

Financial Assets vs Physical Assets

Assets are commonly known as anything with a value that represent economic resources or ownership that can be converted into something of value such as cash. Financial assets and physical assets, both represent such ownerships of value, even though they are very different to each other based on their features and characteristics. Since many easily confuse the two types of assets to be of similar meaning, the following article provides a solid explanation of the difference between the two, and explore a few points that may help readers understand the difference between these two types of assets.

Financial Assets

Financial assets are intangible, meaning that they cannot be seen or felt and may not have a physical presence except for the existence of a document that represents the ownership interest held in the asset. It is important to note that the papers and certificates that represent these financial assets do not have any intrinsic value (the paper held is only a document certifying ownership and is of no value). The paper derives its value from the value of the asset that is represented. Examples of such financial assets include stocks, bonds, funds held in a bank, investments, accounts receivable, company goodwill, copyrights, patents, etc. Regardless of the fact that financial assets do not exist in physical form, they are still recorded in a firm's balance sheet, to represent the value that is held by them.

Physical Assets

Physical assets are tangible assets and can be seen and touched, with a very identifiable physical presence. Examples of such physical assets include land, buildings, machinery, plant, tools, equipment, vehicles, gold, silver, or any other form of tangible economic resource. From an accounting point of view, physical assets refer to the things that may be liquidated when the entity wound up its interest. Physical assets have a useful economic life, when it ascertains its age it may be disposed off. They usually experience a reduction in value due to wear and tear of the asset through continuous use known as depreciation, or may lose their value in becoming obsolete, or too old for use. Certain tangible assets are also perishable, such as a container of apples, or flowers that need to be sold soon in order to ensure that they do not perish and lose their value.

What is the difference between Financial Assets and Physical Assets?

The main similarity between tangible and physical assets is that they both represent an economic resource that can be converted into value, and both assets are recorded in a firm's balance sheet. The main difference between the two is that physical assets are tangible and financial assets are not. Physical assets usually depreciate or lose value due to wear and tear, whereas financial assets do not experience such reduction in value due to depreciation. However, financial assets may lose value to changes in market interest rates, fall in investment returns or fall in the stock market prices. Physical assets also require maintenance, upgrades and repairs, whereas financial assets do not incur such expenses.

Differences between Money Markets and Capital Markets.

Major Points	Money Markets	Capital Markets
Participant	Institutional participants like RBI, banks, financial institutions and finance companies. Individual investors are permitted to transact but do not normally do so	Financial institutions, banks, corporate entities, foreign investors and ordinary retail investors from the members of the public.
Instruments	Short term debt instruments such as T-bills, trade bills reports, commercial paper and certificate of deposit.	Equity shares, debentures, bonds and preference shares etc.
Investment Outlay	Transactions require huge sums of money and are quite expensive	Do not require a huge financial outlay. The value of units of securities is generally low i.e. Rs. 10, 100 and minimum trading lot of shares is kept small as 50 or 100 units.
Duration	Instruments usually have a maximum tenure of one year and may even be issued for a single day.	Deals in medium and long term securities such as equity share and debentures
Liquidity	Higher liquidity since the DFHI the Discount Finance House of India has been established for the specific objective of providing a ready market for these instruments.	Considered as liquid instruments because they are marketable on the stock exchanges, However it might be difficult to find a buyer sometimes with the fluctuations of the stock market.
Safety	Minimum risk and are safer since the issuers mostly are the agencies of the Government and also because of the shorter duration.	Riskier because of the long duration and may be the issuing companies fail to perform as per the projection shown during issue.
Expected return	Less	High for long duration earnings are through dividend and bonus shares.

SPOT MARKET

What It Is:

Also called the cash market or the physical market, the **spot market** is where assets are sold for cash and delivered immediately.

How It Works/Example:

Spot markets differ from futures markets in that delivery takes place immediately. For example, if you wish to purchase Company XYZ shares and own them immediately, you would go to the cash market on which the shares are traded (the New York Stock Exchange, for example). If you wanted to buy gold on the spot market, you could go to a coin dealer and exchange cash for gold.

The foreign exchange (FOREX) market is one of the largest spot markets in the world. People and companies all over the world are constantly exchanging one currency for another as transactions occur all over the globe.

Why It Matters:

It is important to know the difference between the *spot market* and the futures market as well as the difference between spot prices and futures prices. This difference -- known as the time spread -- is important economically because it illuminates the market's expectations about futures prices.

For the most part, spot markets are influenced solely by supply and demand, whereas futures markets are also influenced by expectations about future prices, storage costs, weather predictions (for perishable commodities in particular), and a host of other factors.

FUTURES MARKET

What It Is:

Futures are financial contracts giving the buyer an obligation to purchase an asset (and the seller an obligation to sell an asset) at a set price at a future point in time.

How It Works/Example:

Futures are also called futures contracts.

The assets often traded in futures contracts include commodities, stocks, and bonds. Grain, precious metals, electricity, oil, meat, orange juice, and natural gas are traditional examples of commodities, but foreign currencies, emissions credits, bandwidth, and certain financial instruments are also part of today's commodity markets.

There are two kinds of futures traders: hedgers and speculators. Hedgers do not usually seek a profit by trading commodities but rather seek to stabilize the revenues or costs of their business operations. Their gains or losses are usually offset to some degree by a corresponding loss or gain in the market for the underlying physical commodity.

Speculators are usually not interested in taking possession of the underlying assets. They essentially place bets on the future prices of certain commodities. Thus, if you disagree with the consensus that wheat prices are going to fall, you might buy a futures contract. If your prediction is right and wheat prices increase, you could make money by selling the futures contract (which is now worth a lot more) before it expires (this prevents you from having to take delivery of the wheat as well). Speculators are often blamed for big price swings, but they also provide liquidity to the futures market.

Futures contracts are standardized, meaning that they specify the underlying commodity's quality, quantity, and delivery so that the prices mean the same thing to everyone in the market. For example, each kind of crude oil (light sweet crude, for example) must meet the same quality specifications so that light sweet crude from one producer is no different from another and the buyer of light sweet crude futures knows exactly what he's getting.

Futures exchanges depend on *clearing members* to manage the payments between buyer and seller. They are usually large banks and financial services companies. Clearing members guarantee each trade and thus require traders to make good-faith deposits (called margins) in order to ensure that the trader has sufficient funds to handle potential losses and will not default on the trade. The risk borne by clearing members lends further support to the strict quality, quantity, and delivery specifications of futures contracts.

Futures Exchanges

There are several futures exchanges. Common ones include The New York Mercantile Exchange, the Chicago Board of Trade, the Chicago Mercantile Exchange, the Chicago Board of Options Exchange, the Chicago Climate Futures Exchange, the Kansas City Board of Trade, and the Minneapolis Grain Exchange.

Why It Matters:

Futures are a great way for companies involved in the commodities industries to stabilize their prices and thus their operations and financial performance. Futures give them the ability to "set" prices or costs well in advance, which in turn allows them to plan better, smooth out cash flows, and communicate with shareholders more confidently.

Futures' trading is a zero-sum game; that is, if somebody makes a million dollars, somebody else loses a million dollars. Because futures contracts can be purchased on margin, meaning that the investor can buy a contract with a partial loan from his or her broker, futures traders have an incredible amount of leverage with which to trade thousands or millions of dollars worth of contracts with very little of their own money.

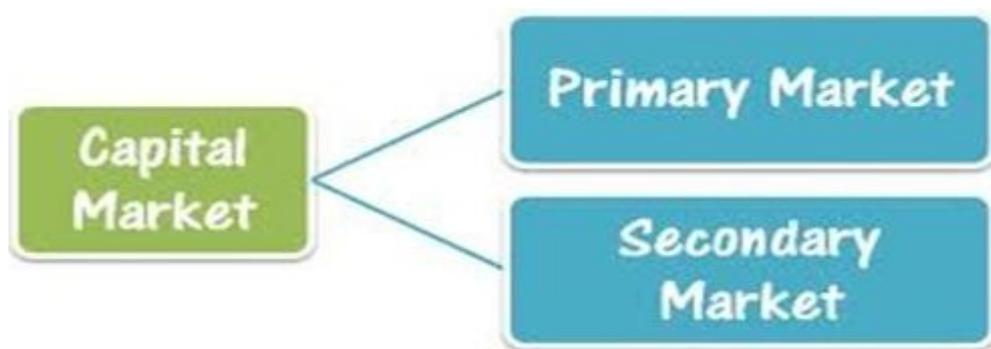
For additional reading:

http://web.mit.edu/rpindyck/www/Papers/Dynamics_Comm_Spot.pdf

Primary and Secondary markets

The financial market is a world where new securities are issued to the public regularly. It is a world full of varied financial products and services, tailored to the need of every individual from all income brackets. These financial products are bought and sold on the *capital market*, which is divided into primary market and secondary market.

This post will be a detailed explanation of primary market and secondary market, and will draw the distinction of primary market vs. secondary market.



What Is Primary Market?

The primary market is also known as *new issues market*. Here, the transaction is conducted between the issuer and the buyer. In short, the primary market creates new securities and offers them to the public.

For instance, Initial Public Offering (IPO) is an offering of the primary market where a private company decides to sell stocks to the public for the first time. An important point to remember here is that in the primary market, securities are directly purchased from the issuer.

Capital or equity can be raised in primary market by any of the following four ways:

1. Public Issue

As the name suggests, public issue means selling securities to public at large, such as IPO. It is the most vital method to sell financial securities.

2. Rights Issue

Whenever a company needs to raise supplementary equity capital, the shares have to be offered to present shareholders on a pro-rata basis, which is known as the *Rights Issue*.

3. Private Placement

This is about selling securities to restricted number of classy investors like frequent investors, venture capital funds, mutual funds and banks comes under *Private Placement*.

4. Preferential Allotment

When a listed company issues equity shares to a selected number of investors at a price that may or may not be pertaining to the market price is known as *Preferential Allotment*.

The primary market is also known as the *New Issue Market* (NIM) as it is the market for issuing long-term equity capital. Since the companies issue securities directly to the investors, it is responsible to issue the security certificates too. The creation of new securities facilitates growth within the economy.

What Is Secondary Market?

In secondary market, the securities issued in the primary market are bought and sold. Here, you can buy a share directly from a seller and the stock exchange or broker acts as an intermediary between two parties.

The secondary market is actually formed by another layer of investors who deal with primary market investor to buy and sell financial securities such as bonds, futures and [stocks](#). These dealings happen in the proverbial stock exchange.

National Stock Exchange (NSE) and New York Stock Exchange (NYSE) are some popular stock exchanges. Majorly, the trade happens between investors without any involvement with the company that issued the securities in the primary market.

The secondary market is further divided into two kinds of market.

1. Auction Market

The auction market is a place where buyers and sellers convene at a place and announce the rate at which they are willing to sell or buy securities. They offer either the 'bid' or 'ask' prices, publicly. Since all buyers and sellers are convening at the same place, there is no need for investors to seek out profitable options. Everything is announced publicly and interested investors can make their choice easily.

2. Dealer Market

In a dealer market, none of the parties convene at a common location. Instead, buying and selling of securities happen through electronic networks which are usually fax machines, telephones or custom order-matching machines.

Interested sellers deliver their offer through these mediums, which are then relayed over to the buyers through the medium of dealers. The dealers possess an inventory of securities and earn their profit through the selling. A lot of dealers operate within this market and therefore, a competition exists between them to deliver the best offer to their investors. This makes them deliver the best price to the investors. An example of a dealer market is the NASDAQ.

The secondary markets are important for price discovery. The market operations are carried out on stock exchanges.

A variation to the dealer market is the *OTC market*. OTC stands for 'Over the Counter' market. The concept came into existence during the early 1920's period through Wall Street trading, which implied the prevalence of an unorganized system of dealers who conducted trades via networks. Stock shops existed to buy and sell shares over-the-counter. In other words, these were unlisted stocks which were sold privately.

Over time, the notion of OTC underwent a change. These days the over-the-counter denotes those stocks which are not traded over NYSE, NASDAQ or American Stock Exchange (AMEX). The over-the-counter implies those stocks which are traded on the *pink sheets* or on *over-the-counter bulletin boards* (OTCBB). Pink sheets are a name given to the daily list of stocks published with ask and bid prices by the National Quotation Bureau. The OTCBB service is offered by the National Association of Securities Dealers (NASD) which

accurately displays the last sale prices, real time quotations and other volume information of over-the-counter securities.