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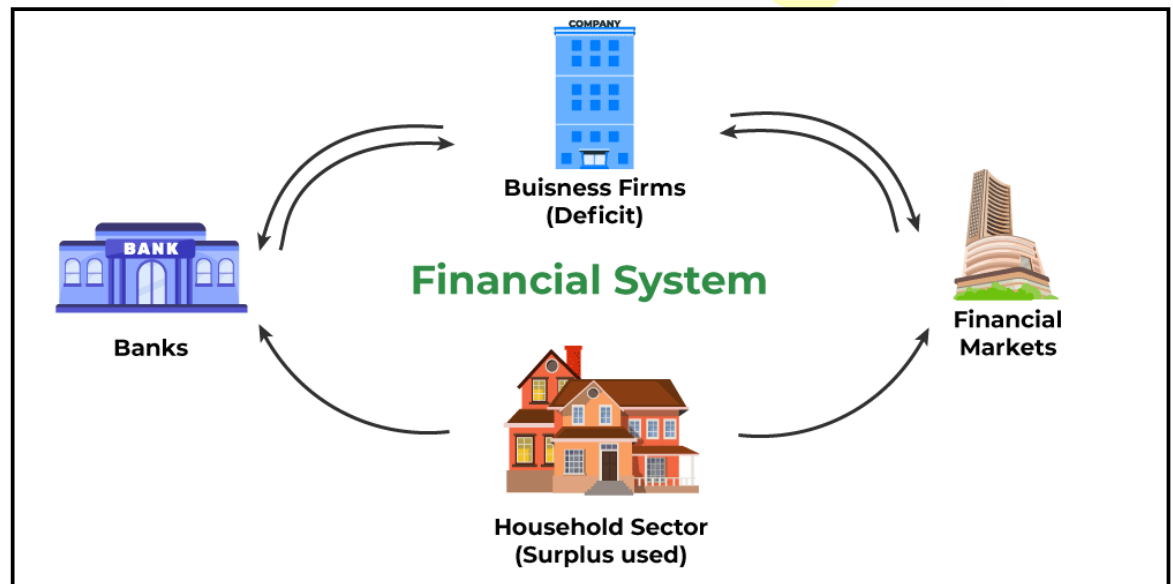
Advance Accounting - Module 22

Financial Market: Overview and Functions

What is a Financial Market?

A financial market is a place where people buy and sell financial assets like stocks, bonds, currencies, and other securities. It acts as a platform for those who want to invest their money (like individuals or institutions) and those who need money for various purposes (like companies or governments).

Think of it as a big marketplace where buyers and sellers trade different types of financial products. The goal of these markets is to help facilitate the flow of money in the economy, ensuring that funds move from those who have extra money (savers) to those who need money (borrowers).



Functions of Financial Markets

1. Price Discovery:

- Financial markets help determine the prices of financial assets. When buyers and sellers agree on a price during a transaction, that price reflects the value of the asset at that moment. This process is known as price discovery.
- For example, if a company's stock is highly sought after, its price will go up, reflecting its high value.

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2. Liquidity:

- Liquidity refers to how easily an asset can be converted into cash without affecting its price. Financial markets provide liquidity by allowing assets to be bought and sold quickly.
- For instance, if you own shares in a company, you can sell them on the stock market and get cash in return almost immediately.

3. Risk Sharing:

- Financial markets allow investors to share and transfer risks. Different financial instruments have different risk levels, and investors can choose where to put their money based on their risk tolerance.
- For example, government bonds are usually considered low-risk, while stocks may be riskier but offer the potential for higher returns.

4. Efficient Allocation of Resources:

- Financial markets ensure that money is allocated efficiently in the economy. They channel funds from savers (those with excess funds) to borrowers (like companies that need funds for expansion).
- This means that businesses can get the capital they need to grow, and investors can earn returns on their investments.

5. Facilitation of International Trade:

- Financial markets also facilitate international trade by enabling currency exchange. Companies that do business in different countries need to exchange currencies, and financial markets provide the platform for these transactions.
- This helps global businesses operate smoothly, even when dealing with different currencies.

6. Capital Formation:

- Financial markets play a crucial role in capital formation by mobilizing savings and directing them towards productive investments. This leads to economic growth and development.
- For example, when you invest in a company's stock, you are providing the company with capital that it can use to expand its operations.



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Summary

In simple terms, financial markets are like marketplaces for money and financial products. They help in setting prices, provide liquidity, allow risk-sharing, ensure efficient use of resources, support international trade, and contribute to economic growth by facilitating capital formation. These functions make financial markets essential for the smooth functioning of the economy.

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