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Literature Review on Capital Market

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Abstract

This article provides a literature review and analysis of the capital market, including the following: the difference between the capital market and the financial market, the main participants in the capital market, the financing methods of listed companies and non-listed companies in the capital market, and the difference between the various methods in the division of equity and so on.

Keywords

Capital Market; Financial Market; Financing Method; Equity Division.

1. Introduction

In the past years, financial industry in China and western countries has continued to develop and grow into a more mature stage. The capital market occupies a very important position in the financial industry. The capital market, as a long-term financial market characterized by mid- and long-term credit vouchers, has received more and more attention and research from scholars and financial professionals since the 1980s. As scholars' research on the efficiency of the capital market continues to deepen, the financial industry is developing faster and faster, which is of great significance to economic growth. The financial market has become an important part of the global economic system,with the better infrastructure, improved legal system,and more standardized market regulations. The improvement of capital market efficiency is conducive to optimizing resource allocation, promoting economic system reform and rapid economic development. With the continuous reform of the financial industry, the capital market is constantly evolving, so it is necessary to do the research and reform of the capital market .

2. Capital Market

2.1. Definition and Division of Capital Market

The capital market is one of many market forms. As the name suggests, the market must be composed of sellers, buyers and exchanges. From ancient times to the present, market transactions have been constantly evolving. The financial market is the market where buyers and sellers trade financial products. The capital market is intricate, and there have been many controversies and different definitions since its existence. Mengnan Zhu(1999) [1] and Juan He (2014) [2] define the capital market as a long-term capital market, which refers to securities financing, trading and fund borrowing and lending for more than one year, which can also be called the medium and long-term capital market. In the searched literature, there are many classification methods for the capital market. The classification method introduced by Mengnan Zhu (1999) [1] is generally accepted and recognized by scholars: the capital market is divided into medium and long-term credit markets and securities markets according to financing

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capital. Different financial instruments, which are used for financing between fund suppliers and demanders in different market forms, thus proving that debt transactions are reasonable and legal.

2.2. Financial Instruments

The capital market is a long-term financial market, and the financial instruments circulating in the market are long-term financial products. According to the nature of financial instruments, capital market can be divided into equity markets and bond markets. Stocks, equity and annual dividends are the mainly used in the equity market. Di Yang(2011) [3] indicates that company stocks are the most popular in the stock market, and shareholders' equity only has annual dividends. The bond market mainly uses bonds, commercial promissory notes, certificates of deposit, and loans with fixed maturities and known yields, and complete resale rights. For the capital market, the important investment value of financial instruments is unique. Its profitability creates assets for the capital market, and its risk is also a guarantee of safety from another perspective. Liquidity gives financial products the ability to realize liquidity and circulation.

2.3. Participants

Participants in the capital market are also diverse. As a financing market, participants must include capital contributions, capital recipients, and financial products Qinhua Pan (2010) [4] introduces that the capital market is subject to capital requirements and who will pay to provide future equity capital. Investors are capital providers such as financial institutions. Market economic activities on the capital market mainly include buying and selling stocks. bonds and loans to natural persons.

2.4. Functions

The direct function of the financial market is well known. As a market for buying and selling. the purpose of buyers and sellers is very simple and direct. Financing is the first important function The financing function of the capital market is to turn the idle and abundant fund-raising in the society into assets or liquid funds for some enterprises to use in the daily activities of the enterprise. Buyers and sellers in the market rely on the transfer of claims, assets and cash flow to obtain their own needs such as funds.

3. Comparison with Capital Market and Financial Market

3.1. Definition and Division of Financial Markets

The capital market is a long-term financial market, and the financial market is a larger scale.

The financial market includes many market forms such as the currency market and the capital market, that is, markets that realize currency lending, financing, and other transactions. According to the nature of the transaction, market can be divided as the issuance market and the circulation market are divided. Capital market and the currency market are divided according to the financing duration. The capital market is the long-term financial market we introduced in the previous article.

3.2. Financial instruments and its' characteristics

Since the existence of the financial market, various financial instruments have been traded. For example, stocks, bonds, and loan contracts are all traded in the financial market. The direct purpose is to achieve financing. The most notable feature of the financial market is liquidity, which allows all kinds of capital in society to flow between various industries. Due to the need for adjustment of surplus and deficiencies, funds always flow from surplus sectors to scarce sectors, thereby optimizing the allocation of resources.

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3.3. Functions

The role of the financial market is direct and important. On the one hand, it promotes the rational allocation of resources. Resources always flow to sectors with great development potential, high efficiency, and scarce funds. At the same time, it also promotes the redistribution of wealth and risks, and the diversified investment structure of residents. The financial market also promotes capital accumulation. On the one hand, the financial market regulates the macro-economy, and the implementation of the government in turn creates conditions for indirect macro-economic regulation. The government can rely on the financial market to adjust monetary and financial policies. The two jointly promote the smooth operation of the national economy. In addition, the financial market is also one of the important ways to reflect the level of the national economy.

3.4. Relationship between the Financial Market and the Capital Market

3.4.1. Connection

The capitalist market belongs to the financial product market, and the financial market can be divided into a money market and a capital market according to the financing period. The capital market is a long-term financial market, including long-term borrowing and bond markets. It is also a place for trading medium and long-term credit instruments and realizing long-term financing activities.

3.4.2. Comparison

(1) The capital market is the long-term fund market, which is a place to buy and sell medium- and long-term credit instruments for financing funds with a loan period of longer than one year. The financial market is divided into long-term and short-term markets. (2) The transaction objects in the capital market generally include medium and long-term government bonds, long-term securities (more than one year), medium and long-term bank loans, stocks, etc.; the financial market transaction objects mainly include other financial assets, monetary funds and other financial instruments.

4. Financing Methods

Many small and medium-sized enterprises have narrow concepts in financing.They are afraid of the risks behind the financing about losing opportunities for corporate development, which restricts the speed of corporate development.Funds are undoubtedly the blood of an enterprise. Financing is a management technique and also a development strategy. It is the competitiveness of an enterprise to survive and grow bigger and stronger.

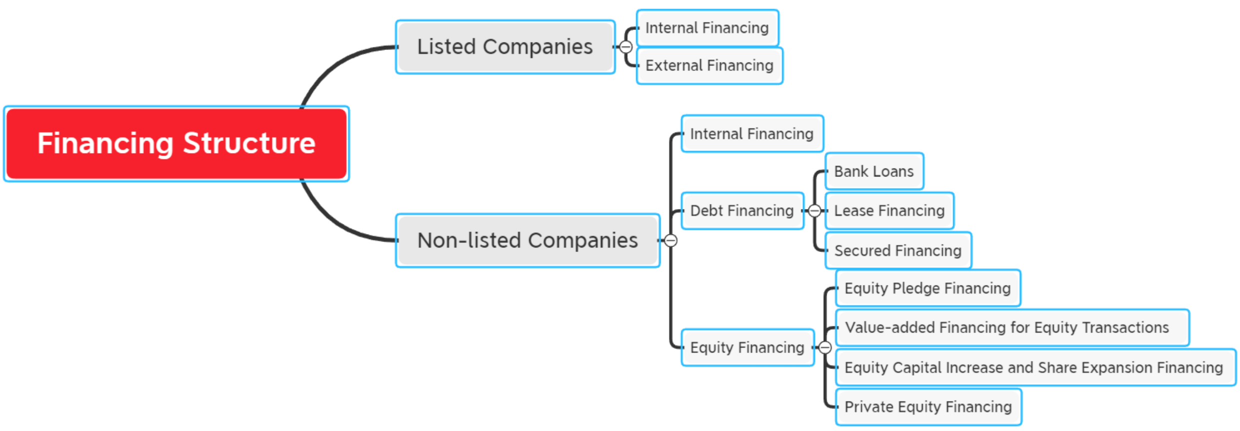

Figure 1. Financing Methods

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4.1. Financing Methods for Listed Companies

4.1.1. Internal Financing

Internal financing refers to the funds saved by the company which are mostly generated by the business and service income of the company itself. The shareholders and partners of the company adopt a non-dividend method to keep the funds as retained earnings and depreciation and convert them into the company's own investment capital. Many domestic companies will also choose employee stock ownership for internal financing. Haisheng Lan(2014) [6] takes Huawei as an example. In 2001, Huawei used a one-yuan-one-share allotment system to share rights and interests with employees. After Huawei's option reforms, employees can obtain a corresponding amount of equity by working rather than using personal funds.

In terms of equity, internal financing allows the company to obtain sustainable blood without generating shares or resource outflows, and no external interest payments, which reduces the company's financing costs. At the same time, internal financing is also a potential benefit for stimulating company profits and reducing operating costs. From this, we can see that a company's own operating capability is the guarantee of its strength in internal financing, and it is the foundation of the company. In terms of equity rights, Huawei allows employees to allocate equity at one yuan per share. There is no outflow of the company's equity rights during the financing process.

4.1.2. External Financing

There are various ways of corporate financing, as well as an important way of external financing. It refers to the financing method in which enterprises obtain external financial support from the government and society through bank loans, contractual agreements, share sales and government policy support, etc., to expand their own business capabilities. According to whether banks and other financial institutions are used to raise funds, external financing methods can be divided into two different forms: direct financing and indirect financing. In terms of equity, external financing has the problems of borrowing, selling and transferring shares, and the financing cost is relatively high. In the case of bank borrowing, companies also need to bear the cost of paying interest.

External financing has made many large domestic and foreign companies, and it can even be said that external financing is the growth factor for these companies to take off. As the largest e-commerce company in China, Alibaba received USD 20 million support from Japan's SoftBank at the beginning of the domestic e-commerce market in 2000. While Alibaba achieved its own business myth, it also led SoftBank to glory.

Qian Sun(2020)[7] points that listed companies need to comprehensively consider their own economic strength, company operating conditions, actual market conditions, and the security of the capital chain, combined with the advantages and rights of internal and external financing, to analyze and optimize the company's shareholding structure and capital allocation methods, and select appropriate financing methods.

4.2. Financing Methods for Non-listed Companies

Although listing financing is still the dream of many companies as the mainstream method of corporate financing and large-scale financing of investors [8]. For small and medium-sized enterprises and even some large enterprises, listed companies also need to face tremendous pressure from corporate management and rational allocation of funds.

4.2.1. Internal Financing

Like listed companies, non-listed companies can also use corporate dividend retention and depreciation to accumulate profits as investment funds for their own development. Internal financing is a basic financing method for most companies. For non-listed companies, due to the limited scale of enterprise development and immature business models, non-listed companies lack working capital, and there is a greater risk of entrepreneurship.

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4.2.2. External Financing

Debt financing refers to the financing of enterprises through debt. In 2004, based on inventory support, Leo Steel Development adopted "the right to mortgage loans for future goods" and signed an agreement "future credit pledge for goods" to provide supply chain financing. It is an example of successful domestic bank loan for small companies using goods as collateral in trade.

4.2.3. Equity Financing

Equity financing includes equity pledge, equity transaction appreciation, equity capital increase and equity private placement. Due to the need for funds for operations and the maturity of domestic financial market supervision, cost of equity financing is undoubtedly lower than the cost of internal financing financing, enterprises can obtain working capital with no need to pay interest to social capital investors or repayment costs,, for their own company to inject new vitality.

5. Conclusion

As one of the most important components of financial market, capital market has greatly influenced the reform and economic development of financial industry. Deepening our understanding of the capital market and related fields of financial market will help us penetrate the financial industry more deeply, so as to reform the capital market, finance industry and economic system more powerfully, quickly and efficiently, which can finally promote the improvement of people's economic level and living standard. The most important role of capital market and financial market -financing, can bring great convenience and opportunity to the companies. The lack of investment funds will inevitably limit the company's operation and development model. In this increasingly competitive social market, if companies want to survive, they must rush forward, seize market opportunities, and take the lead in occupying a favorable position in the market. They must assess the situation in the process of company development, seize opportunities in a timely manner, determine financing risks, and grasp financing opportunities to expand their own business scale, and move forward to the next stage. While, in the financing process, listed companies and non-listed companies in the capital market are equal, they both can obtain funds, which is very friendly to non-listed companies, so that non-listed companies also have ability to compete with the listed companies. Therefore, both listed and non-listed companies should make good use of the capital market, raising the company funds to maintain the daily business activities, to promote enterprises develop better.

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