

## ↳ Financial System:

→ Consists of institutions which help to match one person's savings with another person's investment.

→ key ingredients of long-run economic growth:  
savings & investment

→ Moves the economy's scarce resources from

savers to borrowers.

↓  
• spend less than what they earn

• ~~invest~~ supply their money

to financial institutions expecting to get back the money at ↑ rate of interest from them.

↓  
• spend more than they earn

• borrow money from financial institutions expecting that they should repay their loans.

→ Consists of various financial institutions to co-ordinate savers & borrowers.

Financial institutions in which a person who wants to save can directly save by supplying ~~money~~ funds to those who want to borrow.

Financial markets

Financial intermediaries

banks, mutual funds.

Bond market

Stock (share) Market

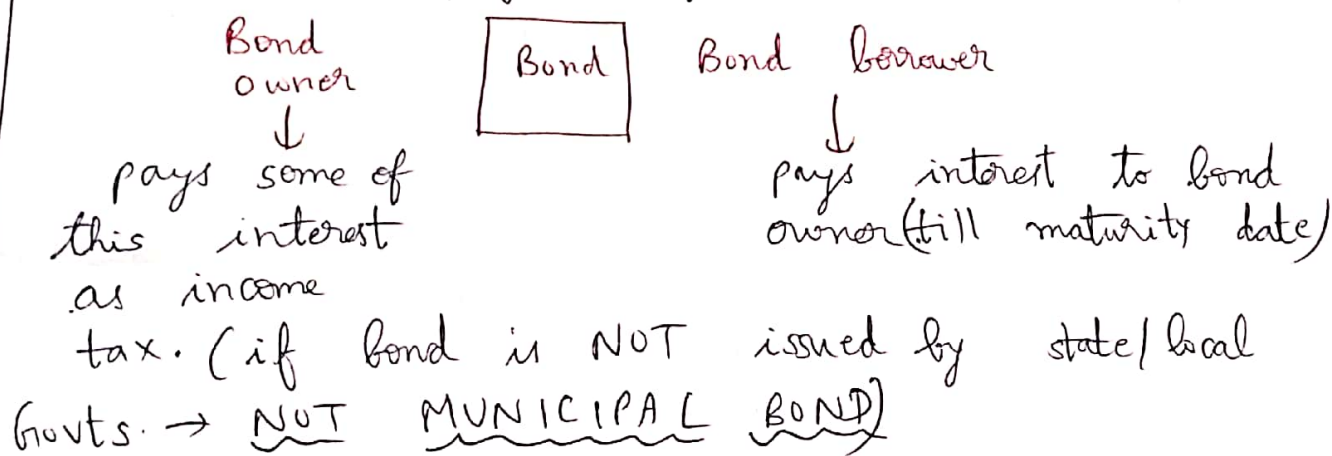
mutual funds  
↓  
diversification → distributing wealth among many assets.

Perpetuity

→ A bond that never expires  
↳ never repays the principal  
↳ A bond with no maturity date  
↳ interest paid forever to the firm.

(In some British firms)

- long-term bonds are riskier as holders of long-term bonds need to wait longer for getting their principal amount back. So, long-term bonds pay  $\uparrow$  rates of interests than short-term bonds.
- Credit risk of bonds → The probability that the borrower of the bond fails to pay some of the interest/principal.
- Failure to pay → default.



## • Stock Market (Shares)

- ↳ ownership in a firm ⇒ claim to a portion of the firm's profits.
- ↳ A way to raise funds → ~~can~~ sell stock in the company.

↳ Eg: 1000 shares in a firm ⇒ Each share can claim =  $\frac{1}{1000}$  of the firm's profit.

↳ firm's stock →  $\uparrow$  demand ⇒  $\uparrow$  profit of firm  
 ⇒ price of each stock  $\uparrow$  <sup>ser.</sup> Firm →  $\downarrow$  profit ⇒  
 price of each stock  $\downarrow$  <sup>ser.</sup>

## Bond vs Shares (stock)

## Bonds

- Bond lender sells a bond.
- Less risky as borrower pays bond owner interest regularly.
- Bond lenders get a fixed interest from borrowers.
- Maturity date
- Tax deductible

## Shares (stock)

- A firm owner sells stock to raise funds.
- Share holders get dividends of profit, depending on profit.
- Share holders get dividends of profit which is not fixed.
- No maturity date
- Shares are given on dividends of already tax deducted ~~interest~~ profit.