



INTERNATIONAL  
BUSINESS SCHOOL

# Financial Markets History Structure and Functions

Principles and Practices of  
Business Finance

Dr. Sam Mohamad

# Agenda

1. History of Financial Markets
2. Financial System. Flows of Funds
3. What is a Financial Market
4. Classification of Financial Markets
5. Financial Securities
6. The Functions of Financial Markets

# History of Financial Markets

## Bruges, 1309

- First Exchange Market appeared in Belgium, 1309: Van der Buerse family operated the Ter Buerse inn in Bruges, and the square in front the inn became the commercial & financial center of the city where merchants and brokers were meeting and making businesses, currency, commodities, and merchant credit exchange. , but it was not about trading shares. So it is considered as the first organized financial exchange.

# History of Financial Markets

## Amsterdam, 1602

- Amsterdam Bourse (open air commodity market) was created in 1530, it listed the Dutch East India company shares in 1602 and had its own specialized building in 1608.
- This first stock issuance of the Dutch East India company in 1602 was done through a complete process of bookkeeping, money transfer and share ownership transfer to the buyer's account in the company's ledger, transaction cost. Hence, it is considered as the first stock market.

# History of Financial Markets

## Amsterdam, 1602

- In 1607, the emergence of derivatives markets.
- In 1609, short selling technique existed.
- In 1611, it started to have trading on weekdays from 11:00-12:00am. Thus, considered the first formal stock market in history.

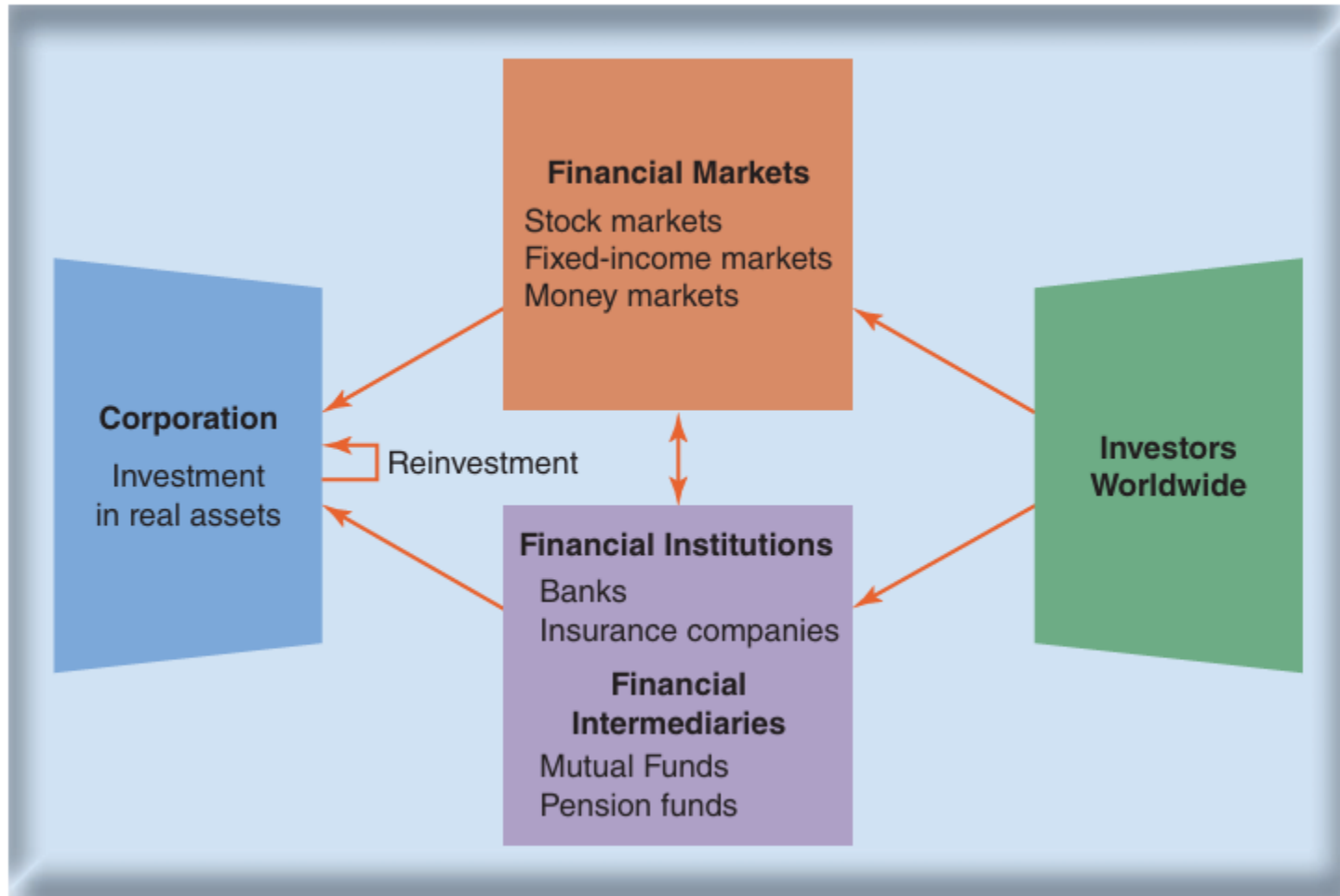
# First shares

- Shares in companies for single voyage trip to India.
- In 1600 AD: East India Company whose shares were traded in informal markets and coffee houses in London, so we can say privately traded..
- 1602 AD: the Dutch East India company was the first stock company who issued the first publicly tradable shares and bonds in Amsterdam stock market.

# Chronological Establishment of Major Stock Markets

- 1602 – Amsterdam Stock Exchange (Netherlands)
- 1698 – London Stock Exchange (UK)
- 1792 – New York Stock Exchange (NYSE, USA)
- 1801 – Paris Bourse (France)
- 1801 – Milan Stock Exchange (Italy)
- 1875 – Bombay Stock Exchange (India)
- 1878 – Tokyo Stock Exchange (Japan)
- 1891 – Madrid Stock Exchange (Spain)
- 1896 – Dow Jones Industrial Average (USA) **Index**

# Financial System. Flows of Funds





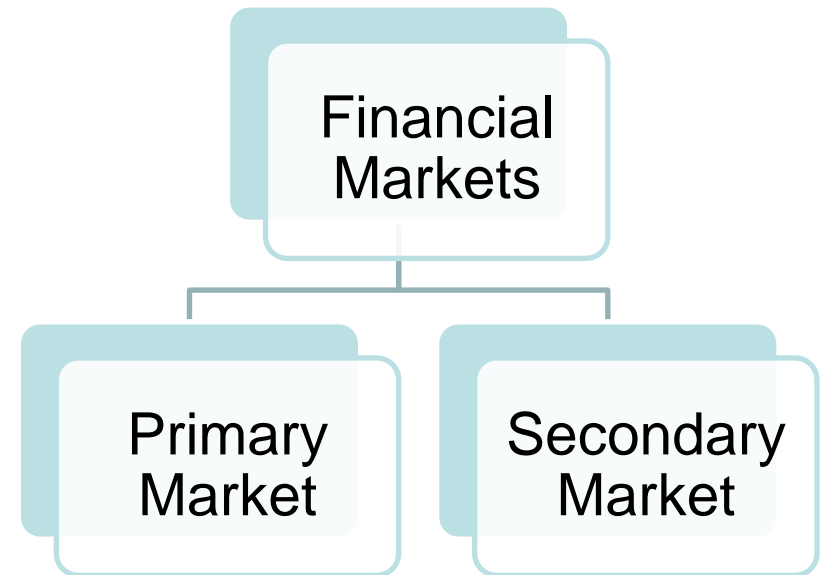
# What is a Financial Market

- **A financial market is a market where securities are issued and traded.**
- Financial Markets are like a central component of the financial system, where financial instruments are bought and sold and traded. These markets satisfy the needs of both parties: lenders and borrowers, and also for the economy by ensuring the use of unused savings and direct them to best different investment opportunities.

# Classification of Financial Markets

By issuance and trading

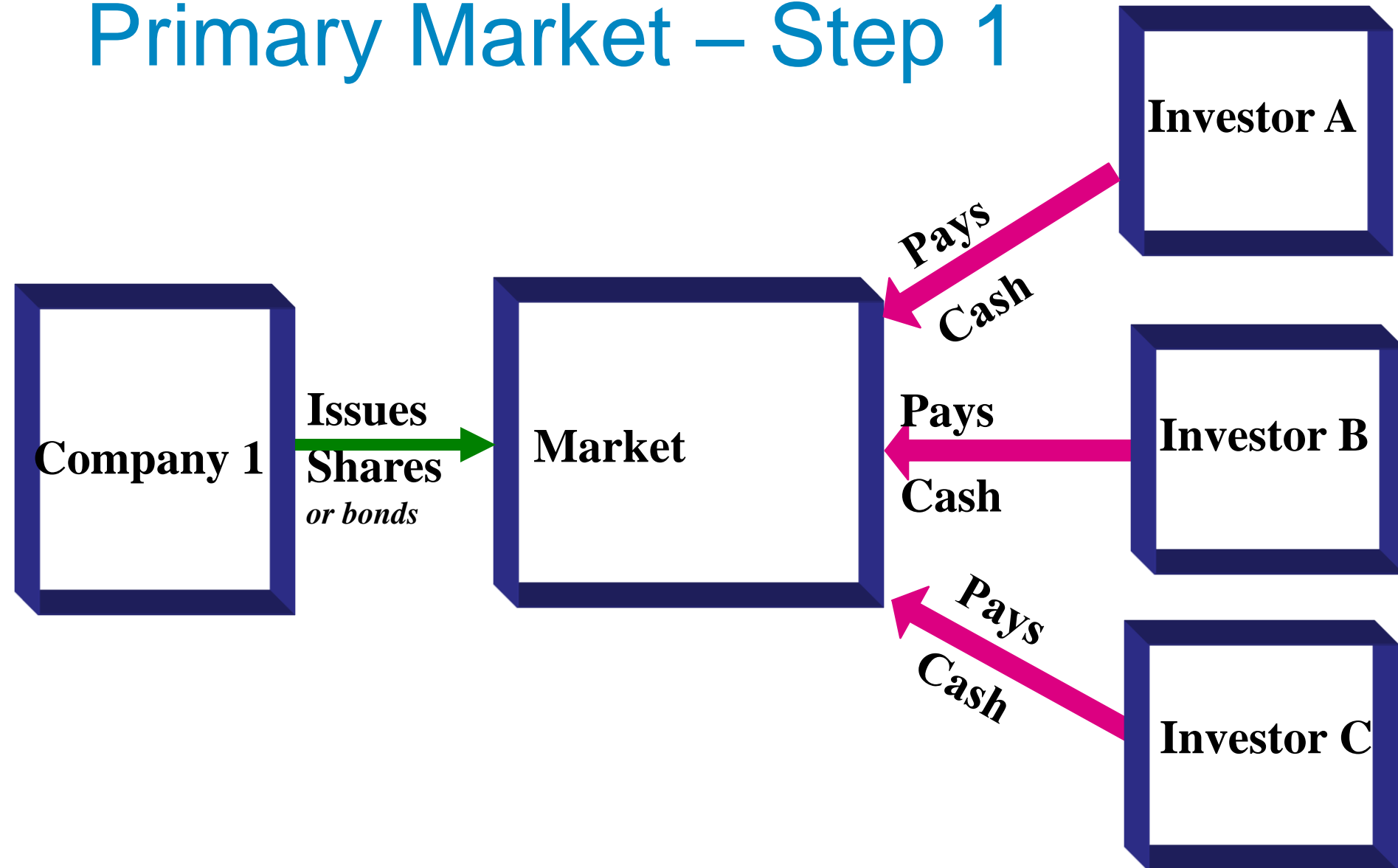
- Primary market: for the sale of newly issued securities.
- Secondary market: in which previously issued securities are traded among investors



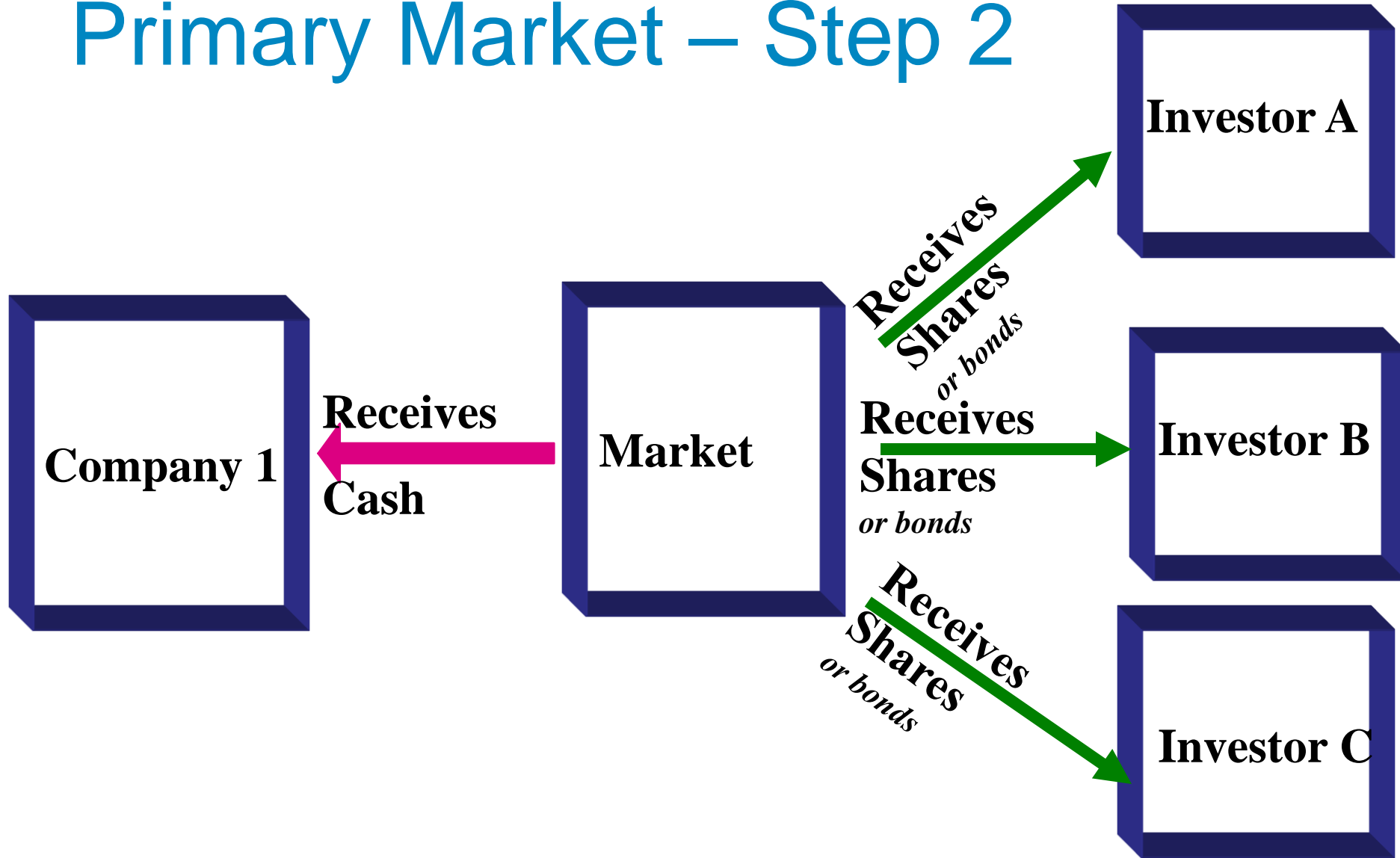
**Primary:** where those who need financing( '*issuers*') receive the funds that they need by selling the securities to those who have savings ('*investors*')

**Secondary:** where investors trade between themselves the securities previously issued on the primary market

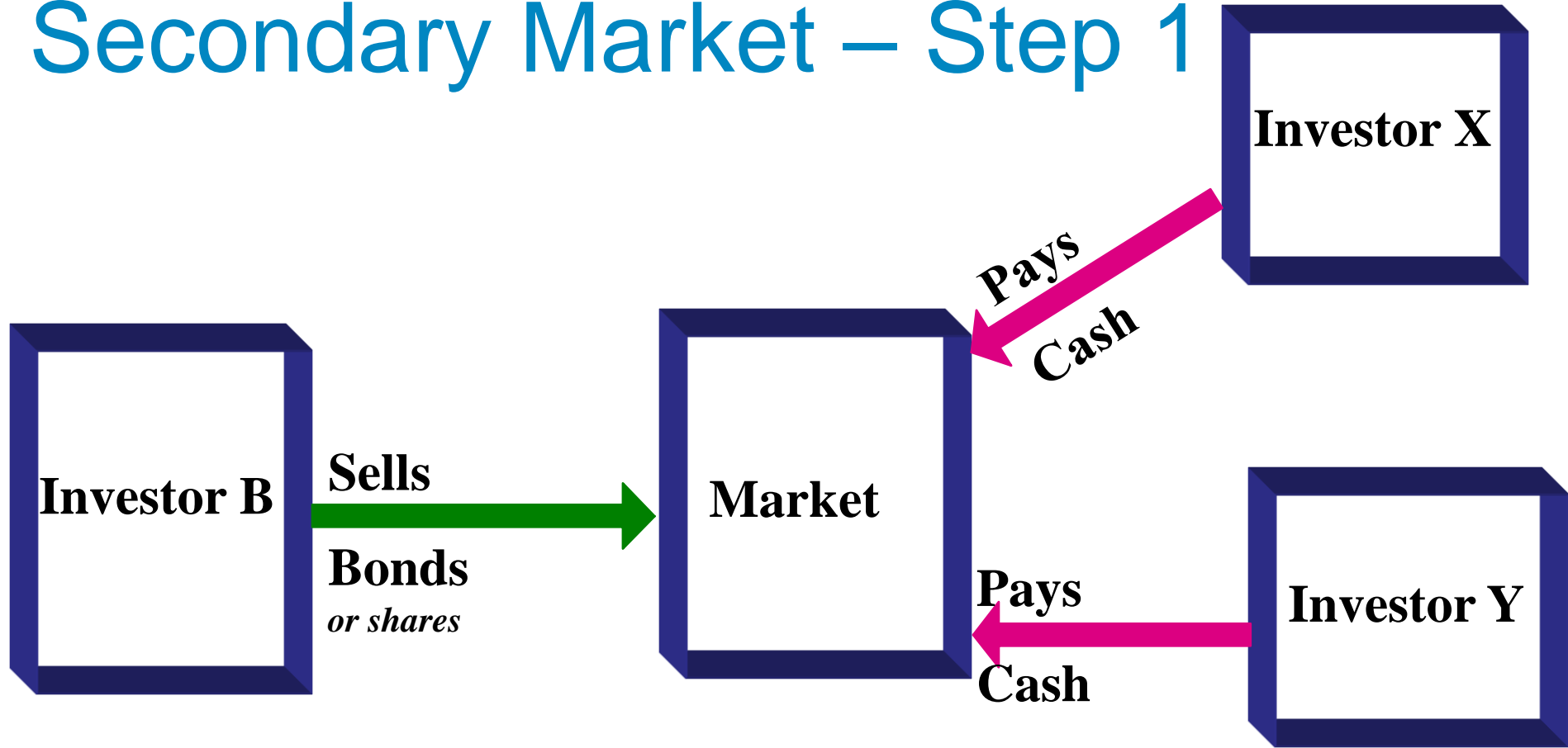
# Primary Market – Step 1



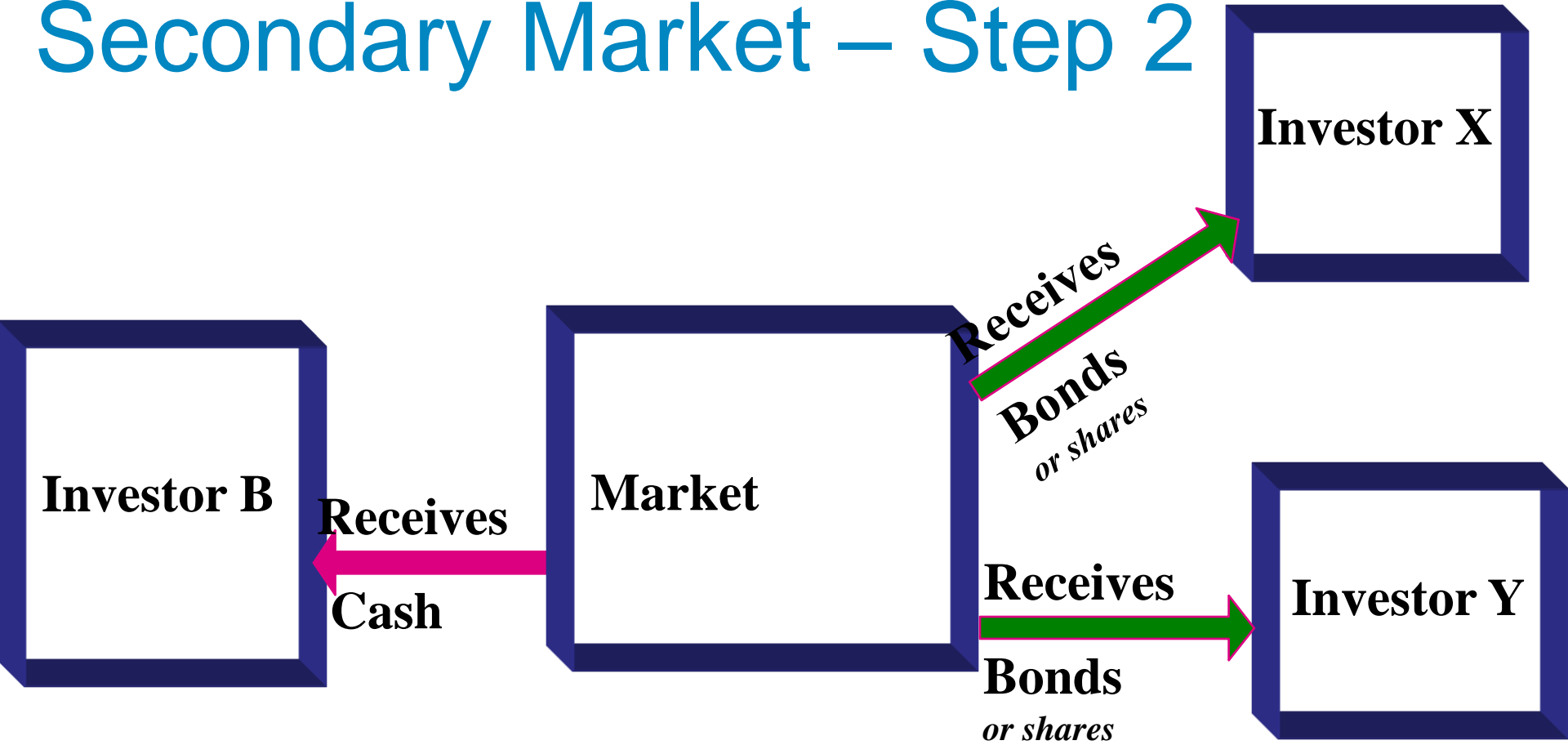
# Primary Market – Step 2



# Secondary Market – Step 1



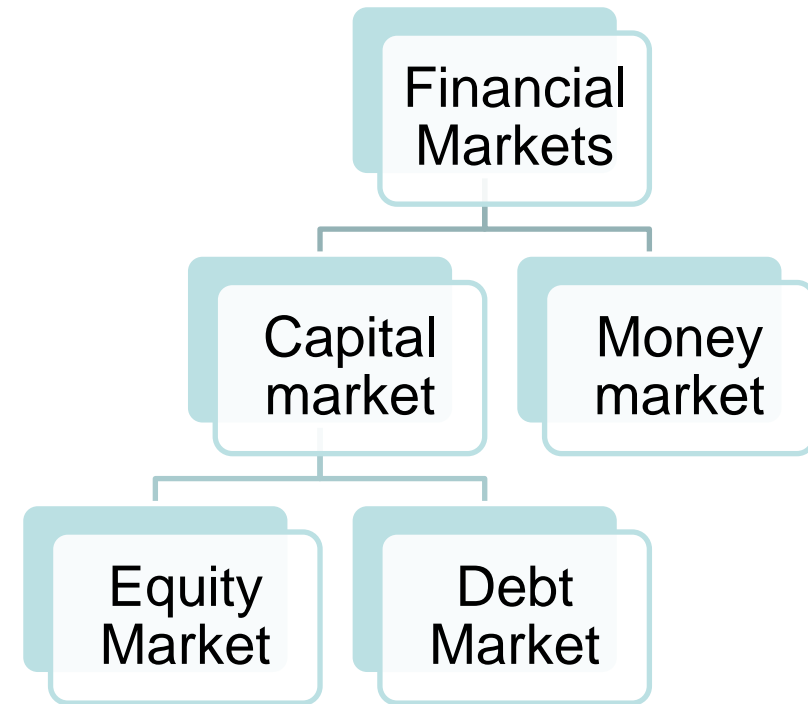
# Secondary Market – Step 2



# Classification of Financial Markets

By maturity:

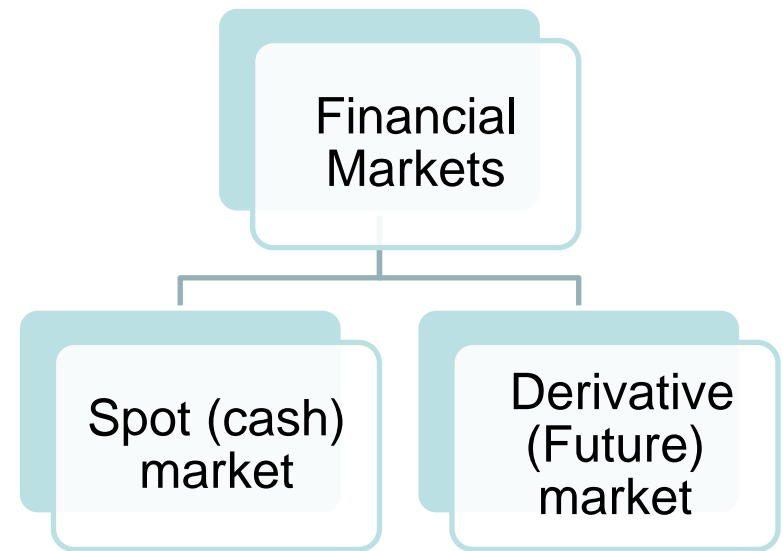
- Money Market for short-term financing (less than 1 year).
- Capital Market for long-term financing (less than 1 year).
- Debt Market: it also called Fixed-income Market. It is for debt securities (Bonds).
- Equity Market: for stock securities



# Classification of Financial Markets

By delivery of fund or asset

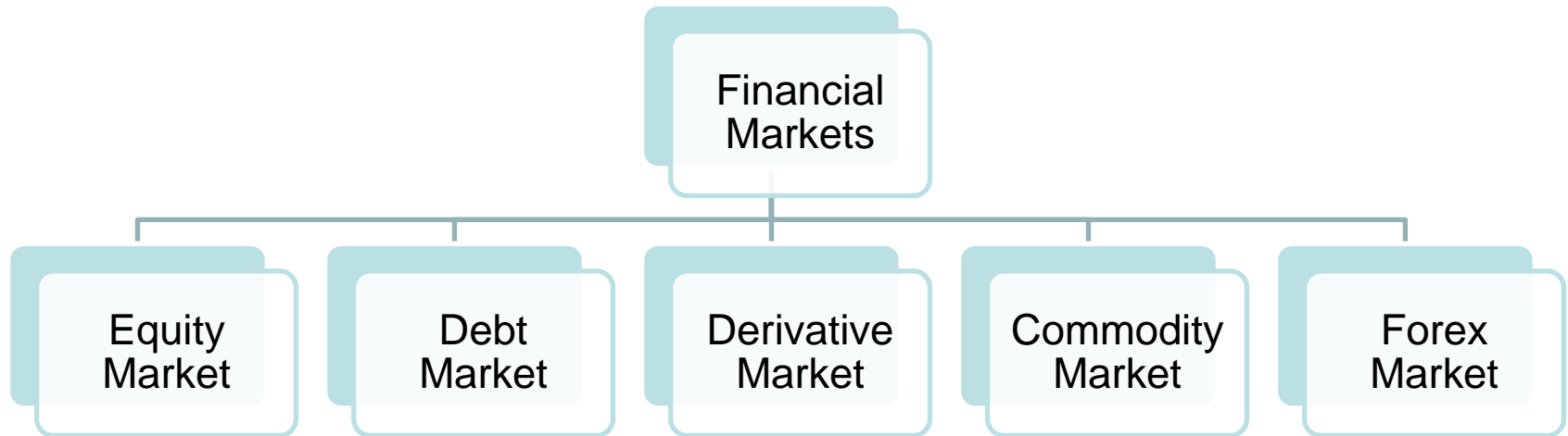
- Spot (cash) Market: where financial instruments are traded with immediate delivery where settlement happens immediate for FX and commodities, and with T+2 days for stock.
- Derivative Market: it has different types of contracts: Futures, Options, Swaps, Forwards





# Classification of Financial Markets

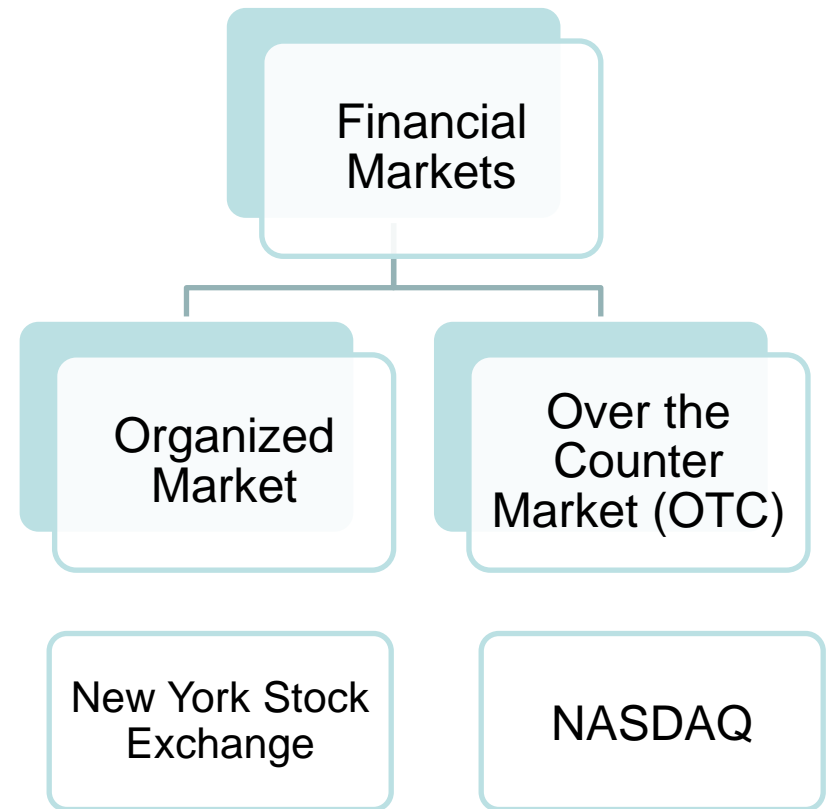
- By instrument



# Classification of Financial Markets

By organizational and trading mechanism and conditions:

- **Organized Markets** (Exchanges) are regulated markets, where trading is standardised and occurs through the exchange itself, where a central settlement system guarantees the execution of the trade (delivery of money versus the securities)
- **OTC** (*'Over-the-counter'*) is a decentralized, non-standardised market, where trade occurs directly between two participants and trades are directly settled between them



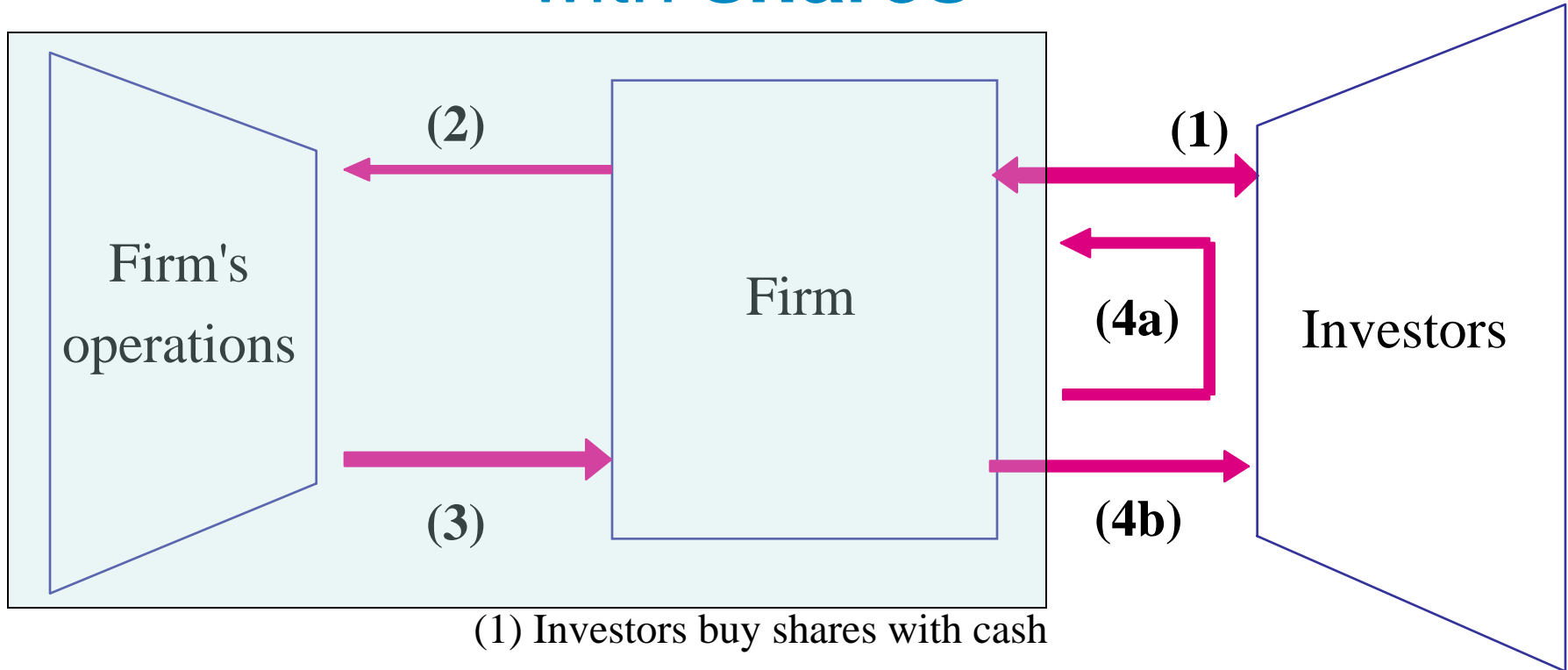
# Financial Securities

- **Securities** = Tradable certificates about ownership or debt
- **Bonds** = debt owed by the company
- **Shares** = ownership in the company

# Stocks

- **Shares** = ownership security
- Gives right to a proportional share of the corporation's profit and wealth. Receive dividends.
- Issued via an IPO (Initial Public Offering) which is the first offering of stock to the general public.
- Traded on exchanges or OTC,
- Types
  - Common: Voting rights, non-guaranteed dividends, paid last in liquidation.
  - Preferred: no voting rights, guaranteed dividends, paid before common stocks in liquidation.

# Financing a Company – with **shares**



(1) Investors buy shares with cash

(2) Cash is invested

(3) Company's operations generates cash

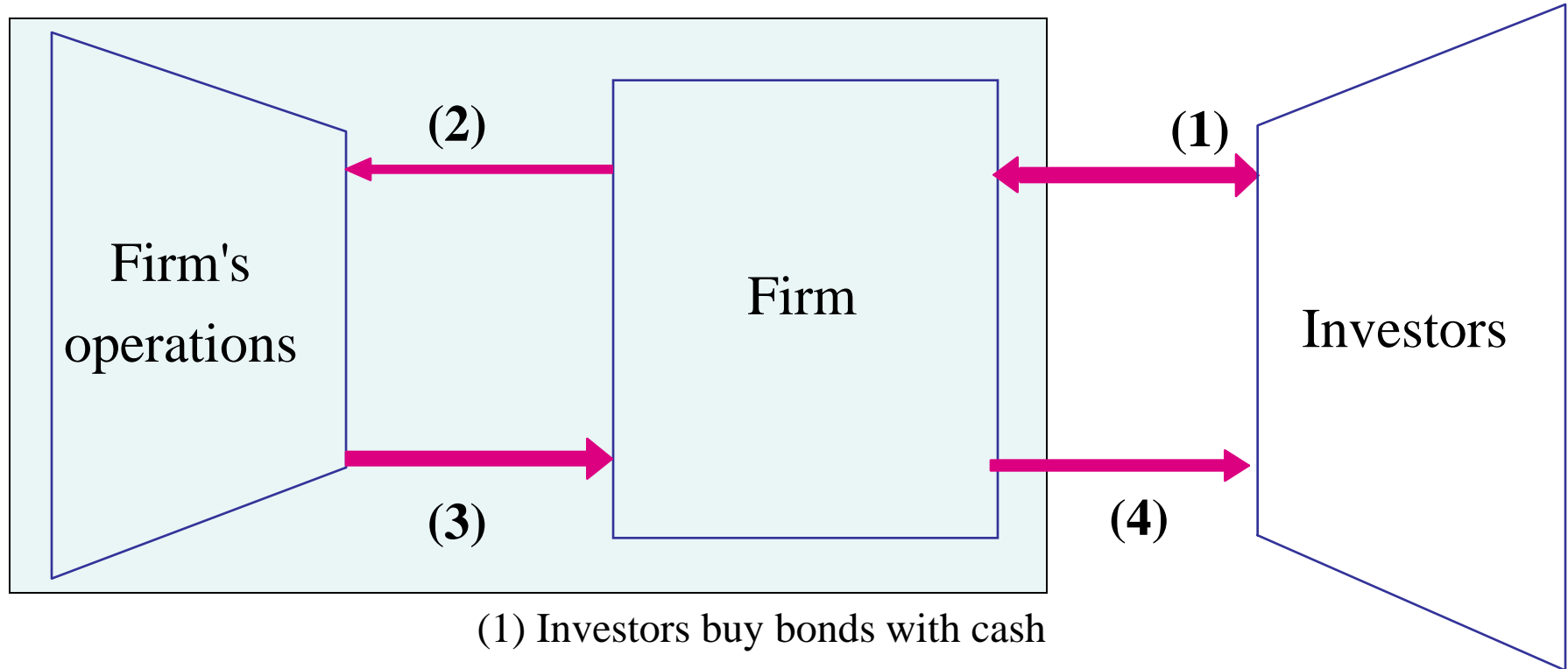
(4a) Most cash is reinvested

(4b) A small part of the cash is sometimes returned to investors (dividends)

# Bonds

- **Bonds** = debt security
- The company that needs financing sells bonds ('The issuer issues bonds'), which are bought by investors. The issuer promises to repay the amount borrowed (the 'principal') and a regular interest payment ('coupon'), until the end of the loan ('maturity')

# Financing a Company – with **bonds**



(1) Investors buy bonds with cash

(2) Cash is invested

(3) Company's operations generates cash

(4) Borrowed cash is returned in full to investors  
(bond is repaid – principal and coupons)

# The Functions of Financial Markets

1. Provide investment and funding channels for borrowers and investors
2. Risk lowering and sharing
3. Asset pricing (supply-demand mechanism)
4. Liquidity
5. Lowering transaction costs
6. Information source
7. Performance evaluation
8. Economy growth