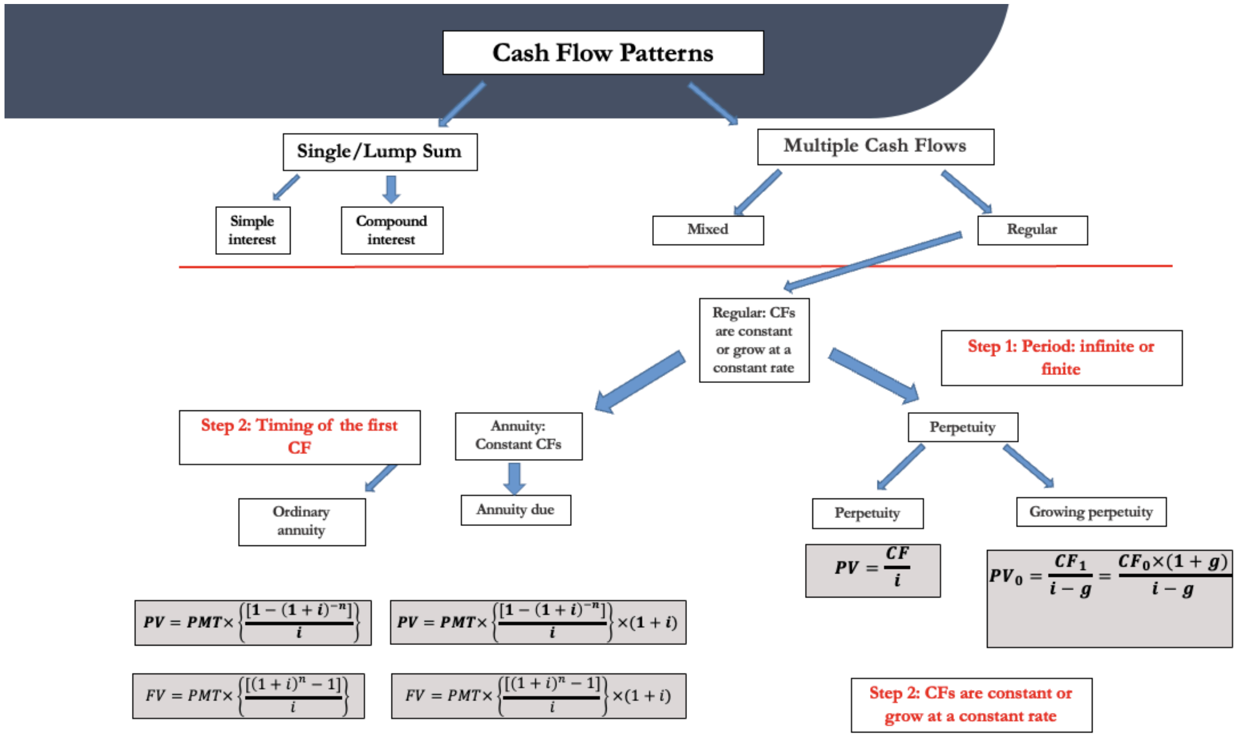

Financial Markets and Financial Institutions

Real Assets

- The wealth of a society is determined by the productive capacity of its economy
  - The goods and services that its members can create
  - The output of a company is determined by its productive assets, or real assets
- This capacity is a function of the real assets of the economy that can be used to produce goods and services:
  - Tangible assets: Property, plant, and equipment (PPE), land, buildings, machines
  - Intangible assets: Knowledge, intellectual property
- The Investment Decision:
  - The purchase, maintenance, and upgrade of real assets, which generate cash flows

Financial Assets

- Financial assets (eg, stocks and bonds) are financial "securities":
  - Legal assets (historically nothing but sheets of paper)
  - Issued by demanders of capital
  - Do not contribute directly to the productive capacity of the economy
- Financial assets represent claims over the income/cash flows generated by real assets
  - Real assets generate net cash flows to the economy; financial assets define the allocation of those cash flows
- The Financing Decision:
  - The creation of financial assets, representing capital providers' claims on cash flows
- Example:
  - Qantas decides to buy a new fleet of Boeings → real asset investment decision
  - Qantas issues new shares to pay for the Boeings → financing decision creates new financial asset
  - The new Boeings generate profits → cash flow distributed back to the shareholders

Financial System

- An ecosystem that allows lenders/investors and borrowers/issuers to trade-off between different attributes to achieve their desired needs based on information disclosure
- A place/platform facilitating the trading of financial assets
- Types of financial assets:
  - Organisations facilitating/intermediating financial transactions

Financial Markets

- Financial markets: The marketplaces (physical and/or virtual) in which financial assets are issued, bought, and sold
- Financial markets can be classified according to different criteria:
  - Maturity: Money vs Capital Market
  - Organisation of transactions: Exchange-traded vs Over-the-counter (OTC)
  - Asset types: Equity, Bond, FX, Derivatives
  - New vs Outstanding security: Primary vs Secondary