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**Article**

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# THE IMPORTANCE OF CAPITAL MARKET IN ECONOMY

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**Abstract:** *All participants in capital markets are asking how to finance investments or to invest money available. The answer to these questions depends on the situation you have: deficit or surplus capital. This article addresses issues concerning the place and role of capital market within the financial markets and in financing investments, trying to highlight the growing importance of this subsystem, shown both to economic agents and to all categories of investors.*

**Keywords:** capital market, stock exchange, investment, economic development

**JEL Classification:** O42, E44, G11, G14, E22

## 1. INTRODUCTION

It is very difficult today to imagine ourselves the times when there were no banks, stock markets, money markets, public debts, times when the fortune of a person was only measured by the surface of land owned, by the number of animals one possessed as well as by the number of work hands one could use in the working the field. Economies presented themselves in the form of gold or silver goblets or jewels, and usury – the practice consisting of the charging of interest on money – was prohibited both by law and by the Church.

The capital market today is a reality met in any modern economy. It is a market the necessity of which is unchallengeable, an extremely dynamic and innovative structure, permanently adapting to the economic environment and at the same time an influential factor of it, generating opportunities and to the same extent risk for all categories of participants to the economic activity, being a replica of a national economy to a small scale, but nevertheless especially representative.

Tributary to the conditions in which it was formed and developed, the capital market brings together under this syntagma different conceptions. The continental-European conception attributes to this market a more comprising structure, containing the monetary market, the mortgage market and the financial market. In the Anglo-Saxon conception, which the economic practice has also adopted in our country, the capital market is a component of the financial market together with the monetary market and the insurance market.

## 2. CAPITAL MARKETS COMPONENTS AND FUNCTION

The specificity of this market derives from numerous aspects, but defining and at the same time delimitative in relation to other components of the financial market are the following traits:

- ✓ It is a market specialized in transactions with medium and long term financial assets, unlike the monetary market which offers solutions for refinancing through short and medium term capitals;
- ✓ It is a public, open and transparent market, in the sense that anyone can be a participant on this market, without there being notable entry or exit barriers, the transactions having a public character;
- ✓ The dissemination of information on this market, through its volume or, quickness and with the possibility of equal reception by all participants, is probably the best one from the ones existing in the structures of a market economy;
- ✓ The capital circulation vehicle is represented by securities, characterized through negotiability of the price and immediate transferability with very low transaction costs;
- ✓ The transaction is made through intermediaries, who have an essential role in connecting the owners or issuers of securities with the owners of capitals;
- ✓ It entails risks both for the issuer and for the investor, specific for each financial instrument in question, but at the same time it also offers complex solutions for minimizing and dispersing it, both the financial and the operational one;
- ✓ It is an organized market, in the sense that the transactions are performed according to certain principles, norms and rules known and accepted by participants. This does not mean the administration of the market, but its regulation with the purpose of creating or preserving the conditions for the unfolding of free competition, so a system for guaranteeing the free and open character of all transactions.

In a market economy, the role of the capital market is of first rate. The well functioning of the capital market is vital in the contemporary economy in order to be able to perform an efficient transfer of money resources from those who save towards those who need capital and those who succeed to offer it a higher capitalization; the capital market can significantly influence the quality of the investment decisions.

Depending on the moment when the transaction is performed, the capital market is divided into two temporal dependant segments: primary and secondary.

*The primary market* has the role of placing the issuing of securities, to attract the available financial capitals on medium and long term, both on the internal capital markets, and on the international one appealing to the public economies.

*The secondary market* – once the securities are set into circulation, through the issuance on the primary market, they are the object of transactions on the secondary market. The existence of this type of market offers to the owners of shares and bonds the possibility to capitalize them before they bring a profit (dividends or interests). The secondary market represents, at the same time, the way to concentrate in the same place private or institutional investors who can sell or buy securities, having the guarantee that they are valuable and can be reinserted into the circuit at any time.

The secondary market is also the almost perfect expression of the free adjustment between the offer and demand of securities, being a barometer, in the first place for the need for capital, but also for the economic, social and political state of a country. From this point of view, the secondary capital market can be considered a perfect market, where the law of demand and offer finds the perfect terrain for its unfenced action. Ensuring the mobility of capitals, of liquidities on long and medium term, of the negotiability of any security that passes the primary market, the secondary market attracts, at the same time, professional investors, but also amateur investors, in the hope of a maximum profit in record time.

*The stock exchange* is an important institution of the capital market, specific to the market economy, which concentrates in the same geographical and economic space the demand and offer of securities, openly, freely and permanently negotiated, based on known regulations. The stock exchanges always represent an extremely sensitive and accurate barometer of the status quo in the economic, geo-political and foreign currency field. The price a security is negotiated for accurately reflects the economic-financial state of the company that issued it, in a positive or negative sense. Most times, because of the interdependencies in a national economy, but also at world level, the modification of the rate of a certain security can attract with it chain modifications, with repercussions on other securities. It is true that, sometimes, the stock exchange can register false signals (incidental or directed), disturbing the real situation. The psychological and emotional factors have always had and will continue to have a notable role.

A question the enterprisers and the smaller or larger companies always ask themselves is: Which is the optimum way for financing investments? The answers are not many and along time they were the same: either using the own fortune, either requesting a subsidy from the state or from another institution or from anywhere else, or obtaining a bank loan or turning to the stock market. The first option is only possible for those who own the necessary capital. The second option is determined by exceptional situations. In regard to the bank loan, although it is a more realistic

option than the other two, it is maybe not the most wanted one, first because it is expensive (the interests are, in general, quite high) and, second, the banks set a series of hard and strict conditions, often difficult to meet by the applicant.

A possibility, for an enterpriser or for a company, to obtain money (capital), avoiding the problems raised by the options above, is represented by the public sale of shares or bonds with the help of the stock exchange. The stock exchange ensures the shortest and most efficient circuit between the economies or temporary surplus of capital of those who want to invest on medium or long term (be it companies, funds, banks, insurance companies or plain private individuals) and the needs for financing of the enterprisers or of the commercial companies. The stock exchange becomes thus a strong competitor for the banks, representing a serious alternative to the bank loan, often times more expensive and difficult to obtain.

From the above it is clearly noted that the main role of the stock markets is that of financing the economy (especially the economic agents), by mobilizing capitals on medium and long term. Also, another important role of the stock exchange is that it facilitates the circulation of capitals, the securities being easily transformed into liquidities or exchanged into other securities, by selling or re-selling them on this market.

The most important function of the stock exchange is that the transactions with the securities issued and initially placed on the primary capital market are performed here. After the securities have been issued and placed with the investors, they can be freely transacted on the stock exchange because of their negotiable character, thus guaranteeing the investor that he can recuperate the placed money funds, of course for the value they have on that date on the market.

Also, the stock exchange is the place and instrument for some important sector reorganizing and restructurings. On the stock markets a redistributing of the financings within the economy takes place: the financial funds are oriented towards more lucrative or perspective fields, because an investor can very easily sell here the securities he no longer considers to be a very good placement and invest in a sector he considers more attractive.

Another interesting aspect is that of the acquiring of companies and of mergers on the stock market, which are increasingly frequent. The stock exchange facilitates these operations and the main instrument through which the tender offer is performed. The tender offer is the operation performed through a intermediation company through which an investor announces that he is willing to buy partially or all the shares on the market of a commercial company he is interested on, for a firm price and within a well defined period of time. This is how most takeovers, transfers and mergers take place on the stock market.

On the stock exchange the sell-buy price for the quoted securities is permanently established and displayed. The stock market offers systematic information concerning the rate of the quoted securities and, implicitly, information on the listed companies and even on the respective economy on the whole. In this sense an important indicator is the stock exchange capitalization of a listed company, which shows the market value of that company: it is calculated by multiplying the total number of shares of that company with their market rate. In order to evaluate the dimensions of a stock market the total stock exchange capitalization can also be calculated by adding all the stock exchange values (stock exchange capitalizations) of the companies listed on those markets.

Finally, the stock exchange reflects especially accurately the overall situation of an economy, as well as its trends and perspectives. Especially useful for this purpose is the studying of the stock exchange indexes, calculated as an average of the evolutions and of the volume of transactions for a representative sample of shares or for their totality, on each stock exchange in part.

The collection of the temporary available capitals in the economy, the reallocation of those insufficient of inefficiently capitalized at a certain point and even the favoring of some sector restructurings, are meant to outline the place presently occupied by the capital market in the economy of many countries, not only the most developed ones.

The observation that in the developing countries the same attention must be granted to the starting and developing of an efficient financial market is well-founded, just as much as the preoccupations for developing the infrastructure of telecommunications. This is more important in the transition countries, considering the necessity to reorient resources from the inefficient sectors towards to efficient ones, thus ensuring the increase of efficiency in economy, supporting the economic reform process and even the privatization actions.

### **3. CONCLUSIONS**

The importance of the financial market is given by the significant role it plays in the finances (financing) of the enterprises and of the state, by the percentage the direct financing has among the methods for financing. Beyond what is apparently important - the high volume of transactions on the stock market - what really counts is the place the (primary) market holds in the development first of the stock companies (direct financing), and this is sometimes forgotten, or appears secondary. The well functioning of the financial market is a strong fundament for ensuring a lasting growth, on the long term, of the national economy; the financial market and firstly the

capital market represent in many countries – and could also represent in Romania – the engine for economic development.

If to a certain extent they can be replaced as financing sources, it must not be understood that financing through the banking system and financing through the capital market are perfectly replaceable, but rather complementary. In most cases, the issuing of shares or bonds tend to sooner supplement, than replace the bank loans, especially when the allocation of some important resources is wanted for sustaining some large investment plans, when a farther horizon for the maturity of the loan is sought, or even obtaining non-refundable funds for the price of dilution of capital and future dividends.

More and more issuers turn to financing instruments which not until long ago seemed too sophisticated, and the “theoretical” advantages of the listing on the stock exchange start to be the put into practice. The ability of the capital market to mobilize important financial resources now is no longer doubted and any company listed on the stock exchange will also consider from now on the issuing of bonds or shares among its financing options.

The Romanian capital market is ready both for the financing of companies and for the use of some sophisticated methods for forming the subscription price, and through the behavior of investors recently, it seems keen for new securities. This does not mean it can absorb the entire necessary of financing of the Romanian economy or that it can handle *debt/equity* financing ratios such as those from the developed capital markets, but nor can it be said that it does not offer sufficient liquidity or that the risk of the volatility of prices in the case of some public offers is alarming. Moreover, the current moment is an especially favorable one for the unfolding of this financing process for businesses, process also propelled by an overall economic conjuncture favorable for investments, through a stock market found under the sign of the bull, through a penetration in Romania of important foreign capital funds that seek placements as profitable as possible.

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