Discuss the primary purpose of financial markets assignment

Business

Borrowers and lenders of funds use financial markets for buying necessary goods or for saving. Borrowers (or deficit units) require funds and this is provided by lenders (or surplus units). Generally deficit units will require large amounts of funding for buying goods such as cars or houses, however most surplus units will not have enough money to lend out to them standalone. Because of this, a financial institution is used to facilitate the flow of funds from the lender to the borrower.

A financial Institution such as a bank or credit union will have a large number of small-fund savers at any one time and a small number of large-fund borrowers. Provided that borrowing and saving Is spread out over time. There is no problem In providing the surplus units' funds to the deficit units. Since the primary purpose of financial markets is facilitating the flow of funds (as mentioned above a financial institution must ensure that there will always be enough money to lend and so must take certain steps to avoid catastrophe.

There must be restrictions on lending according to people's income and assets as well as various other criteria. If this was not the case, the financial institution would not be able to lend funds to deficit units that would be able to pay the loan back. To ensure that there will always be enough money, people are encouraged to save by providing low Interest rates that reward the customer. In the same respect, those that borrow money must pay interest to cover the expenses of the bank's intermediation in borrowing and lending as well as the interest that is paid to the earplugs unit.

The bank’s intermediation also allows the spread of risk over many borrowers and many lenders. So far we have seen how financial markets use financial Institutions to facilitate the flow of funds, In particular, money. However, as well as money there are other financial Instruments that can be traded to facilitate the flow of funds Including bonds which are salary to Souse which can be traded from person to person. There Is also equity or ‘ shares’ which, as the name suggests, are a share In a business – a nits to cover the needs of deficit units, a long-term or short-term debt should be covered by long-term or short-term equity.

This stems from the basic principle of liquidity – if debt increases, the debt must be able to be covered straight away if necessary. A higher liquidity allows investment decisions to be changed at short notice without any damaging effects. Since the deregulation of financial markets, the debt to equity ratio has increased from 50% to over 90%, but because of increased genealogy (global communications etc) this is seen as acceptable.

In this case, technology plays a role in facilitating the flow of funds in a corporation by allowing a change in the debt to equity ratio. In comparison to the above example, debt can be viewed as deficit units and equity can be viewed as surplus units. As can be seen in the above examples through the use of financial institutions and instruments, the facilitation of the flow of funds is by far the primary purpose of financial markets.