

Financial Market, Classification, Functions, Differences, Purpose

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The Financial Markets act as the foundation of a country's economic system. It manages the financial resources from individuals and institutions that have surplus funds to those who are in the need of capital. By providing investments, it not only drives business growth but also plays an important role in strengthening the overall economy. In this article, we are going to cover the Financial Markets, its functions, classification and structure.

Financial Market

The Financial Market is referred to as the arrangement, institution or platform where buyers and sellers meet to trade financial assets such as equities, bonds, currencies and derivatives. Its main purpose is to transfer funds from surplus holders, also known as investors, to deficit units that are to the borrowers who require capital. Financial markets are marked by transparent pricing mechanisms, regulatory norms on trading, transaction costs and the influence of market forces in determining security prices.

Financial Market Classification

Financial Markets can be classified on the basis of maturity of securities traded. The financial market is classified in the following categories: Money Market and Capital Market

Money Market

The Money Market is a segment of Financial Market where short term and highly liquid financial instruments are bought and sold along with a maturity period of up to one year. The main goal is to meet the immediate credit requirements of the economy, particularly working capital for industries. The money market covers major institutes like commercial banks, regional rural banks and the bill market. The instruments traded in the money market include call money, treasury bills, commercial papers and the Certificates of Deposits.

Capital Market

The Capital Market is an area of the financial market where securities with a maturity of more than one year are traded. It provides a platform of raising medium to long term funds that are able to fund projects and investments on a larger scale.

The capital market includes institutions like Stock Exchanges and Development Financial Institutions. The key instruments include shares, bonds, debentures and derivatives.

Money Market and Capital Market

Money Market and **Capital Market** both are components of the financial market but both cater to different requirements of the economy.

Money Market and Capital Market Similarities

1. **Complementary Nature:** Both Money market and capital markets complement each other instead of compete, providing balanced economic development by meeting short-term and long-term financial needs.
2. **Common Institutions:** Some institutions operate in both markets. For example, commercial banks, while traditionally focused on short-term credit, have increasingly extended long-term loans.
3. **Interdependence:** The functioning of one market influences the other. For example, a surge in capital market demand for funds often impacts interest rates in the money market. Similarly, changes in monetary policy affect both markets simultaneously.

Money Market and Capital Market Differences

The Money Market and the Capital Market has the following differences:

Basis	Money Market	Capital Market
Definition	Market for short-term instruments with maturity up to 1 year.	Market for medium and long-term instruments above 1 year.

Maturity Period	Up to 1 year.	More than 1 year.
Institutions	RBI, Commercial Banks, NBFCs, RRBs.	Stock Exchanges, Insurance Companies, Pension Funds.
Instruments	Call Money, T-Bills, CPs, CDs.	Shares, Bonds, Debentures, Government Securities.
Purpose	Meets short-term borrowing needs like working capital.	Provides fixed capital for long-term investments.
Risks	Lower risks due to short-term exposure.	Higher risks due to long-term nature.
Merit	Enhances liquidity in the economy.	Mobilizes savings for long-term development.
Return	Lower returns.	Higher comparative returns.
Formality	Less formal, fewer compliance requirements.	Highly formalized and regulated transactions.
Regulating Body	Regulated by RBI.	Regulated by SEBI.

Financial Market Functions

Financial Markets have the following functions in the economy:

- **Mobilization of Savings:** They redirect household and institutional savings into productive investments.
- **Liquidity Provision:** Financial Markets provide liquidity by giving the options of easy buying and selling of assets without drastic price changes.
- **Risk Management:** Derivative instruments within markets help investors and businesses hedge against uncertainties like currency fluctuations.
- **Price Discovery:** Markets establish fair prices for securities through demand and supply dynamics, providing efficient resource allocation.
- **Information Integration:** Market prices reflect collective information, helping coordinate economic activities and decisions.

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