

Financial Market in Sri Lanka

AAT Level I BEN - Business Environment

Susantha Weerakoon
B.Sc. (MIS), MBA (ISM), PHD (Business Psychology)



Finance Market in Sri Lanka



Meaning and Definition of Financial Market

According to Brigham, Eugene F,

"The **place where people and organizations wanting to borrow money** are **brought together with those having surplus funds** is called a financial market."

Role of Financial Market

➤ Mobilization of Savings

As the **financial institution** in the financial market is **functioning as intermediary role**, institutions where situated in the financial market **channels the money from surplus unit or savers** such as household, business firms, public sector to **deficit unit where the investment is needed**

➤ Collecting Investment

Financial market plays a **key role in arranging the investment of funds thus collected**, in those units which are in need of the same.



Role of Financial Market

➤ Contributing to the National Growth

As the financial **market place for intermediary functions**, Financial markets **contribute to a nation's growth** by **ensuring an unfettered flow of surplus funds to deficit units**. Flow of funds for productive purposes is also made possible. It leads to overall economic growth.

➤ Supporting to the Entrepreneurship Growth

Financial markets contribute to the development of the entrepreneurial class by **making available the necessary financial resources**.

➤ Contributing to the Industrial Development

The different components of financial markets **help an accelerated growth of industrial and economic** development of a country and thus contributing to raising the standard of living and the society's well-being.



Components of Financial Markets and Instruments of Financial Market

➤ Basically, the **financial market** categorized as **Money market** and **Capital Market** based on the maturity of the financial claims.

➤ **The money market** is the market for **short-term interest bearing assets** with maturities of less than one year, such as **Treasury bills**, and **certificates of deposits** and it **facilitate liquidity management of the country**.

➤ The **main issuers** in the money market are the **Government**, **banks** and **private companies**, while the **main investors** are **banks**, **insurance companies** and **pension and provident funds**.



Components of Financial Markets and Instruments of Financial Market

- **The Capital Market** is the market for trading in assets for **maturities of greater than one year**, such as Treasury bonds, private debt securities (bonds and debentures) and equities (shares).
- The **main purpose** of the Capital Market is to facilitate the **raising of long-term funds**.
- The main issuers in the Capital Market are the **Government, banks and private companies**, while the **main investors are pension and provident funds and insurance companies**.



Components of Financial Markets and Instruments of Financial Market

- In addition to that, the **Financial Market can also be classified according to instruments**, such as the **debt market** and the **equity market**
- The **debt market** is also known as the **Fixed Income securities Market** and its **segments are the Government Securities Market** (Treasury bills and bonds) and the **Private Debt Securities Market** (commercial paper, private bonds and debentures).
- Another distinction can also be drawn between **primary and secondary markets**.
- The **Primary Market** is the **market for new issues of shares and debt securities**, while the **Secondary Market** is the **market in which existing securities are traded**.



Types of Financial Market

On the basis of types of financial claims:

- Equity Market
- Debt market

On the basis of maturity of financial claim

- Money Market
- Capital Market

On the Basis of Time of Issue of Financial Claim

- Primary Market
- Secondary Market

On the Basis of Timing of Delivery of Financial Claim

- Cash/Spot Market
- Forward and Future Market

Capital Market

- Capital market can be defined as “**a market for borrowing and lending of long-term capital funds required by business enterprises**”. Capital market offers an **ideal source of external finance**.
- The capital market **consists of development banks, commercial banks and stock exchanges**.
- An ideal capital market **is one where finance is available at reasonable cost**.
- The process of economic development is facilitated by the existence of a well-functioning capital market.



Characteristics of Capital Market

Securities Market

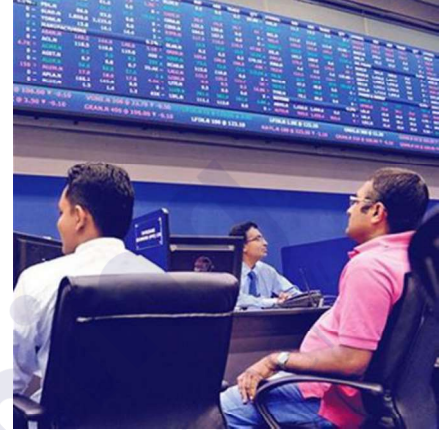
The dealings in a capital market are done through the securities like shares, debentures etc. The capital market is thus called securities market.

Price

The price of the securities is determined based on the demand and supply prevailing in the capital market for securities.

Participants

There are many players in the capital market. The participants of the capital market include individuals, corporate sectors, Govt., banks and other financial institutions.



Characteristics of Capital Market

Location

Capital market is not confined to certain specific locations, although it is true that parts of the market are concentrated in certain well-known centers known as Stock Exchanges.

Market for Financial Assets

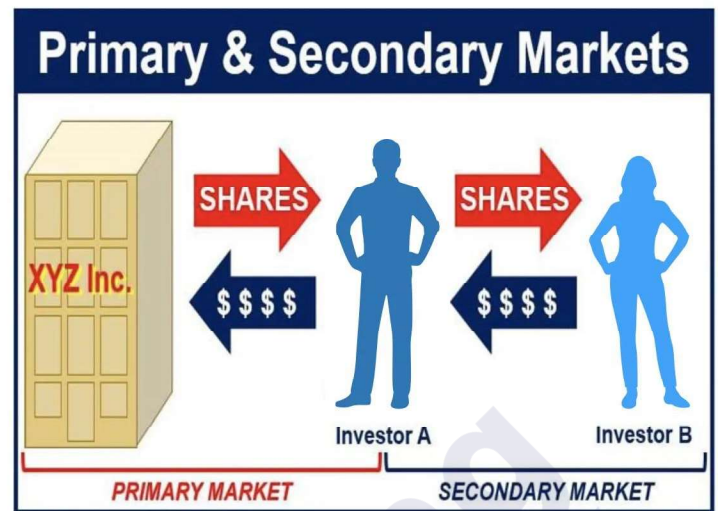
Capital market provides a transaction platform for long term financial assets.



Types of Capital Market

Primary Market

- Primary market is a market for **new issues or new financial claims**.
- Hence, it is also called **New Issue Market**.
- The primary market **deals with those securities which are issued to the public for the first time**.
- There are **three ways** by which a company may raise **capital in a primary market** such as **public issue, right issue, and private placement**.

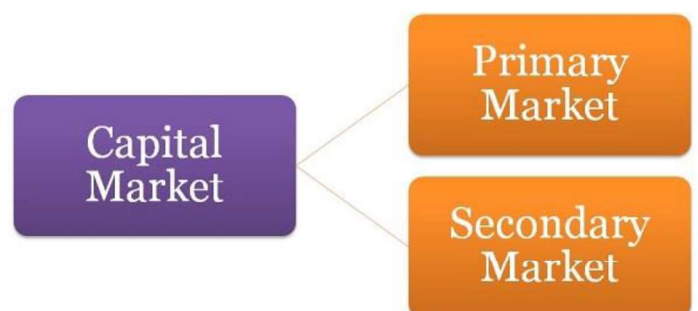


A **rights issue** is an invitation to **existing shareholders** to purchase **additional new shares** in the company.

Types of Capital Market

Secondary Market

- Secondary Market may be defined as the market for old securities, in the sense that securities which are **previously issued in the primary market are traded here**.
- The trading takes place between investors who follow the original issue in the primary market.
- It covers both stock exchange and **over-the counter** market.



Over-the-counter or off-exchange **trading** is **done directly between two parties**, without the supervision of an exchange

Functions and Importance of Capital Market

Savings and Capital Formation

- In capital market, various types of securities help to mobilize savings from various sectors of population (Individuals, Corporate, Govt., etc.).
- The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities.
- This accelerates the capital formation in the country.



Permanent Capital

- The existence of a capital market/stock exchange enables companies to raise permanent capital.
- The investors cannot commit their funds for a permanent period but companies require funds permanently.
- The stock exchange resolves this dash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.



Functions and Importance of Capital Market

Industrial Growth

- The stock exchange is a central market through which resources are transferred to the industrial sector of the economy.
- The existence of such an institution encourages people to invest in productive channels.
- Thus, it stimulates industrial growth and economic development of the country by mobilizing funds for investment in the corporate securities.



Ready and Continuous Market

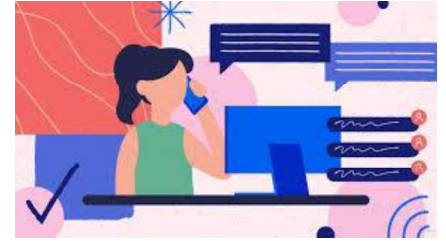
- The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities.



Functions and Importance of Capital Market

Reliable Guide to Performance

The capital market serves as a reliable guide to the performance and financial position of corporate, and thereby promotes efficiency.



Proper Channelization of Funds

The prevailing market price of a security and relative yield are the guiding factors for the people to channelize their funds in a particular company. This ensures effective utilization of funds in the public interest.



Functions and Importance of Capital Market

Provision of Variety of Services

- The financial institutions functioning in the capital market provide a variety of services such as grant of long term and medium-term loans to entrepreneurs, provision of under-writing facilities, assistance in promotion of companies, participation in equity capital, and giving expert advice.



Development of Backward Areas

- Capital Markets provide funds for projects in backward areas.
- This facilitates economic development of backward areas.
- Long term funds are also provided for development projects in backward and rural areas.



Functions and Importance of Capital Market

Easy Liquidity

- With the help of secondary market investors can sell off their holdings and convert them into liquid cash.



Foreign Capital

- Capital markets makes possible to generate foreign capital. Sri Lankan firms are able to generate capital funds from overseas markets by way of bonds and other securities.

Money Market

- Money Market is a market for purely short-term funds.
- It deals with the financial assets and securities whose maturity period does not exceed one year.
- Treasury bills, commercial bills, Certificate of deposit are main instruments in the money market.



Characteristics of money market

- It is a market purely for **short-term funds** or **financial assets** called near money.
- It deals with financial assets having a **maturity period up to one year only**.
- It deals with only those assets which can be converted into cash readily without loss and with minimum transaction cost.
- Generally, **transactions take place through phone**, i.e., oral communication. **Relevant documents and written communications can be exchanged subsequently**.
- There is **no formal place like stock exchange** as in the case of a capital market.



Characteristics of money market

- It is **not a single homogeneous market**. It comprises of **several sub-markets each specializing in a particular type of financing**. E.g., Call Money Market, Acceptance Market, Bill Market.



An **acceptance market** is a **short-term credit investment between parties**, usually non-financial firms who are backed by a bank to make payment

Call money is minimum maturity period of one to fourteen days or overnight to a fortnight. It is used for **inter-bank transactions**

Bill Market refers to the **market for short-term bills generally of three months maturity**. A bill is a promise to pay a specified amount by the borrower (drawer) to the creditor (drawee).



Characteristics of money market

- The **Commercial Banks** are the nerve center of the whole **money market**. They are the **principal suppliers of short-term funds**. The commercial banks serve as vital link between the Central Bank and the various segments of the money market.
- There should be a **large demand and supply of short-term funds**. It presupposes the existence of a large domestic and foreign trade.



Participants in Money Markets

Government

Central Banks

Private and Public Banks

Mutual Funds Institutions

Insurance Companies

Non-Banking Financial Institutions

Commercial Banks

State Governments :

Public

Money Market Vs Capital market

| Features | Money Market | Capital Market |
|-------------------------------|--|--|
| Duration of Funds | Deals with short-term loanable funds for a period of not exceeding one year. | It is a market for long-term funds exceeding period of one year. |
| Supply of Funds | supplies funds for financing current business operations working capital requirements of industries and short period requirements of the government. | supplies funds for financing the fixed capital requirements of trade and commerce as well as the long-term requirements of the government. |
| Deals with Instruments | It deals with instruments like commercial bills (bill of exchange, treasury bill, commercial papers etc.). | It deals with instruments like shares, debentures, Government bonds, etc., |

Money Market Vs Capital market

| Features | Money Market | Capital Market |
|------------------------------------|---|---|
| Role of Major Institution | The central bank and commercial banks are the major institutions in the money market. | Development banks and Insurance companies play a dominant role in the capital market. |
| Availability of Instruments | Money Market instruments generally do not have secondary market. | Capital market instruments generally have secondary markets. |
| Subdivision | In money market there is no such subdivision. | In capital market there is a division of primary market and secondary market. |
| Place of Transaction | Transactions mostly take place over the phone and there is no formal place. | Transactions take place at a formal place. Eg. stock exchange. |

Stock Exchange

- Stock exchanges and organized market **provide a place for the investors to buy and sell securities.**
- The market offers **perfectly competitive conditions where a large number of sellers and buyers participate.**
- Further, stock exchanges **provide an auction market in which members of the exchange participate** to ensure continuity of price and liquidity to investors.

According to Hastings:

"Stock exchange or securities market comprises all the places where **buyers and sellers of stocks and bonds or their representatives undertake transactions involving the sale of securities.**"



Role and importance of Colombo Stock Exchange

- Colombo stock exchange (CSE) **established in 1985 in Colombo**, there are 298 listed companies from 20 sectors registered in CSE as at 18 January 2018.
- The Colombo stock exchange (CSE) operates as the **only share market in the economy and is responsible for providing a transparent and regulated environment** where **both institutional and individual investors can operate in the capital market.**
- Today the CSE **interacts with many stakeholders like Investment banks, Fund managers, financial advisors, Market data vendors and investors**



Functions of Stock Exchange

➤ Ready and Continuous Market

Stock Exchange is, in fact, a market for existing securities. If an investor wants to sell his securities, he can easily and quickly dispose them off on a stock exchange. In other words, he **can convert his shares into cash and with the same ease he can convert his cash into securities**



➤ Correct Evaluation of Securities

The prices at which **securities are bought and sold are recorded and made public.**

One can **easily evaluate the worth of one's securities on the basis of these quotations**

➤ Proper Channelization of Capital

People like to invest in the shares of such **companies which yield good profits.** The savings of **individuals are directed towards promising companies which declare good dividends over a period of time.**

Functions of Stock Exchange

➤ Aid to Capital Formation

The publicity which the stock exchange gives to various industrial securities and their prices and the facilities provided by it for their purchase and sale induce people to save and invest

➤ Facilities for Speculation

Speculation is an integral part of stock exchange operations. As a result of Speculation, **demand for and supply of securities are equalized. Similarly, price movements are rendered smoothly.**

➤ Seasoning of Securities

Speculators and underwriters **hold for a temporary period,** securities issued by **new companies.** They **unlock them when the market is prepared to absorb the new issues.**

➤ Clearing House of Business Information

listed companies are required to furnish **all important information relating to capital management, dividend distribution etc., and forward copies of financial Statements, annual reports etc., to the stock exchange.** They publish every year, books detailing the financial position of companies.

Importance of Colombo Stock exchange

Significance to the community/Country

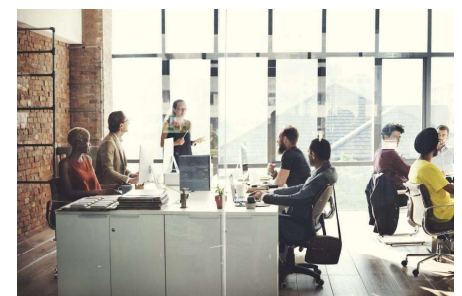
- It **accelerates the economic development** by ensuring steady flow of savings into productive purposes.
- It enables the **well-managed, profit-making companies to raise limitless funds** by **fresh issue of shares from time to time**.
- Scarce resources are thus **diverted to efficiently run enterprises for better utilization**.
- **Supporting for capital formation**
- It **enables government to raise funds for undertaking projects through sale of securities on the stock exchange**.



Importance of Colombo Stock exchange

Significance to the Company

- Companies whose shares are quoted on a stock exchange **enjoy greater goodwill and credit standing**.
- There is a wide and **ready market for such securities**.
- Stock Exchange can raise **huge funds easily by issue of shares and debentures**.
- Companies whose shares rise in the stock exchange command **higher bargaining power in the event of further expansion, merger or amalgamation**.



Importance of Colombo Stock exchange

Significance to Investors

- Stock exchange helps an investor to convert his shares into cash quickly and thus increases the liquidity of his investments.
- The fact that a security is dealt on a stock exchange makes it a good collateral security for obtaining loan from banks.
- The stock exchange safeguards, investor's interest and ensures fair dealing by strictly enforcing its rules and regulations.
- An investor can easily assess the real worth of securities in his hands, as market quotations are published daily in the newspapers and in websites.
- Stock Exchange provides a mechanism by which purchase and sale of listed securities take place in a matter of few minutes.



Thank You