Capital Markets

Where equity-backed securities and long-term debt are both bought and sold

What are Capital Markets?

Capital markets are the exchange system platform that transfers capital from investors who want to employ their excess capital to businesses that require the capital to finance various projects or investments.

Capital markets primarily feature two types of securities – equity securities and debt securities. Both are forms of investments that provide investors with different returns and risks and provide users with capital with different obligations.

1. Equity Securities

Equity securities are traded on the stock market and are essentially ownership shares of a business or venture. When you own equity securities of a company, you essentially own a portion of that company and are entitled to any future earnings that the company brings in.

However, the money that you invest in equity securities is *not* required to be paid back by the business.

2. Debt Securities

Debt securities are traded on the bond market and are IOUs that can come in the form of bonds or notes. They essentially represent the borrowing of money that will be paid back at a later date with interest.

Interest is the required compensation that entices lenders to lend their money. The borrowers will take the money today, use it to finance their operations, and pay back the money in addition to a prescribed rate of interest at a later date.

The securities can be bought and sold on two types of markets:

> The **primary market** is when a company directly issues the securities in exchange for capital.
>
> The **secondary market** is when the security holders trade with other investors in a transaction that is separate from the issuing company.

Capital markets feature trading of other securities as well, including:

- Foreign exchange (forex)
- Commodities
- Derivatives

Capital Market Transactions

As mentioned earlier, transactions can take place in two types of markets. Both the primary market and the secondary market host such transactions.

As a company matures from a start-up to a larger company, it will usually require capital to finance the expansion of its operations. They will raise the required capital either through equity markets – on a stock exchange – or through debt markets.

The transactions are facilitated by investment bankers, lawyers, and accountants who ensure that the ownership transfer is legally executed and that enough investors are willing to invest their capital into the company.

After the money's been invested, and securities are issued in exchange, investors can decide to sell their securities on the secondary market to other investors.

The transactions are facilitated either through a centralized exchange – such as the New York Stock Exchange (NYSE) – or facilitated over-the-counter (OTC), which is a decentralized way of trading securities without a central exchange or broker.

traded to anyone, and there is full disclosure on a public company's operations. However, there is also a large private market where securities are held privately.

There is less attention and information on private companies, making it difficult to invest in them, especially for smaller investors. In the private markets, there is less liquidity, meaning that it is more difficult to buy and sell securities.

It leads to longer time horizons for investors; in public markets, you can sell a security in a matter of seconds, but in the private markets, it can take much longer to find a buyer.

Investors are compensated for the lack of liquidity and lack of information. There are usually much greater returns from private capital markets. From the company's perspective, they can raise capital without the scrutiny and regulation that comes with being publicly listed.

Capital Market Products

There are many different capital market products, some of which we referred to earlier:

- Equity securities
- Commodities
- Debt securities
- Foreign exchange
- Derivatives

Each of the above is traded in different markets and exchanges. Some of

Others are decentralized and traded between market participants without an exchange or a broker, such as debt securities, commodities, and other derivatives.

Derivatives can get complicated, but they represent a huge market as well. They are versatile and can be structured and created to tailor features such as risk and return for other securities.

Capital markets are a staple of the global economy. They provide an arena in which investors looking to invest saved funds in return for compensation. They can funnel their capital towards people and businesses who need the capital now in order to expand. This is the crux of how a capitalist, market-based economy grows.

Related Readings

To keep learning and developing your knowledge of financial analysis, we highly recommend the additional resources below:

- Alternative Investment Market (AIM)
- London Stock Exchange (LSE)
- Over-the-Counter (OTC)
- Types of Markets – Dealers, Brokers, Exchanges

Capital Markets & Securities Analyst

CMSA certification bridges the gap from where you are now to where you want to be – a world-class capital markets analyst.