FINANCIAL MARKETS 101: A FOUNDER'S ONE-PAGE BRIEF

TO: Non-Finance Founders | **FROM:** Finance Research | **RE:** How Markets Work | **DATE:** January 2026

THE PROBLEM MARKETS SOLVE

You have ₹50 Lakh in savings. An entrepreneur needs ₹50 Lakh to build their company. Banks won't lend the full amount. **Financial markets connect you both efficiently, at scale, with managed risk.** Without markets: Capital stays idle, ideas don't get funded, economies stagnate.

THE BASIC FLOW (Your ₹50,000 investment journey)

YOU → **BROKER** (charges 0.05%) → **EXCHANGE** (matches buyers/sellers) → **CLEARING CORP** (guarantees trade) → **DEPOSITORY** (holds electronically) → **COMPANY** (receives capital)

Total cost: ₹69 (0.14%) | 1990s cost: ₹250 (0.5%) — Technology made markets 5x cheaper.

THREE TYPES OF PARTICIPANTS (And Who Actually Moves Markets)

RETAIL INVESTORS (That's You)	**INSTITUTIONAL INVESTORS**	**INTERMEDIARIES**
30% of trading volume	**70% of trading volume**	Brokers, Exchanges, Clearing Corps
₹5-50 Lakh portfolio	₹100+ Lakh Crore AUM	Execute trades, ensure fairness
Mutual funds, bonds, stocks	Mutual funds, insurance, pension funds	Cost: 0.14% per transaction
Time horizon: 5-20+ years	Time horizon: 3-7 years	Revenue from fees, not trading
Behavior: Buy & hold	Behavior: Strategic allocation	Regulatory responsibility

KEY INSIGHT: When FIIs sell ₹5,000 Cr in one week, Sensex drops 2-3%. Your ₹50,000 is noise. Institutions move markets. Understand them, not retail behavior.

HOW COMPANIES RAISE CAPITAL (Why you'll see this)

IPO: Company goes public (Hyundai raised ₹3,325 Cr at ₹1,900/share). Cost: 1-2% in fees.

BONDS: Company borrows ₹100 Cr at 8% for 5 years. You get ₹8 Cr/year, lower risk than stocks.

MUTUAL FUNDS: Your ₹50K pooled with others → Fund manager invests in 30 stocks. Fee: 1% annually.

THE INTERESTING PART: When Systems Failed (And How They Fixed It)

1992 Harshad Mehta Scam: Trader stole ₹450 Cr using fake securities → Market crashed 30% → ₹500 Cr retail investor loss → **System evolved:** Dematerialization (no more physical certificates), electronic settlement, real-time surveillance, circuit breakers.

2008 Lehman Collapse: One bank's failure → Global recession triggered → Stock markets crashed 50% → ₹50+ Lakh Cr wealth destroyed → **Lesson:** Financial system interconnected—one failure cascades.

India's Solution - Circuit Breakers: Market drops 10%? Trading halts 15 min. Drops 20%? Halts 1 hour. Prevents panic selling cascade.

Bottom line: Regulation isn't bureaucracy. It's the immune system markets built after fraud/crashes destroyed wealth.

THREE CONFLICTS YOU NEED TO KNOW (They're permanent)

1. **Broker Conflict:** Earns from trading (wants you to trade more) but advises you (should recommend less trading). **Protection:** Fiduciary duty rules, demand transparency.
2. **Rating Agency Conflict:** Paid by company issuing bonds (bias: generous ratings). Lehman was rated AA just before collapse. **Protection:** Disclose who paid, use multiple raters.
3. **Auditor Conflict:** Wants long-term client (bias: go easy on accounting). **Protection:** Mandatory 5-year rotation, NFRA oversight.

THE COST OF CAPITAL CONCEPT (Critical for you)

Your company raises ₹100 Cr:

- ₹60 Cr debt at 8% = ₹4.8 Cr annual cost
- ₹40 Cr equity (12% expected return) = ₹4.8 Cr annual cost
- **Total: 9.6% cost of capital**

You must find investments earning >9.6% to make profit. Debt cheaper but risky. Equity expensive but no repayment pressure. **Use debt for stable ventures, equity for growth.**

WHAT THIS MEANS FOR YOU (As Founder or Investor)

When raising capital:

- Institutional investors (70% of capital) care about: Can you earn returns >their cost of capital?
- Answer: Competitive moat, unit economics, path to profitability
- Structure: Optimal mix of debt/equity minimizes cost, maximizes founder control

When investing:

- Market drops 20%? Usually just institutional reallocation, not economic collapse
- Long-term winner: Buy when others panic (fundamentals didn't change)
- Beat inflation: 6% inflation needs 10%+ returns (stocks, not bank deposits)

THREE MINDSETS THAT CHANGE EVERYTHING

1. **Follow Money, Not Price** — Stock dropped? Did fundamentals change or did institutions reallocate? Two different things.
2. **Understand Incentives** — Brokers want volume, exchanges want listings, regulators want enforcement. Predict behavior from incentives.
3. **Systems Thinking** — RBI cuts rates → Banks lower lending → Companies borrow cheaper → Valuations increase → Stock prices rise. One decision cascades.

BOTTOM LINE

Financial markets are **perfectly orchestrated systems** connecting those with capital to those who need it. Institutions (not you) control 70% of volume and determine direction. Every intermediary fee solves a real problem. Every regulation exists because past fraud destroyed wealth.

- **As founder:** Know your cost of capital before raising.
- **As investor:** Think long-term, don't panic at crashes.
- **As both:** Understand that markets reward value creation, not short-term gaming.

For specific guidance on your capital structure or institutional behavior analysis, consult your investment banker or CFO.