

Unit 08

Financial Market in Sri Lanka

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Intended Learning Outcomes

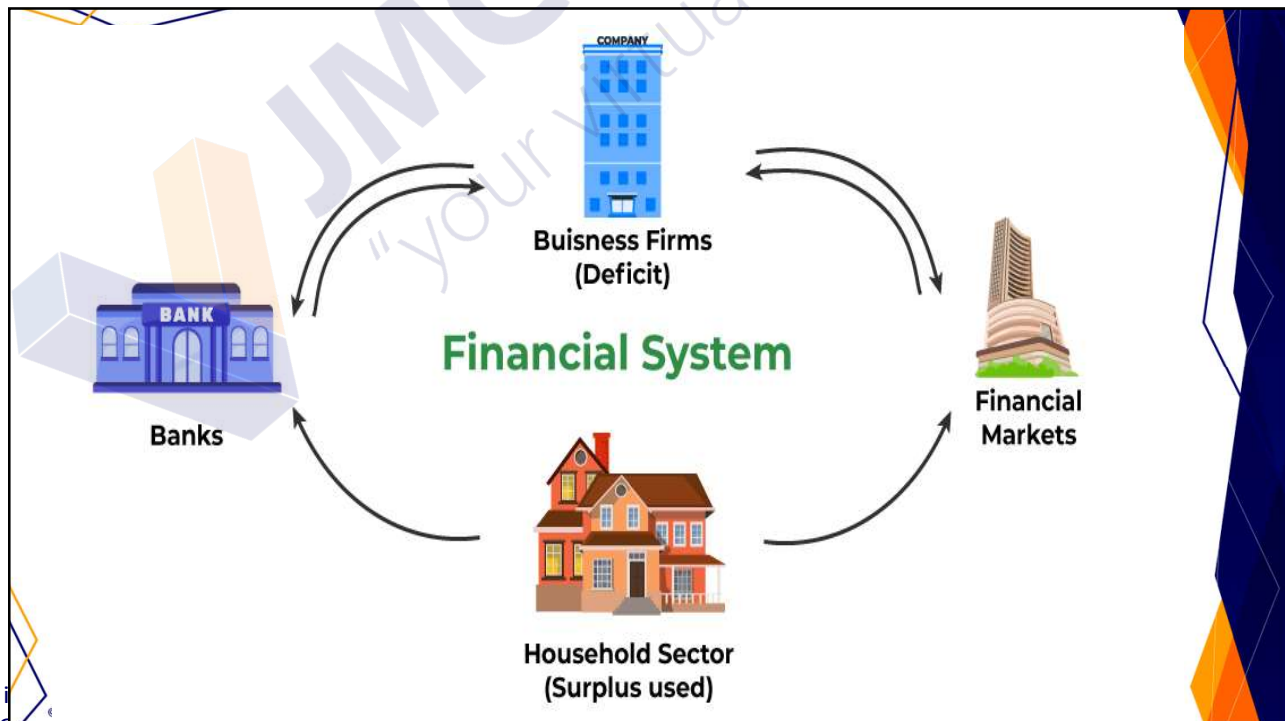
- Identify composition of financial market
- Identify instruments exchanged in financial market
- Explain importance and role of Colombo Stock Exchange



Financial Market

A market that serves as a link between the savers and borrowers, by transferring the capital or money from those who have a surplus amount of money to those who are in need of money or investment, is known as **Financial Market**. Simply put, Financial Market is a market that creates and exchanges financial assets.

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Key functions of financial market

Capital Allocation: Channel funds from savers to borrowers, enabling investments in businesses, infrastructure, and other productive ventures.

Price Discovery: Establish the market price of financial instruments based on supply and demand dynamics.

Liquidity: Provide a mechanism for participants to buy and sell financial instruments easily.

Risk Management: Enable hedging of risks through instruments like options, futures, and derivatives.

Economic Indicator: Reflect the overall economic conditions and investor sentiment.

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Composition of financial market

The **financial market** is broadly composed of various interconnected segments that facilitate the exchange of financial instruments.

- **Money Market**

Purpose: Deals with short-term funds and financial instruments with maturities of less than one year.

Instruments: Treasury bills, commercial paper, certificates of deposit, call money, and repurchase agreements (repos).

Participants: Central banks, commercial banks, corporations, and governments.

Role: Ensures liquidity and efficient short-term borrowing and lending.

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• Capital Market

Purpose: Facilitates long-term investment and financing.

Sub-segments:

Equity Market: Trading of shares/stocks of companies.

Debt Market: Trading of long-term bonds and debentures.

Participants: Individual investors, institutional investors, corporations, and governments.

Two types of market: Primary market and secondary market

Role: Drives economic growth by providing long-term funds for businesses and infrastructure projects.

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• Insurance Market

Purpose: Provides risk management services by offering financial protection against unforeseen events.

Instruments: Life insurance, health insurance, property insurance, and liability insurance.

Participants: Insurance companies, reinsurers, and policyholders.

Role: Helps individuals and businesses manage risks and uncertainties.

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• Pension Funds and Mutual Funds

Purpose: Pool resources from multiple investors for diversified investment.

Participants: Individual investors and fund managers.

Role: Provides professional management and access to diversified portfolios.

• Commodity Market

Purpose: Enables the trading of physical goods or commodity-related contracts.

Types of Commodities:

Hard Commodities: Natural resources like gold, oil, and metals.

Soft Commodities: Agricultural products like coffee, wheat, and cotton.

Participants: Producers, traders, speculators, and investors.

Role: Provides price discovery and hedging opportunities for producers and consumers.

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Money Market Vs. Capital market

The **money market** and **capital market** are two segments of the broader financial market, each serving distinct purposes and catering to different types of participants.



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Money market Vs. Capital market

Aspect	Money Market	Capital Market
Definition	A segment of the financial market dealing with short-term instruments that mature within one year.	A segment of the financial market that facilitates trading of long-term securities with maturities longer than one year.
Purpose	Provides short-term liquidity and funds to businesses, governments, and institutions.	Facilitates long-term investment and financing for economic growth and development.
Instruments	Treasury bills, commercial paper, certificates of deposit	Stocks, bonds, debentures, and other long-term securities.
Maturity	Less than one year.	More than one year
Risk	Low risk due to short maturities and high liquidity.	Relatively higher risk due to longer maturities and market fluctuations.
Return	Lower returns compared to the capital market.	Potentially higher returns over the long term.

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Key differences

- **Time Horizon:** The money market focuses on short-term financing needs, while the capital market caters to long-term capital requirements.
- **Risk and Return:** The money market is safer but offers lower returns, whereas the capital market involves higher risks but with the potential for greater returns.
- **Role in the Economy:** The money market ensures liquidity and smooth functioning of financial systems, while the capital market drives economic growth by funding infrastructure, businesses, and innovations.

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Colombo Stock Exchange

The **Colombo Stock Exchange (CSE)** is the primary stock exchange in Sri Lanka, facilitating the trading of equity and debt securities.

It plays a crucial role in the country's financial system by providing a platform for companies to raise capital and for investors to trade securities.



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Key Features of the Colombo Stock Exchange

Establishment:

Originated in 1896 as the **Colombo Share Brokers Association**.

Renamed the Colombo Stock Exchange in 1985.

Operates as a member of the World Federation of Exchanges.

Ownership and Regulation:

Operates as a privately-owned company.

Regulated by the **Securities and Exchange Commission of Sri Lanka (SEC)**.

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Types of Securities Traded:

Equities (shares of companies).

Corporate debt instruments.

Government securities.

Technology:

Uses an automated Electronic Trading System (ETS).

Provides online and mobile trading platforms for accessibility.

Indices:

All Share Price Index (ASPI): Tracks the overall performance of all listed companies.

S&P Sri Lanka 20 Index: Tracks the performance of the top 20 companies by market capitalization.

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Branches of CSE

- Jaffna branch
- Anuradhapura branch
- Batticaloa branch
- Negombo branch
- Kurunegala branch
- Kandy branch branch
- Rathnapura branch
- Panadura branch
- Ambalantota branch
- Matara branch

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Importance of CSE

- **Capital Formation:** Helps companies raise funds for expansion and growth.
- **Investment Opportunities:** Enables investors to diversify their portfolios.
- **Economic Growth:** Supports national development by mobilizing savings into productive investments.
- **Transparency and Governance:** Encourages accountability and transparency in listed companies.

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Main instruments in financial market

1. Equity Instruments

- **Stocks/Shares:** Represent ownership in a company. Shareholders may earn returns through dividends and capital appreciation.
- **Preferred Stocks:** Have features of both equity and debt, providing fixed dividends but usually without voting rights.

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- **Debt Instruments**

Bonds: Fixed-income securities issued by governments, municipalities, or corporations to raise funds, paying periodic interest (coupon payments) and returning principal at maturity.

Treasury Bills (T-Bills): Short-term government debt instruments with maturities of less than one year, issued at a discount and redeemed at face value.

Commercial Paper: Unsecured, short-term debt issued by corporations for immediate funding needs.

Certificates of Deposit (CDs): Time deposits with banks offering fixed interest rates over a specified period.

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Past Papers



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2024 July

Which one of the following is an example for an instrument in Money Market?

- (1) Ordinary shares.
- (2) Treasury Bond.
- (3) Commercial papers.
- (4) All of the above.

State two(02) differences between “Capital Market” and “Money Market”.

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January 2024

Select the correct statement with reference to the Money Market:

- (1) It is a market for purely short-term funds.
- (2) Its transactions are made in the Colombo Stock Exchange.
- (3) Shares and debentures are main instruments in the money market.
- (4) There are two sub divisions as primary market and secondary market.

List two(02) functions of the Colombo Stock Exchange.

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2023 July

Select the correct statement from the following with reference to the financial market:

- (1) Capital market can be divided into two as primary market and secondary market.
- (2) Money market is a market for purely long-term funds.
- (3) Treasury bills and commercial bills are main instruments in the capital market.
- (4) Equity shares are example for an instrument in money market.

Which one of the following is not in composition of the financial system of Sri Lanka?

- (1) Financial Institutions.
- (2) Central Bank of Sri Lanka.
- (3) Ministry of Trade.
- (4) Financial Market.

The Colombo Stock Exchange (CSE) operates as the only share market in the Sri Lankan economy(T/F)

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2023 January

Consider the following statements with reference to the Colombo Stock Exchange:

- (a) It manages the official foreign reserves of Sri Lanka.
- (b) It provides a regulated environment for both institutional and individual investors operated in the capital markets.
- (c) It helps investors to convert their shares into cash.

Of the above, the correct statement/s regarding the Colombo Stock Exchange is/are:

- (1) (b) only. (2) (c) only.
- (3) (b) and (c) only. (4) (a) and (c) only.

Capital market is a market for short-term finance. (Yes/ No)

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2022 July

Which one of the following is an example for an instrument in capital market?

- (1) Ordinary shares. (2) Commercial papers.
- (3) Treasury bills. (4) Cheques.

State two(02) differences between money market and capital market.

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2022 January

Money market deals with instruments such as shares, debentures, etc.

State three(03) reasons for importance of the Colombo Stock Exchange to investors.

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