# Capital Markets Explained

Center Forward Basics
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## Overview

Capital markets serve as an essential organized system for the free flow of capital, as raised through equity or debt. Markets provide diversified funding options by bringing participants together — buyers, sellers, investors, lenders, borrowers, and entrepreneurs – to meet financial needs.
The United States has the strongest capital markets in the world, which continue to be among the deepest, most liquid and most efficient. US markets represent 40.9% of the $85 trillion global equity market cap, or $35 trillion (as of May 2020). This is 4.1x the next largest market, the EU. US fixed income and structured products markets comprise 38.9% of the $106 trillion securities outstanding across the globe, or $41 trillion (as of FY19). This is 1.9x the next largest market, the EU.

## Why are Capital Markets Important?

Capital markets are important because they finance the economy, allocate risk, and support economic growth and financial stability. In the U.S., capital markets fund 72% of all economic activity, in terms of equity and debt financing of non-financial corporations. This strength ensures that businesses have more continual access to affordable funding options and liquidity and are able to fund growth and job creation.

Capital markets enable debt issuance, which is a more efficient and less restrictive form of borrowing for corporations. The use of debt capital markets is more prevalent in the U.S, at 79% of the total, whereas bank lending is more dominant in other regions, around 24% on average. Capital markets match borrowers and investors, acting as shock absorbers during times of economic stress or market turmoil when bank lending can dry up. By diversifying risk, capital markets provide a stable source of fuel for companies, governments and therefore economies.

Additionally, capital markets help individuals generate wealth and invest in their futures. They can invest in a multitude of types of securities, including stocks, ETFs, mutual funds, corporate bonds, US Treasuries, municipal securities, etc. Capital invested, and any corresponding appreciation, can be used by individuals to invest in their retirement, buy homes or save for college.

Further, capital markets provide the fuel for companies or entrepreneurs to turn an idea or industry innovation into an actual company or expansion for an existing firm. This in turn creates jobs and spurs economic growth. Below we show just a few of the many examples of capital markets turning innovative ideas into economic growth:

## Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

## Key Facts

- U.S. Capital Markets are the largest and the strongest in the world. They fund over 70% of the economic activity of non-financial corporations in the U.S.
  - They represent:
    - 41% of global equity,
    - 40% of global fixed income,
    - An average 46% of total global market activity.

- Walmart (WMT): Sam Walton had a vision to provide consumers with lower producers. After going it alone as a small business for 20+ years, WMT incorporated in 1969. It then tapped the capital markets in 1970, raising $4.5 million from investors ($16.50 a share, now $137.07) to fund its expansion into one of the largest companies in the world. At the time, it had 1,500 employees, 38 stores and $44 million in revenue. Today, WMT employs 2.2 million people working at 11,909 stores and distribution facilities, with revenue of $524 billion per annum.
- FedEx (FDX): In 1971, with the help from an $80 million investment from venture capitalists, Frederick Smith turned an idea from a business school paper into a viable company. FDX sought wider market investment to fund growth with an IPO in 1978 ($24.00 a share, now $238.74), and it is now one of the most successful delivery and logistics companies in the world. The company now employs 245 thousand people working at 98 thousand drop-off locations or delivering packages on its 79 thousand vehicles and 679 aircraft.
- The Home Depot (HD): In 1978 co-founders Bernie Marcus and Arthur Blank (along with merchandising expert Pat Farrah) raised $2 million from investment banker and now notable businessman Ken Langone to fund their vision to open one-stop shops for the do-it-yourself consumer. By 1981, the company turned to the capital markets for an IPO to fuel growth ($12.00 a share, now $272.35). It is now the largest home improvement retailer (by market cap), employing 415.7 thousand employees working at 2,291 stores, with annual revenue of 110 billion.
- Apple (AAPL): Founded in 1976 by Steve Jobs and Steve Wozniak (also Ronald Wayne, who sold out that same year), AAPL received $250,000 from an angel investor the following year to realize their vision to build the new home computer. AAPL tapped the capital markets in 1980 ($22.00 per share, now $110.08), becoming one of the leading technology companies today. It now employs 137 thousand people, with revenue of $260 billion per annum.
- Tesla (TSLA): As the world looked to the future of sustainability and green technology, in 2003 engineer Elon Musk and other founders established electric vehicle and clean energy company TSLA. In 2010, the company turned to the capital markets to fund expansion and bring green technology into mass reality ($17.00 a share, now $449.39). It now employs 48 thousand people, with $24.5 billion in revenue per annum.

## Who do Capital Markets Serve?

Capital that is raised through equity and debt can be used to grow businesses, finance investments in new facilities, equipment, and technology, and fund infrastructure projects. These investments create jobs and flow money into the economy. Capital markets have helped the following:

- Colleges and universities – expand campuses, upgrade teaching facilities, invest in new educational technologies etc.
- Everyday main street investors – invest in securities to generate wealth to save for retirement, pay for children's education, etc.
- Businesses of all sizes and stages of growth – expand organically or via mergers and acquisitions, pay down debt, reach the next stage in the business life cycle, etc.
- Homeowners / mortgage lenders – purchase a home / maintain the affordability of home ownership
- Local, state and federal governments – underwrite public projects, including infrastructure, utilities, schools and transportation.

Through receiving funding these individuals and groups are able to finance operations, invest in organic growth and expansion plans, fund mergers and acquisitions, pay down existing debt, and underwrite public projects.

## Public Policy's Impact

Public policy can either constrain capital markets' growth and resiliency if it is punitive or ill-fitting or it can provide financial stability during times of market disruption. Legislation or regulation that intentionally or unintentionally hinders business growth or constrains long-term investment ultimately reduces incentives to engage with the capital markets. Additionally, investor confidence in the financial markets could also decrease if a policy is harmful.

The U.S. capital markets are the deepest, most resilient and innovative in the world, which translates directly to making the country more globally competitive. However, it is estimated that by 2030, Asia-Pacific will overtake the Americas' market

share and account for more than half of all global capital markets activity by 2040. Additionally, Americas' market share could decrease from 46% today to 40% in ten years. Many suggest that certain steps need to be taken so that U.S. capital markets remain the deepest, most liquid, and foremost markets around the world. Some of these steps include ensuring high standards of market integrity and investor protection, encouraging pools of capital through workplace and private pensions, promoting financial literacy and strong investor culture, and calibrating supervision and regulation to ensure regulators do not impose bank-like regulation on capital markets activities.

## Capital Markets and COVID-19

Because capital markets are designed to withstand sudden economic shocks and changes, U.S. capital markets were resilient during unprecedented market volatility during the global health pandemic. While market volatility was up 563% from the start of the year, markets remained opened and functioning throughout the market turmoil. Additionally, many capital markets firms have led the financial services industry in business continuity planning and execution in order to ensure that both customers and investors are served safely and effectively throughout the pandemic. Many groups, including investors, corporations, and governments benefit from healthy, strong capital markets.

## Links to Other Resources

- SIFMA - Global Capital Markets & Financial Institutions Primer
- SIFMA - Our Markets
- Third Way - Why Capital Markets Matter
- World Economic Forum - Retirees will outlive their savings by a decade