

An in-Depth Understanding of Capital Market Theory: a Literature Review in the Context of Financial Management

Novita Chyndi Pratiwi¹, Dinasty Ratu Ayu Dyah Pytaloka², Zainul Arifin³

Departemen of Magister Manajemen, Institut Teknologi dan Bisnis Widya Gama Lumajang, Indonesia^{1,2,3}

Corresponding Author: Novita Chyndi Pratiwi (novitachyndi48@gmail.com)

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ABSTRACT

This article aims to present an in-depth understanding of capital market theory and its relevance in the context of corporate financial management. A literature review was conducted to analyze various concepts, theories, and principles that underlie the functioning of the capital market and their impact on financial decision-making. By exploring the current literature, this article provides comprehensive insights into capital market concepts, including market efficiency, stock prices, portfolio diversification, and investment strategies. In addition, this article also discusses the role of the capital market in allocating financial resources, increasing liquidity, and reducing risk for companies. As such, this article provides a solid theoretical foundation for further understanding of effective financial management.

Keywords: Capital Market Theory, Financial Management



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INTRODUCTION

The capital market is one of the important instruments in a company's financial management. Capital market theory is the basis for understanding stock market behavior and how stock prices can predict a company's performance. In this context, a literature review of capital market theory is important to understand the concept and application of the theory in corporate financial management.

Capital market theory is based on the premise that the stock market is efficient, that is, a market that accurately and timely describes the information available. This theory emphasizes that stock prices reflect the intrinsic value of a company, and that investors can profit by buying shares at a low price and selling them at a high price.

In the context of financial management, capital market theory is important in investment decision-making. Investors can use the information available on the stock market to evaluate the company's performance and predict the company's future earnings. One of the important measures in evaluating the market's response to a company's earnings information is the Earnings Response Coefficient (ERC)(R. W. D. Paramita & Hidayanti, 2013).

In addition, agency theory is also the focus of this literature review. This theory emphasizes the existence of a working relationship between the party who authorizes (principal), namely the investor, and the party who receives the authority (agency), namely the manager, in the form of a contract. Conflicts of interest between managers and owners can create agency problems, which require additional costs called agency costs to address the problem.

In the context of the capital market, research on the influence of ERC on stock prices makes a significant contribution to understanding stock market behavior and the importance of financial information in investment decision-making. The implications of this study can help investors make better investment decisions in the stock market, taking into account the market's response to the company's earnings information.

Thus, a deep understanding of capital market theory becomes important in the context of corporate financial management. This literature review provides a better understanding of the concept and application of capital market theory in investment decision-making, as well as the importance of financial information in predicting company performance.

LITERATURE REVIEW

History of the Capital Market

1. In the 17th century, the capital markets had existed and developed, especially with the advent of the Amsterdam Stock Exchange in the Netherlands. The stock exchange was founded in 1602 by the Netherlands East India Company and is considered the world's first formal stock exchange.
2. In the 18th century, industrial revolution in the United Kingdom played an important role in the growth of the capital market with the emergence of companies that needed capital for expansion.
3. In the 20th century, the capital market grew rapidly in the 20th century, especially after World War II. Many countries have begun to form their own national stock exchanges and regulate capital markets to ensure transparency and fairness in stock trading.

So it can be concluded that the capital market has experienced significant development from the 17th century to the 20th century. The emergence of the benchmark stock exchange in Amsterdam, the Industrial Revolution and post-World War II capital market regulation are some of the important milestones in the development of the capital market.

The Role of the Capital Market

The capital market plays a very important role in the economic development of a country. With an efficient market mechanism, the capital market can be a driving force for economic growth by allocating resources to the most productive sectors. Capital market efficiency allows companies to obtain funds at lower costs, thus encouraging investment and business expansion. On the other hand, investors can also obtain returns in accordance with the level of risk taken, thereby increasing confidence and participation in the capital market.

Good capital market regulation is also a crucial factor in ensuring the integrity of the capital market. Strict regulation and effective supervision are necessary to protect investors, prevent illegal practices, and create a stable and sustainable market environment. With good regulation, investors can feel safer and more confident to invest in the capital market, thereby increasing market liquidity and overall economic growth. Capital market education and literacy also have an equally important role. A good understanding of the capital market by the general public can increase participation in the capital market, curate investment risks, and ensure that investment decisions are made smarter. With high capital market literacy, people can take advantage of existing investment opportunities and manage risks better.

Thus, the capital market is not only a place for financial transactions, but also one of the main pillars in the country's economic development. With good regulation, intensive capital market education, efficient resource allocation, transparency and accountability, the capital market can play a key role as a driver of sustainable and inclusive economic growth.

Implication

The capital market has various important implications for the economy of a country and its stakeholders. Here are some of the significant capital market implications:

- a. Fundraising: The capital market allows companies to raise funds from investors by issuing stocks and bonds. This provides access to long-term funding sources that are essential for business expansion, investment in major projects and innovation.
- b. Resource Allocation: Through the capital market mechanism, economic resources are allocated to the most productive and profitable sectors. Investors can choose to invest in a variety of financial instruments according to their risks and investment goals.
- c. Transparency and Fairness: An efficient capital market promotes transparency and fairness in stock trading. Accurate and publicly available information allows investors to make more informed investment decisions and minimize risk.
- d. Increased Liquidity: With the capital market, investors have the ability to buy and sell stocks with relative ease. This increases market liquidity and provides flexibility for investors to change their investment portfolios.
- e. Development of the Financial Industry: The growing capital market is also driving the growth of the financial industry, including securities companies, investment management firms, and other financial institutions. This creates new jobs and increases the contribution of the financial sector to the economy.
- f. Increased Economic Growth: A healthy and growing capital market can make a positive contribution to a country's economic growth. Investments made through the capital market can encourage the growth of high-potential economic sectors and create new jobs.

By understanding the implications of the capital market, governments and regulators can design policies that support the healthy and sustainable development of the capital market, as well as ensure that the benefits can be felt by all communities and the economy as a whole.

Benefit

The capital market has various benefits that are important for the economy of a country and its stakeholders. Here are some of the key benefits of the capital market:

- a. Long-Term Funding Sources: The capital market provides companies and governments with access to long-term funding sources through stock and bond offerings. This allows entities to obtain the necessary funds for business expansion, investment in large projects, and infrastructure development.
- b. Portfolio Diversification: Investors can use the capital markets to diversify their investment portfolios. By investing in various financial instruments such as stocks, bonds, and mutual funds, investors can reduce risk and increase the potential return on investment.
- c. Investment Liquidity: The capital market provides high liquidity for investors by allowing them to buy and sell financial assets with ease. This allows investors to quickly convert their investments into cash if needed.
- d. Transparency and Regulation: A well-regulated capital market promotes transparency in corporate financial reporting and stock trading activities. Strict regulation helps protect investors from fraudulent practices and market manipulation.
- e. Increased Company Value: Through stock offerings, companies can increase the value of their company and provide an opportunity for shareholders to share in the profits from the company's growth.

- f. Economic Growth: A healthy and growing capital market can contribute positively to a country's economic growth. Investments made through the capital market can encourage the growth of high-potential economic sectors and create new jobs.

By understanding the benefits of the capital market, economic actors can harness the potential of the capital market to support economic growth, create jobs, and improve the overall welfare of society (Suhardini, 2015).

METHODS

The research method used in this article is the study of literacy. Literature study is a research approach that is carried out by collecting, reviewing, and analyzing literature or publications related to a certain research topic. In the context of this article, the author conducted a literature review to analyze various concepts, theories, and principles that underlie the functioning of the capital market and their impact on corporate financial decision-making (Widodo et al., 2023).

RESULTS AND DISCUSSION

This article aims to provide an in-depth understanding of capital market theory and its relevance in corporate financial management. Through literature review, this article seeks to analyze the basic concepts, theories and principles that are the foundation of the capital market and its impact on financial decision-making. Capital markets have a key role in a company's financial management, especially in investment decision-making. Capital market theory emphasizes market efficiency, where stock prices reflect the intrinsic value of companies and investors can benefit from stock price differences. This article discusses the conflict of interest between managers and company owners explained by agency theory. The history of the capital market from the 17th to the 20th century shows significant developments, including the emergence of the first stock exchange in Amsterdam and the regulation of the capital market after World War II. This historical understanding is important to understand the foundations and evoludi of the current capital market.

The capital market plays an important role in the economic development of a country with efficient mechanisms, proper resource allocation, and a strong regulatory role. Capital market literacy is the key to increasing participation and minimizing investment risks. The capital market has significant implications for the economy, such as fundraising, resource allocation, increased liquidity and economic growth. Good regulation and high capital market literacy are important to ensure that the benefits of the capital market can be felt by the entire community. The article mentions several benefits of the capital market, including long-term funding sources, portfolio diversification, investment liquidity, increased company value, and economic growth. Understanding these benefits is important to motivate participation and investment in the capital market. This article provides a strong theoretical foundation and a deep understanding of the capital markets and their relevance in corporate financial management. By outlining the concepts, theories, and implications of the capital markets, this article can be a valuable source of knowledge for readers interested in this field.

CONCLUSION

This article has provided an in-depth understanding of the capital markets and their relevance in the context of corporate financial management. Through a literature review, the article explains the basic concepts, theories, roles, implications, and benefits of the capital market in comprehensive detail.

The capital market plays a crucial role in a country's economic growth by allocating financial resources efficiently, increasing liquidity, and reducing risks for companies. Capital market theories, such as market efficiency, stock prices, and portfolio diversification, provide the foundation for better investment decision-making.

In addition, this article also highlights the importance of good capital market regulation and capital market literacy in ensuring transparency, fairness, and stability of the capital market. With a deep understanding of capital markets, companies and other stakeholders can harness their potential to support economic growth, create jobs, and improve the overall well-being of society. As such, this article provides important insights for readers to understand the role and impact of the capital market in the context of corporate financial management, as well as emphasizing the importance of developing a healthy and inclusive capital market to achieve sustainable economic growth.

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