of preference share has the claim of the company asset and earning of the company .
- Normally has the first priority if there is any dividend payment than common stock holder.
- The main benefits to owning preference shares are that the investor has a greater claim on the company's asset than common stockholders.

PREFERENCE SHARE (PREFERRED SHARES)

- Preferred shareholders always receive their dividends first and, in the event the company goes bankrupt, preferred shareholders are paid off before common stockholders.
- In general, there are four different types of preferred stock.
- Cumulative preferred stock
- Non cumulative preferred stock
- Participating preferred stock
- Convertible preferred stock

CUMULATIVE PREFERRED STOCKS

- A preferred stock will typically have a fixed dividend yield based on the per value of the stock. The dividend usually is paid out at set of interval, usually quarterly to preferred stock.
- If a company runs into some financial problems and is unable to meet all of its obligations, it will likely suspend its dividend payments and focus on paying the business-specific expenses. If the company gets through the trouble and starts paying out dividends again, it will first have to pay back all of the dividends that are owed to preferred shareholders.

NON-CUMULATIVE PREFERRED STOCKS

- A type of preferred stock that does not pay the holder any unpaid or omitted dividends.
- If the corporation chooses to not pay dividends in a given year, the investors does not have the right to claim any of those forgone dividends in the future.

Example XYZ Company chooses not to pay its $1.10 annual dividend to its cumulative preferred stockholders. In this case, these shareholders do not receive the dividend this year, but they are entitled to collect this dividend at some point in the future. If the preferred shares mentioned above were noncumulative, the shareholders would never receive the missed dividend of $1.10. This example illustrates why a cumulative preferred share is worth more than a noncumulative preferred share.

PARTICIPATING PREFERRED STOCKS

- A type of preferred stock that gives the holder the right to receive dividends equal to the normally specified rate that preferred dividend receive as well as an additional dividend based on some predetermined condition.
- The additional dividend paid to preferred shareholders is commonly structured to be paid only if the amount of dividends that common shareholders receive exceeds a specified per-share amount.
- Furthermore, in the event of liquidation , participating preferred shareholders can also have the right to receive the stock's purchasing price back as well as a pro rata share of any remaining proceeds that the common shareholders receive.

PARTICIPATING PREFERRED STOCKS

- Example: *For example, suppose Company Z issues participating preferred shares with a dividend rate of $1 per share. The preferred shares also carry a clause on extra dividend for participating preferred stock, which is caused whenever the dividend for common shares exceeds that of the preferred shares*.
- *If, during its current quarter, Company Z announces that it will release a dividend of $1.05 per share for its common shares, the participating preferred shareholders will receive a total dividend of $1.05 per share ($1.00 + 0.05) as well*

CONVERTIBLE PREFERRED STOCKS

- Preferred stock that includes an option for the holder to convert the preferred stock into a fixed number of common shares, usually any time after a predetermined date.
- Most convertible preferred stock is exchanged at the request of the shareholder, but sometimes there is a provision that allows the company (or issuer) to force conversion.
- The value of convertible common stock is ultimately based on the performance of the common stock.

Right Shares

Bonus Shares

Blue- Chip Shares

DEBT INSTRUMENTS

- A paper or electronic obligation that enables the issuing party to raise funds by promising to repay a lender in accordance with terms of a contract. Types of debt instruments include notes, bonds, certificates, mortgages, leases or other agreements between a lender and a borrower.
- Debt instruments are a way for markets and participants to easily transfer the ownership of debt obligations from one party to another

DEBT INSTRUMENTS

- A debt instrument is used by govemment or organization to generate funds for longer duration.
- The relation between person who invest in debt instrument is of lender and borrower .
- This gives no ownership right.
- A person receives fixed rate of interest on debt instrument.
- A debt instrument is used by either companies or governments to generate funds for capital-intensive projects. It can obtained either through the primary or secondary market.

TYPES OF DEBT INSTRUMENTS

There are many kinds of debt instruments among of them are as follow.

- Debenture.
- Bond
  - Government bond
  - Corporate bond
  - Convertible bond
- Loan
- Mortgages.

HYBRID INSTRUMENTS

- A single financial security which combines two or more different financial instruments.
- The most common type of hybrid security is:
- convertible bond: which have features of an ordinary bond but is heavily influenced by the price movements of the stock into which it is convertible. Normally the owner of convertible bond have the right to convert convertible bond to share (common stock) in the issuing company or cash of equal value.

HYBRID INSTRUMENTS

- Issuing convertible bonds is one way for a company to minimize negative investor interpretation of its corporate actions. *For example, if an already public company chooses to issue stock, the market usually interprets this as a sign that the company's share price is somewhat overvalued. To avoid this negative impression, the company may choose to issue convertible bonds, which bondholders will likely convert to equity.*
- From the investor's perspective, a convertible bond has a value-added component built into it; it is essentially a bond with a stock option hidden inside.

HYBRID INSTRUMENTS

- Thus, it tends to offer a lower rate of return in exchange for the value of the option to trade the bond into stock.
- Furthermore, another popular type of hybrid security is :
- convertible preference share : which pay dividends at a fixed or floating rate before common stock dividends are paid and can be exchanged for shares of the underlying company's stock.

INSURANCE INSTRUMENTS

- Is a financial instruments whose values are driven by insurance loss events. Those such instruments that are linked to property losses due to natural catastrophes represent a unique asset class, the return from which is uncorrelated with that of the general financial market.
- Insurance companies are in the business of assuming risk for individuals and institutions.
- They manage those risks by diversifying over a large number of policies, perils and geographic regions.

INSURANCE INSTRUMENTS

- There are two important ways insurers profit in this business.

❖ One is by selling portfolios of insurance policies grouped into packages, to interested investors. The risk from low severity, high probability events can be diversified by writing a large number of similar policies. This reduces an insurer's risk because should a policy default, then the loss is shared between a large numbers of investors.

INSURANCE INSTRUMENTS

- The second way insurers profit on policies is by re-insuring them through other insurers. A reinsurance policy would allow a second insurer to share in the gain and potential loss of the policy, much like an investor. The secondary insurer would share invested interest and risk. The reinsurance of policies offers additional risk capital and high returns for the policy originator, and minimizes their liability, while also providing high returns for any secondary insurer.

CONCLUSION

- The lack of an advance and vibrant capital market can lead to under utilization of financial resources. The developed capital market also provide access to the foreign capital for domestic capital industry.
- Thus capital market definitely play a constructive role in the overall development of an economy.