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Role of Stock Market in the Economy of a Country

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Abstract: **Finance is like blood for any organization. If finance is taken out of an organization, whole system will collapse. Stock markets are important in order to increase the investment in any company. The importance of stock market cannot be neglected in the economy of a country. This paper will explain various types of stock markets, how do they operate, and how they impact the economy of a country. There are two types of stock markets in any country, primary markets and secondary markets. The company that is attracting the investors with the first time share issue receives money through Initial Public Offering (IPO). Dealers and brokers are found in a stock market who are important part of stock market operations. Stock market impacts the economy of a country in many ways. The strength of stock market shows the strength of the country's economy. Stock markets makes the cash and investments available for the companies. With the availability of investment, corporations perform better and add to the economy of the country. There are certain economic factors that impact the stock market as well. These factors include inflation and interest rates. As a conclusion it can be said that the role of stock market for the betterment of a country's economy can never be ignored.**

Keywords: **Stock market impacts, investment, Corporations perform, Initial Public Offering (IPO).**

1. INTRODUCTION

There are several financial institutions in a country that help to manage the finance of that country. These financial institutions include banks, stock markets, and other mortgages firms. The importance of stock market cannot be neglected in the economy of a country (GARCIA and LIU 30). This paper will demonstrate the importance and role of stock market in the economy of the country. The paper will also explain that how stock markets work and, then, adds in the growth of the economy of a country.

2. STOCK MARKET

The simplest definition of stock market can be that it is a place where the shares of publicly held corporation are traded. Primarily there are two kinds of stock markets available in any country (Furgang 41).

1. Primary market
2. Secondary market

Primary Market:

In primary market the new shares or issues of a corporation are brought to be traded. For example if a corporation offers new shares then the market where these shares will first be traded will be called primary market (Ross, Westerfield and Jordan 250).

Secondary Market:

Secondary market are those stock markets where the existing or already issued shares of a corporation are traded (Ross, Westerfield and Jordan 250).

3. STOCK MARKET PROCESS

When a company needs to raise capital it offers its company shares in the primary market. This process is called Initial Public Offering (IPO). The price of company's shares is determined based on the worth of the company. The interested buyers of the shares purchase the shares of new offering. The company receives the money only through IPO, the investors keep buying and selling the shares of the company later on. The traders and investors keep buying or selling the shares of a company after its IPO. This is because the perceived value of the company changes over time. If the share price of a company increases over time then more investors are willing to buy the shares to earn more profit. On the other hand if the stock price of a company decreases then the investors are most likely to sell its stock to reduce the potential loss (Schaefer).

So stock market is a place which brings the buyers and sellers of shares together. There are dealers and brokers in stock market. Dealers are those persons who maintain an inventory of shares and are ready to sell the shares at any particular time. On the other hand the brokers do not maintain an inventory of shares rather they bring the buyers and sellers together to make a deal (Ross, Westerfield and Jordan 252).

Some other important functions of stock market includes the following:

- It works as an economic barometer
- Stock markets make the transaction of share safe and secure
- It provides liquidity and better allocation of capital
- It promotes the habit of savings and investment
- It contributes to economic development of a country

Importance of Stock Market for Country's Economy:

Studies have shown that stock market growth and the growth of economy are very much related with each other. The liquidity in stock market helps the development of the economy. Stock market provides general idea about the strength of the economy. Countries that have better performing stock markets generally have better performing economies too. The everyday activities in stock market impacts the economy of a country. Stock market works as a barometer that explains the health of a country's economy (Boubakari and Jin 18).

The importance of stock market can be understood with this example that in 1929 the stock market crash caused the great depression of 1930. In 1929 there were certain economic imbalances and structural disasters that led to a downfall of stock markets around the globe. As a result of this stock market crash there was a great depression in the economy of whole world (Boubakari and Jin 19).

Corporations add to the economy of a country. If, in any case, the corporations need to raise capital they go to stock market and issue new shares to have more investment and capital. In this way stock markets keep the corporations alive by providing them the fresh capital which makes the corporations capable of keep adding to the economy of the country (Petros 45).

Studies have found that overall growth of the economy depends on the performance and efficiency of stock markets. Stock markets mobilizes the savings of individuals to the corporations and corporations then add to the GDP of the economy. So indirectly stock markets injects the savings of individuals to the growth of the economy. Rising stock prices create a sense of improvement in the economy and build the confidence of the investors (Petros 44).

Impact of Economic Factors on Stock Markets:

The stock market acts as the reflector of country's economy however there are certain economic factors that affect the stock markets as well. Some of these factors are discussed below.

Inflation is one of the most important economic factors affecting the stock markets. As discussed above individuals invest their savings in the stock market. When there is an increase in the inflation rate the price of products increases and thus there is a reduction in savings for the individuals. Decline in saving leads to decline in the stock market by the individuals.

Interest rate is another economic factor that impacts the performance of stock market of a country. Higher interest rates are certainly beneficial for investors but in this way the cost of borrowing becomes very high for corporations so they avoid more investment from the investors. Thus there is a low supply of shares than the demand which affect the stock market negatively (Arestis, Demetriades and Luintel 19).

4. CONCLUSION

As a conclusion it can be said that the role of stock market for the betterment of a country's economy can never be ignored. Stock market plays a role of bridge between individual investors and the corporations. Both parties meet and agree on various terms inside a stock market. The impact of stock market on the economy is also considerable. Stock market confirms the availability of liquidity for corporations which can add to economy of the country by producing goods and offering employment opportunities. Thus a country should focus on the stock market in order to strengthen its economy (Burton, Nesiba and Brown 148).

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