ECONOMICS OF CAPITAL MARKET

V SEMESTER

CORE COURSE

BA ECONOMICS

(2014 Admission onwards **CU-CBCSS***)*

UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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MODULE 1

Financial Assets

Introduction

An asset is a resource with economic value that an individual, corporation or country owns or controls with the expectation that it will provide future benefit. Assets are reported on a company's balance sheet, and they are bought or created to increase the value of a firm or benefit the firm's operations. An asset can be thought of as something that in the future can generate cash flow, reduce expenses, improve sales, regardless of whether it's a company's manufacturing equipment or a patent on a particular technology.

Meaning of Financial Assets

A financial asset is an intangible asset whose value is derived from a contractual claim, such as bank deposits, bonds, and stocks. Financial assets are usually more liquid than other tangible assets, such as commodities or real estate, and may be traded on financial markets

Tangible assets are physical assets such as land, vehicles, equipment, machinery, furniture, inventory, stock, bonds and cash. These assets are the backbone of a company that keep it in production but are not available to customers. Tangible assets are at risk of damage either from naturally occurring incidents, theft or accidents. The two types of tangible assets are current and fixed. Current assets are inventory, or items a company turns into cash usually by the end of the year. These assets can be used as liquidation to save a company from debt problems or as financial aid. Fixed assets are physical items that will not be sold at any point in the business. These assets include machinery, equipment, vehicles or land, and they are needed to run the business continually.

Intangible assets are nonphysical, such as patents, trademarks, franchises, goodwill and copyrights. Depending on the type of business, intangible assets may include Internet domain names, performance events, licensing agreements, service contracts, computer software, blueprints, manuscripts, joint ventures, medical records, permits and trade secrets. Intangible assets add to a company's possible future worth and can be much more valuable than its tangible assets.

Meaning of debt:

Debt is an amount of money borrowed by one party from another. Debt is used by many corporations and individuals as a method of making large purchases that they could not afford under normal circumstances. A debt arrangement gives the borrowing party permission to borrow money under the condition that it is to be paid back at a later date, usually with interest. The most common forms of debt are loans, including mortgages and auto loans, and credit card debt. Under the terms of a loan, the borrower is required to repay

the balance of the loan by a certain date, typically several years in the future. The terms of the loan also stipulate the amount of interest that the borrower is required to pay annually, expressed as a percentage of the loan amount. Interest is used as a way to ensure that the lender is compensated for taking on the risk of the loan while also encouraging the borrower to repay the loan quickly in order to limit his total interest expense. In addition to loans and credit card debt, companies that need to borrow funds have other debt options. Bonds and commercial paper are common types of corporate debt that are not available to individuals.

Bonds are a type of debt instrument that allows a company to generate funds by selling the promise of repayment to investors. Both individuals and institutional investment firms can purchase bonds, which typically carry a set interest.

Meaning of Equity

The value of an asset less the value of all liabilities on that asset is called as Equity. Generally speaking, the definition of equity can be represented with the accounting equation:

$$\text{Equity} = \text{Assets} - \text{Liabilities}$$

Yet, because of the variety of types of assets that exist, this simple definition can have somewhat different meanings when referring to different kinds of assets. The following are more specific definitions for the various forms of equity:

A stock or any other security representing an ownership interest. This may be in a private company (not publicly traded), in which case it is called private equity; In a company's balance sheet, the amount of the funds contributed by the owners (the stockholders) plus the retained earnings (or losses). It is also referred to as shareholders' equity; In the context of margin trading, the value of securities in a margin account minus what has been borrowed from the brokerage; In the context of real estate, the difference between the current fair market value of the property and the amount the owner still owes on the mortgage. It is the amount that the owner would receive after selling a property and paying off the mortgage. It is referred to as “real property value.”

Properties of Financial Assets

1. Moneyness
2. Divisibility
3. Reversibility (round-trip cost)
4. Term to Maturity
5. Liquidity

6. Convertibility
7. Currency
8. CF and Return Predictability
9. Complexity
10. Tax Status

1. **Moneyness:** the ability to transfer a financial asset into money at little cost, delays or risk. Some examples are cash and checking accounts.
2. **Divisibility:** is related to the minimum size in which a financial asset can be liquidated and exchanged for money.
3. **Reversibility (round-trip cost):** refers to the cost of investing in a financial asset and then getting out of it and back into cash again.
4. **Term to maturity:** this is the length of the interval until the date at which the instrument is scheduled to make its final payment, or the time until the owner is entitled to demand liquidation.
5. **Liquidity:** how much the seller stands to lose if he wishes to sell immediately rather than allowing some time to pass.
6. **Convertibility:** refers to the notion that some financial assets can be converted into other assets, e.g., a convertible bond
7. **Currency:** this refers to the foreign exchange value or foreign exchange currency denomination of the financial asset.
8. **Cash flow and return predictability:** this is the cash yield of a financial asset per unit of time and consists of all the cash distributions that the financial asset will pay to its owners.
9. **Complexity:** this involves combinations of two or more simple assets. For instance, a callable bond can be valued as a straight bond plus the value of the put option to the issuer.
10. **Tax status:** refers to the taxability of interest income generated from a financial asset.

Fınancıal Markets

What is the 'Financial Market'

The financial market is a broad term describing any marketplace where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives.

Financial markets are typically defined by having transparent pricing, basic regulations on trading, costs and fees and market forces determining the prices of securities that trade.

- Financial markets consist of
  - sellers (fund suppliers-lenders)
  - buyers (fund demanders-borrowers)
  - financial instruments (fin assets, securities)
  - financial institutions (intermediaries)

Classification of Financial Markets

Financial markets refer to the system through which funds are transferred from surplus sector to the deficit sector. On the basis of the duration of financial Assets and nature of product money market can be classified into 3.They are following

1) **Money Market**: - It is the institutional arrangement of borrowing and lending into 2 sectors i.e. organised sector headed by RBI and unorganized sector no way related with RBI. Further depending upon the type of instrument used money is divided into various sub mark

   Capital Market: - It deals with long term lending's and borrowings. It is a market for long term instruments such as shares, debentures and bonds. It also deals with term loans. this market is also dividend into 2 types:

   a) Primary or New Issue Market
      - firstly issued securities are traded
      - Issuers raise new capital

   b) Secondary Market of Stock exchange.
      - existing securites are traded
      - Issuers does not raise new capital

2) **Foreign Exchange market:** -It deals with foreign exchange. It is a market where the exchanging of currencies will takes places. It is the market where currencies of different country are purchased and sold. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

3) **Credit Market-** Credit market is a place where banks, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.

Differences	Money Market	Capital Market
Due-date	Short-term	Medium and Long Term
Fin. Instruments	Commercial Papers, Treasury Bills etc.	Securities (Common Stock, Bonds etc.)
Sources of Funds	Individual Savings	Individual and Institutional Savings
Uses of Funds	Working Capital (Current Assets)	Investment Capital (Fixed Assets)

Financial system and economic development

Financial system

In a broad sense, finance refers to funds of monetary resources needed by individuals, business houses and the Government. Finance is a facility that built the Gap between deficit sectors to surplus sector by shifting funds.

Every country aiming at its progress depends on the efficiency of this economic system which depends upon financial system. The economic development of a nation is reflected by the progress of the various economic units. These units are broadly classified into corporate sector, government and household sector. While performing their activities these units will be placed in a surplus/deficit/balanced budgetary situations.

There are organisations or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities. The financial system is the network of institutions and individuals who deal in financial claims to various instruments. Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products.

The financial system of India refer to the system of borrowing and lending of funds or the demand for and the supply of funds of all individuals, institutions, companies and of the Government. Commonly, the financial system is classified into:

a) **Industrial finance**: funds required for the conduct of industry and trade.
b) ***Agricultural Finance*:** funds needed and supplied for the conduct of agriculture and allied activity.
c) ***Development finance*:** funds needed for development; actually it includes both industrial finance and agricultural finance.

d) ***Government finance:*** relates to the demand for and supply of funds to meet Government expenditure.

India's financial system includes various institutions and the mechanism which affects the generation of savings by the community, the mobilisation of savings and the effective distribution of the savings among all those who demand the funds for investment purposes.

Components of the Financial System

The components of financial system are:

1) **Financial Institution:**

A financial institution is an establishment that conducts financial transactions such as investments, loans and deposits. Almost everyone deals with financial institutions on a regular basis. Everything from depositing money to taking out loans and exchanging currencies must be done through financial institutions. Here is an overview of some of the major categories of financial institutions and their roles in the financial system.

i) **Banking Institutions:** Participate in the economy's payment mechanism, deposit liabilities constitute a major part of national money supply.

ii) **Non-Banking Institutions:** LIC, SIDBI, IIBI, IFCI (All India Financial Institutions), SFCs & SIDCs

iii) **Financial intermediaries**: They are the intermediate between savers and investors. They lend money. They also mobilise savings. Examples Likes underwriters, Stock Exchange , Registrars, Depositories, stock brokers etc,,

2) **Financial Markets:**

It is a system through which funds are transferred from surplus sector to the deficit sector. On the basis of the duration of financial Assets and nature of product money market can be classified into 3 types:

i) **Money Markets:** Highly liquid short term debt – instruments market including Call Money Market, Certificates of Deposits, Commercial Papers and Treasury Bills.

ii) **Capital Markets:** Market for Long-Term securities and provides risky capital in the form of equity. Also classified into two.

- Primary (Direct) Market or New Issue Market
- Secondary Market

3) **Financial Instruments:**

It includes through these instruments financial Institution mobilise saving. These are of 2 type's i.e.

i) **Long Term:** Shares, Debenture, Mutual Funds, Term Loans.

ii) **Short Term:** Call Loan (money market), Promissory Notes, Bills of exchange etc.

4) **Financial services**

Financial services include services like depository services, custodial functions, credit rating, leasing, portfolio management, under writing of shares and securities and the like.

Functions/important and role of financial system

a. It links the savers and investors. It helps in mobilizing and allocating the savings efficiently and effectively. It plays a crucial role in economic development through saving-investment process. This savings – investment process is called capital formation.
b. It helps to monitor corporate performance.
c. It provides a mechanism for managing uncertainty and controlling
d. It provides a mechanism for the transfer of resources across geographical boundaries
e. It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).
f. It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
g. It promotes the process of capital formation
h. It helps in promoting the process of financial deepening and broadening. Financial deepening means increasing financial assets as a percentage of GDP and financial broadening means building an increasing number and variety of participants and instruments.

In short, a financial system contributes to the acceleration of economic development. It contributes to growth through technical progress.

Role of Financial System in Economic Development

The financial system performs a crucial role in economic development of all countries through saving investment process, also known as capital formation. It is for this reason that the financial system is sometimes called the financial market. The purpose of the financial market is to mobilize savings effectively and allocate the same efficiently among the ultimate users of funds.

Weakness of Indian Financial system

Even though Indian financial system is more developed today, it suffers from certain weaknesses. These may be briefly stated below:

1) **Lack of co-ordination among financial institutions**: There are a large number of financial intermediaries. Most of the financial institutions are owned by the government.

At the same time, the government is also the controlling authority of these institutions. As there is multiplicity of institutions in the Indian financial system, there is lack of co-ordination in the working of these institutions.

2) **Dominance of development banks in industrial finance:** The industrial financing in India today is largely through the financial institutions set up by the government. They get most of their funds from their sponsors. They act as distributive agencies only. Hence, they fail to mobilise the savings of the public. This stands in the way of growth of an efficient financial system in the country.
3) **Inactive and erratic capital market:** In India, the corporate customers are able to raise finance through development banks. So, they need not go to capital market. Moreover, they do not resort to capital market because it is erratic and enactive. Investors too prefer investments in physical assets to investments in financial assets.
4) **Unhealthy financial practices:** The dominance of development banks has developed unhealthy financial practices among corporate customers. The development banks provide most of the funds in the form of term loans. So there is a predominance of debt in the financial structure of corporate enterprises. This predominance of debt capital has made the capital structure of the borrowing enterprises uneven and lopsided. When these enterprises face financial crisis, the financial institutions permit a greater use of debt than is warranted. This will make matters worse
5) **Monopolistic market structures:** In India some financial institutions are so large that they have created a monopolistic market structures in the financial system. For instance, the entire life insurance business is in the hands of LIC. The weakness of this large structure is that it could lead to inefficiency in their working or mismanagement. Ultimately, it would retard the development of the financial system of the country itself.
6) **Other factors**: Apart from the above, there are some other factors which put obstacles to the growth of Indian financial system. Examples are:
   a) Banks and Financial Institutions have high level of NPA.
   b) Government burdened with high level of domestic debt.
   c) Cooperative banks are labelled with scams.
   d) Investors confidence reduced in the public sector undertaking etc.,
   e) Financial illiteracy.

In the recent past, the most notable aspect of Indian economy is its financial system. Perhaps no system in the world has changed so much as that of our financial system. Indian financial system undergoing fast development and hence not matured like that of developed countries. The government should take reasonable reforms to mould our financial system as healthy one.

MODULE 2

CAPITAL MARKET

Introduction

The capital market is the market for long term capital; it refers to all the facilities and institutional arrangements for borrowing and lending “term funds" medium-term and long-term funds. The demand for long term money capital comes predominantly from private and public manufacturing industries, trading and transport unit etc. and agriculture too requires some funds for long-term purposes. The Central and State Governments require substantial amounts from the capital market. The supply of funds for the capital market comes largely from individual savers (they supply through banks and insurance companies), corporate savers, commercial banks, insurance companies, public provident funds and other specified agencies.

Meaning

Capital market is a market where buyers and sellers engage in trade of long term financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Capital market simply refers to a market for long term funds. It is a market for buying and selling of equity, debt and other securities. Generally, it deals with long term securities that have a maturity period of above one year.

Definition

According to W.H. Husband and J.C. Dockerbay

“The capital market is used to designate activities in long term credit, which is characterised mainly by securities of investment type”.

The functions and characteristics of an efficient capital market are as follows:

1) Mobilise long term savings for financing long term investments.
2) Provide risk capital in the form of equity or quasi-equity to entrepreneurs.
3) Provide liquidity with a mechanism enabling the investor to sell financial assets.
4) Improve the efficiency of capital allocation through a competitive pricing mechanism.
5) Disseminate information efficiently for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment etc.
6) Enable quick valuation of instruments – both equity and debt.

7) Provide insurance against market risk through derivative trading and default risk through investment protection fund.

8) Provide operational efficiency through: simplified transaction procedures, Lowering settlement times, Lowering transaction costs

9) Develop integration among: debt and financial sectors, equity and debt instruments, long term and short term funds.

10) Direct the flow of funds into efficient channels through investment and disinvestment and reinvestment.

Importance of Capital Market in an Economy

1) **Allocation of Capital:** One of the major economic benefits generated by development of the Capital Markets is improved allocation of capital. The prices of Equity and Debt respond immediately to change in market conditions and quickly embodied in current asset prices. The signal created by the price change encourages or discourages capital inflow to an industry/company.
2) **Allocation of Risk:** Capital Markets facilitates investors to earn returns based on their risk taking ability. Investors invest in high-risk instruments either because they are less risk averse or because the new risk is unaffected or negatively correlated with other investments in the portfolio.
3) **Mobilization of Savings:** With the development of capital, market, the banking and non-banking institutions provide facilities, which encourage people to save more. In the less-developed countries, in the absence of a capital market, there are very little savings and those who save often invest their savings in unproductive and wasteful directions, i.e., in real estate (like land, gold, and jewellery) and conspicuous consumption.
4) **Encouragement to Investment:** The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and nonbank financial institutions. Various financial assets, e.g., shares, securities, bonds, etc., induce savers to lend to the government or invest in industry. With the development of financial institutions, capital becomes more mobile, interest rate falls and investment increases.
5) **. Stability in Security Prices:** The capital market tends to stabilise the values of stocks and securities and reduce the fluctuations in the prices to the minimum. The process of

stabilisation is facilitated by providing capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

6) **Benefits to Investors:** The credit market helps the investors, i.e., those who have funds to invest in long-term financial assets, in many ways:

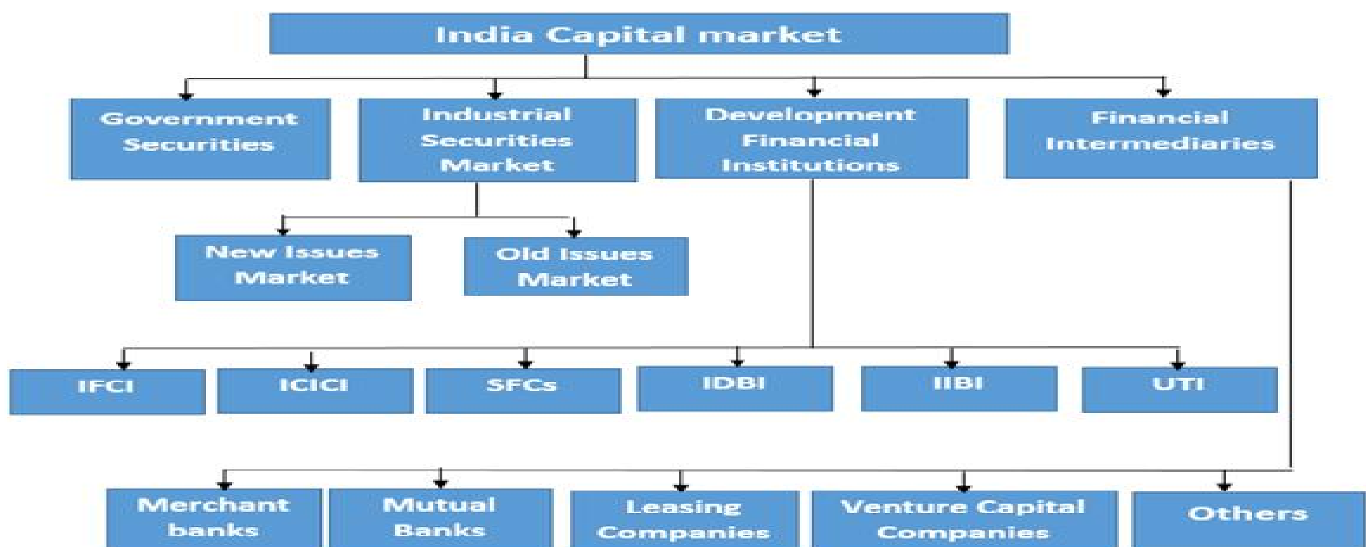
(a) It brings together the buyers and sellers of securities and thus ensure the marketability of investments,

(b) By advertising security prices, the Stock Exchange enables the investors to keep track of their investments and channelize them into most profitable lines,

(c) It safeguards the interests of the investors by compensating them from the Stock Exchange Compensating Fund in the event of fraud and default.

Structure of Financial Market

The structure of financial markets as given as follow by a flow chart :



The Indian capital market is divided into the government securities (gilt- edged market), industrial securities market, development financial institution and financial intermediaries.

1) Government Securities (gilt- edged market)

The Government security is also called gilt-edged market. It refers to the market for government and semi-government securities, backed by the Reserve Bank of India. The securities traded in this market are stable in value and are much sought after by bank and other institutions.

Govt. securities market is a market where govt. securities are traded. It is the largest market in any economic system. Therefore, it is the benchmark for other market. Government securities refer to the marketable debt issued by the government of semi-

government bodies. A government security is a claim on the government. It is a totally secured financial instrument ensuring safety of both capital and income. That is why it is called gilt edged security or stock. Central Government securities are the safest among all securities.

Government securities are issues by:

- Central Government
- State Government
- Semi-Government authorities like local government authorities, e.g., city corporations and municipalities
- Autonomous institutions, such as metropolitan authorities, port trusts, development trusts, state electricity boards.
- Public Sector Corporations
- Other governmental agencies, such as SFCs, NABARD, LDBs, SIDCs, housing boards etc.

Characteristics of government securities Market

The Main characteristics of government securities market are as follows:

1. Supply of government securities in the market arises due to their issue by the Central, State of Local governments and other semi-government and autonomous institutions explained above.
2. Government securities are also held by Reserve Bank of India (RBI) for purpose and sale of these securities and using as an important instrument of monetary control.
3. The securities issued by government organisations are government guaranteed securities and are completely safe as regards payment of interest and repayment of principal.
4. Government securities bear a fixed rate of interest which is generally lower than interest rate on other securities.
5. These securities have a fixed maturity period.
6. Interest on government securities is payable half-yearly.
7. Subject to the limits under the Income Tax Act, interest on these securities is exempt from income tax.
8. The Government security market is an ‘over-the-counter’ market and each sale and purpose has to be negotiated separately.

9. The Government security market is basically limited to institutional investors.

2) Industrial Securities Market

The Industrial security Markets refers to the market for shares and debentures of old and new companies. This market is further divided into the new issue market and the old capital market meaning the stock exchange.

New Issue Market refers to the raising of new capital in the form of shares and debentures whereas the **Old Capital Market** deals with securities already issued by companies. Both markets are equally important, but often the new issue market is much more important from the point of view of economic growth. However, the functioning of the new issue market will be facilitated only when there are abundant facilities for transfer of existing securities.

3) Development Financial institution (DFI'S) :

A DFI'S is defined as an institution promoted or assisted by Government mainly to provide development finance to one or more sectors or sub-sectors of the economy. The institution distinguishes itself by a judicious balance of commercial norms of operation and developmental obligations

DFIs were established mainly to cater to the demand for long-term finance by the industrial sector. India's first DFI was set up in 1948 and it established State Financial Corporation's (SFCs) to provide long term finance to small and medium industrial unit at the State level after passing of the SFCs Act, 1951, followed by the formation of Industrial Finance Corporation of India (IFCI) ,ICIC (1955),IDBI(1964) and UTI(1964) AFT) followed soon after LIC was set up in 1956 to mobilize individual savings and to invest part of the savings in the capital market Many more specialized financial institutions have been set up and are commonly called public sector financial institutions.

These institutions have been doing very useful work in subscribing to the shares and debentures of new and old companies, in giving loan assistance, in underwriting new issues, and so on. At present, many of them have become powerful shareholders in many prominent companies.

4) Financial Intermediaries:

They intermediate between savers and investors. They lend money. They also mobilise savings. The various financial intermediaries

Capital Market Instruments

Capital market instruments divided in to two categories

1) Traditional instruments

This includes:

a. Equity shares
b. Preference shares and its various classes
c. Debentures and its types
d. bonds etc

a) **Equity shares:** equity shares commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertake the maximum entrepreneurial risk associated with business a business venture. The holder of such shares is member of the company and has voting rights. A company may issue shares with differential rights as to voting, payment of dividend etc.

Types of Equity shares

Following are the types of equity shares:

i) **Rights Shares**: it's a type of dividend of subscription rights to buy additional securities in a company made to the company's existing security holders. When the rights are for equity securities, such as shares, in a public company, it is a non-dilutive pro rata way to raise capital. Rights issues are typically sold via a prospectus or prospectus supplement. With the issued rights, existing security-holders have the privilege to buy a specified number of new securities from the issuer at a specified price within a subscription period. In a public company, a rights issue is a form of public offering

ii) **Bonus Share:** It is a free share of stock given to current shareholders in a company, based upon the number of shares that the shareholder already owns While the issue of bonus shares increases the total number of shares issued and owned, it does not change the value of the company. Although the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant.

iii) **Blue chip shares:** A Blue chip shares means that the shares issued by blue chip companies. Blue Chip Company is **very strong financially**, with a solid track record of producing earnings and only a moderate amount of debt. It also has **strong name in its industry** with dominant products or services. The blue chip shares qualified as a high-quality and usually high-priced stock. It has high price because of public confidence in company's long record of steady earnings.

b) **Preference Shares*:*** Preference shares are those, which enjoy the following two preferential rights:

1. Dividend at a fixed rate or a fixed amount on these shares before any dividend on equity shares.
2. Return of preference share capital before the return of equity share capital at the time of winding up of the company.

Preference shares also have a right to participator in part in excess profits left after been paid to equity shares, or has a right to participate in the premium at the time of redemption. But these shares do not carry voting rights.

c) **Debentures or Bonds:** If a company needs funds for extension and development purpose without increasing its share capital, it can borrow from the general public by issuing certificates for a fixed period of time and at a fixed rate of interest. Such a loan certificate is called a debenture. Debentures are offered to the public for subscription in the same way as for issue of equity shares. Debenture is issued under the common seal of the company acknowledging the receipt of money. various types debentures are as follows

i) Convertible Debentures: These are those debentures which can be converted into equity shares. These debentures have an option to convert them into equity or preference shares at the stated rate of exchange after a certain period.

ii)Non-Convertible Debentures: These are those debentures which cannot be converted either into equity shares or preference shares. They may be secured or unsecured. Non-convertible debentures are normally redeemed on maturity period which may be 10 or 20 years.

iii) **Redeemable Debentures**: These debentures are issued by the company for a specific period only. On the expiry of period, debenture capital is redeemed or paid back.

iv) Irredeemable Debentures: These debentures are issued for an indefinite period which is also known as perpetual debentures. The debenture capital is repaid either at the option of the company by giving prior notice to that effect or at the winding up of the company. The interest is regularly paid on these debentures. The principal amount is repayable only at the time of

winding up of the company. However, the company may decide to repay the principal amount during its lifetime**.**

v) **Fully Convertible debentures:** A type of debt security where the whole value of the debenture is convertible into equity shares at the issuer's notice. The ratio of conversion is decided by the issuer when the debenture is issued. Upon conversion, the investors enjoy the same status as ordinary shareholders of the company.

vi) **Partially convertible debentures:** are the debentures part of which can be converted into equity at a price and the time specified by the issuer at the time of issuing such instruments. It may also be defined as a financial instrument that may be converted into a different security of the same company under various specified conditions. The option of this conversion may sometimes be optional, i.e. at the discretion of the investor or sometimes it may be compulsory as well. Generally, in these types of financial instruments no cash is involved.

The other types of capital market instruments are as follow:

Euro issue in India

A Eurobond is an international bond that is denominated in a currency not native to the country where it is issued. Eurobonds are named after the currency they are denominated in. For example, Euro yen and Eurodollar bonds are denominated in Japanese yen and American dollars respectively. Eurobonds were originally in bearer bond form, payable to the bearer and were also free of withholding tax. The bank paid the holder of the coupon the interest payment due. Usually, no official records were kept. The word Eurobond was originally created by Julius Strauss.

Indian companies have been raising funds from international financial markets by issuing Euro bonds. Mainly there are two types of Euro issued by India for raising fund they are:

1) **Euro convertible bonds**: A large proportion of new issues of Euro bonds are called bonds but behave like equity - because they incorporate equity options.
2) **Euro equities:** Compared to various debt financing instruments, issuance of Euro equities stands out as a distinct source of raising finance in international financial markets. By means of such issues, the issuing company offers ownership rights

American Depositary Receipt (ADRs)

The first ADR was introduced by J.P. Morgan in 1927 for the British retailer Selfridges on the New York Curb Exchange, the American Stock Exchanges precursor.

It is a negotiable security that represents securities of a Non U.S. company that trades in the U.S. financial markets. Many companies trade Non U.S shares on U.S. stock exchanges through ADRs, which are denominated and pay dividends in U.S.dollars and may be traded like regular shares of stock. ADRs are also traded during U.S. trading hours through U.S. broker-dealers. They simplify investing in foreign securities by having the depositary bank "manage all custody, currency and local taxes issues".

Global Depositary Receipt (GDRs)

Negotiable certificate issued by one country's bank against a certain number of shares held in its custody but traded on the stock exchange of another country. GDRs entitle the shareholders to all associated dividends and capital gains, and can be bought and sold like other securities. Thus they allow investors in any country to buy shares of any other country without losing the income or trading flexibility, also called European depository receipt (EDR) or international depository receipt (IDR).

Capital Market Institutions

Mutual funds

In recent years, mutual funds are the most important among the newer capital market institutions. Several public sector banks and financial institutions have set up mutual funds on a tax-exempt basis, virtually on the same footing as Unit Trust of India (UTI). Their main function is to mobilize the saving of the general public and invest them in stock market securities. Accordingly, they attracted strong investor support and showed significant progress. There was even diversion of savings of the middle classes from banks to mutual funds. The Government has thrown the field open to the private sector and joint sector mutual funds.

The Narasimham Committee recommended:

- the creation of an appropriate regulatory framework to promote sound, orderly and competitive growth of mutual fund business;

- the creation of proper legal framework to govern the establishment and operation of mutual funds (the UT1 is governed by a special statute); and
- Equality of treatment between various mutual funds including UT1 in the area of lax concessions.

Some of the characteristic features of mutual funds are

- Units can be purchased from the fund house itself instead of other investors on a secondary market
- Units are exchangeable, meaning investors can sell their units back to the fund
- Generally new units are created and sold to accommodate new investors
- The investment portfolios are managed by separate entities known as investment advisors

ADVANTAGES AND DISADVANTAGES

Every investment has advantages and disadvantages. But it's important to remember that features that matter to one investor may not be important to you. Whether any particular feature is an advantage for you will depend on your unique circumstances. For some investors, mutual funds provide an attractive investment choice because they generally offer the following features:

- Professional Management: Professional money managers research, select, and monitor the performance of the securities the fund purchases.
- Diversification: Diversification is an investing strategy that can be neatly summed up as "Don't put all your eggs in one basket." Spreading your investments across a wide range of companies and industry sectors can help lower your risk if a company or sector fails. Some investors find it easier to achieve diversification through ownership of mutual funds rather than through ownership of individual stocks or bonds.
- Affordability: Some mutual funds accommodate investors who don't have a lot of money to invest by setting relatively low dollar amounts for initial purchases, subsequent monthly purchases, or both
- Liquidity: Mutual fund investors can readily redeem their shares at the current Net Asset Value (NAV) plus any fees and charges assessed on redemption at any time. But mutual funds also have features that

Some investors might view as disadvantages, such as:

- Costs despite Negative Returns: Investors must pay sales charges, annual fees, and other expenses (which we discuss in detail on page 13) regardless of how the fund performs. And, depending on the timing of their investment, investors may also have to pay taxes on any capital gains distribution they receive—even if the fund went on to perform poorly after they bought shares.
- Lack of Control—Investors typically cannot ascertain the exact make-up of fund's portfolio at any given time, nor can they directly influence which securities the fund manager buys and sells or the timing of those trades.
- Price Uncertainty: with an individual stock, you can obtain real-time (or close to real-time) pricing information with relative ease by checking financial websites or by calling your broker. You can also monitor how a stock's price changes from hour to hour or even second to second. By contrast, with a mutual fund, the price at which you purchase or redeem shares will typically depend on the fund's Net asset value, which the fund might not calculate until many hours after you've placed your order. In general, mutual funds must calculate their NAV at least once every business day, typically after the major U.S. exchanges close

Securities and Exchange Board of India

The Securities and Exchange Board of India (SEBI) is the designated regulatory body for the finance and investment markets. In January 1995, the Government promulgated ordinance to amend SEBI act, 1992 so as to arm SEBI with additional power for ensuring the orderly development of the capital market and to enhance its ability to protect the interests of the investors. The important features of this ordinance are:

1) To enable SEBI to respond speedily to market conditions and to reinforce its autonomy. SEBI has beer empowered to file complaints in courts and to notify its regulations without poor approval of the Government

2) SEBI is now provided with regulatory powers over companies in the issuance of capital, the transfer of securities and other related matters.

3) SEBI is now empowered to impose monetary penalties on capital market intermediaries and other participants for an listed range of violations The

amendment proposes to create adjudicating mechanism within SEBI for leaving penalties and also constitute a separate tribunal to deal with cases of appeal against orders of the adjudicating authority.

Earlier the SEBI Act provided for the suspension and cancellation of registration and for the prosecution of intermediaries which led to the stoppage of business. The new system of monetary penalties constitutes an alternative mechanism for dealing with capital market violations.

4) While investigating irregularities in the capital market. SEBI is now given the power to summon the attendance of and call for documents from all categories of market intermediaries, including persons from the securities market. Likewise, SEBI has now the power to issue directions to all intermediaries and persons connected with securities markets with a view to protect investors or secure the orderly development of the securities market.

It was thought that SEBI has all necessary powers to control and regulate the securities market on the one side and effectively protect the interests of the shareholders on the other. SEBI has failed miserably to prevent a small coterie of brokers in Mumbai to hammer the MSE in March 2001. The stock markets in India have gone through one of the worst and most prolonged crisis in their history.

The basic function of SEBI

- To regulate the securities market and
- To promote the development of Securities Market;
- To protect the interests of investors in securities;
- For matters connected therewith or incidental there to.

Function of SEBI

Functions of SEBI are classified in to two they are as follows:

1) Regulatory Functions

- Registration of brokers and sub-brokers and other players in the market
- Registration of collective investments schemes and Mutual Funds

- Regulation of stock exchanges and other self-regulatory organisations (SRO) merchant etc
- Prohibition of all fraudulent and unfair trade practices
- Controlling Insider Trading and takeover bids and imposing penalties for such Practices

2) Developmental Functions

- Investor education
- Training of intermediaries
- Promotion of fair practices and Code of conduct for all SROs
- Conducting Research and Publishing information useful to all market Participants

Powers of SEBI - Securities and Exchange Board of India

1) Powers relating to stock exchanges & intermediaries:

SEBI has wide powers regarding the stock exchanges and intermediaries dealing in securities. It can ask information from the stock exchanges and intermediaries regarding their business transactions for inspection or scrutiny and other purpose.

2) Power to impose monetary penalties:

SEBI has been empowered to impose monetary penalties on capital market intermediaries and other participants for a range of violations. It can even impose suspension of their registration for a short period.

3) Power to initiate actions in functions assigned:

SEBI has a power to initiate actions in regard to functions assigned. For example, it can issue guidelines to different intermediaries or can introduce specific rules for the protection of interests of investors.

4) Power to regulate insider trading

SEBI has power to regulate insider trading or can regulate the functions of merchant bankers.

5) Powers under Securities Contracts Act:

For effective regulation of stock exchange, the Ministry of Finance issued a Notification on 13 September, 1994 delegating several of its powers under the Securities Contracts (Regulations) Act to SEBI. SEBI is also empowered by the Finance Ministry to nominate three members on the Governing Body of every stock exchange.

6) Power to regulate business of stock exchanges:

SEBI is also empowered to regulate the business of stock exchanges, intermediaries associated with the securities market as well as mutual funds, fraudulent and unfair trade practices relating to securities and regulation of acquisition of shares and takeovers of companies.

Module III

The Primary Market (New Issue Market)

The primary market is the part of the capital market that deals with issuing of new securities. Companies, governments or public sector institutions can obtain funds through the sale of a new stock or bond issues through primary market. When a company wishes to raise long term capital, it goes to the primary market. Primary market is an important constituent of a capital market. In the primary market the security is purchased directly from the issuer. The primary market is a market for new issues. Hence it is also called new issue market. It is a market for fresh capital. It deals with the new securities which were not previously available to the investing public. Both the new companies and the existing companies can issue new securities on the primary market. The primary market comprises of all institutions dealing in fresh securities. These securities may be in the form of equity shares, preference shares, debentures, right issues, deposits etc.

Meaning and Functions of Primary Market

The main function of a new issue market is to facilitate transfer of resources from the savers to the users. The savers are individuals, commercial banks, insurance companies etc. The users are public companies and the government. The main functions of a primary market are the following:

- Origination: Origination refers to the work of investigation, analysis and processing of new project proposals. Origination begins before an issue actually floated in the market. The function of origination is done by merchant bankers who may be commercial banks, all India financial institutions or private firms.
- Underwriting: When a company issues shares to the public it is not sure that the whole shares will be subscribed by the public. Therefore, in order to ensure the full subscription of shares (or at least 90%) the company may underwrite its shares or debentures. The act of ensuring the sale of shares or debentures of a company even before offering to the public is called underwriting. It is a contract between a company and an underwriter (individual or firm of individuals) by which he agrees to undertake that part of shares or debentures which has not been subscribed by the public. The firms or persons who are engaged in underwriting are called underwriters.

- Distribution: This is the function of sale of securities to ultimate investors. This service is performed by brokers and agents. They maintain a direct and regular contact with the ultimate investors.

Methods of Floating New Issues

A company can raise capital from the primary market through various methods. The methods include:

1. Public Issues

This is the most popular method of raising long term capital. It means raising funds directly from the public. Under this method, the company invites subscription from the public through the issue of prospectus (and issuing advertisements in news papers). On the basis of offer in the prospectus, the investors apply for the number of securities they are willing to take. In response to application for securities, the company makes the allotment of shares, debentures etc.

Types of Public Issues:

Public issue is of two types namely Initial Public Offer and Follow-on public offer.

- Initial Public Offering (IPO): This is an offering of either a fresh issue of securities or an offer for sale of existing securities or both by an unlisted company for the first time in its life to the public. In short, it is a method of raising securities in which a company sells shares or stock to the general public for the first time.
- Follow-on Public Offering (FPO): This is an offer of sale of securities by a listed company. This is an offering of either a fresh issue of securities or an offer for sale to the public by an already listed company through an offer document.

2. Offer for Sale Method

Under this method, instead of offering shares directly to the public by the company itself, it offers through the intermediary such as issue houses/ merchant banks/ investment banks or firms of stock brokers. Under this method, the sale of securities takes place in two stages. In the first stage, the issuing company sells the shares to the intermediaries such as issue houses and brokers at an agreed price. In the second stage, the intermediaries resell the securities to the ultimate investors at a market related price. This price will be higher. The difference between the purchase price and the issue price represents profit for the intermediaries. The intermediaries are responsible for meeting various expenses. Offer for sale method is also called bought out deal. This method is not common in India.

3. Private Placement of Securities

Private placement is the issue of securities of a company direct to one investor or a small group of investors. Generally the investors are the financial institutions or other existing companies or selected private persons such as friends and relatives of promoters. A private company cannot issue a prospectus. Hence it usually raises its capital by private placement. A public limited company can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares. Company law defines a privately placed issue to be the one seeking subscription from 50 members. In a private placement, no prospectus is issued. In this case the elaborate procedure required in the case of public issue is avoided. Therefore, the cost of issue is minimal. The process of raising funds is also very simple. But the number of shares that can be issued in a private placement is generally limited. Thus, private placement refers to the direct sale of newly issued securities by the issuer to a small number of investors through merchant bankers.

4. Right Issue

Right issue is a method of raising funds in the market by an existing company. Under this method, the existing company issues shares to its existing shareholders in proportion to the number of shares already held by them. Thus a right issue is the issue of new shares in which existing shareholders are given pre-emptive rights to subscribe to the new issue on a pro-rata basis.

5. Tender method:

Under tender method, the issue price is not predetermined. The company announces the public issue without indicating the issue price. It invites bids from various interested parties. The parties participating in the tender submit their maximum offers indicating the maximum price they are willing to pay. They should also specify the number of shares they are interested to buy. The company, after receiving various offers, may decide about the price in such a manner that the entire issue is fairly subscribed or sold to the parties participating in the tender.

6. Issue of bonus shares:

Where the accumulated reserves and surplus of profits of a company are converted into paid up capital, it is called bonus issue. It simply refers to capitalization of existing reserves and surpluses of a company.

7. Offer to the employees:

Now a days companies issue shares on a preferential basis to their employees. This attracts, retains and motivates the employees by creating a sense of belonging and loyalty. Generally shares are issued at a discount. A company can issue shares to their employees under the following two schemes: (a) Employee stock option scheme and (b) employee stock purchase scheme.

a. Employee Stock Options Plans means many companies use employee stock options plans to compensate, retain, and attract employees. These plans are contracts between a company and its employees that give employees the right to buy a specific number of the company's shares at a fixed price within a certain period of time.

b. On the other hand an employee stock purchase plan is a company-run program in which participating employees can purchase company shares at a discounted price. Employees contribute to the plan through payroll deductions, which build up between the offering date and the purchase date.

7. Bonus Issue Method:

Companies give away bonus shares to shareholders when companies are short of cash and shareholders expect a regular income. Shareholders may sell the bonus shares and meet their liquidity needs. Bonus shares may also be issued to restructure company reserves. Issuing bonus shares does not involve cash flow. It increases the company’s share capital but not its net assets.

8. Book Building Method:

It is a systematic process of generating, capturing, and recording investor demand for shares during an initial public offering (IPO), or other securities during their issuance process, in order to support efficient price discovery.

9. Pure Prospectus Method:

This is the most popular method of raising funds. The company issues a prospectus inviting applications direct from the public or through some intermediaries such as brokers, investment house and underwriters etc. for tasking up the new shares or debentures. Legally, a public limited company cannot raise share capital from the public without issuing prospectus. Sometimes, company imposes a restriction of the minimum number of shares to be subscribed for, in order to save the cost of issue.

Intermediaries/Players of New Issue Market

There are many intermediaries in the primary market. Important players are as follows:

1. Merchant banker: In attracting public money to capital issues, merchant bankers play a vital role. They act as issue managers, lead managers or co-managers

2. Registrars to the issue: Registrars are intermediaries who undertake all activities connected with new issue management. They are appointed by the company in consultation with the merchant bankers to the issue.

3. Bankers: Some commercial banks act as collecting agents and some act as coordinating bankers. Some bankers act as merchant bankers and some are brokers. They play an important role in transfer, transmission and safe custody of funds.

4. Brokers: They act as intermediaries in purchase and sale of securities in the primary and secondary markets. They have a network of sub brokers spread throughout the length and breadth of the country.

5. Underwriters: Generally investment bankers act as underwriters. They agreed to take a specified number of shares or debentures offered to the public, if the issue is not fully subscribed by the public. Underwriters may be financial institutions, banks, mutual funds, brokers etc. Government Securities Market

Govt. securities are also known as Gilt-edged securities. Gilt refers to gold. Thus govt. securities or gilt-edged securities are as pure as gold. This implies that these are completely risk free (no risk of default). Govt. securities market is a market where govt. securities are traded. It is the largest market in any economic system. Therefore, it is the benchmark for other market. Government securities refer to the marketable debt issued by the government of semi-government bodies. A government security is a claim on the government. It is a totally secured financial instrument ensuring safety of both capital and income. That is why it is called gilt edged security or stock. Central Government securities are the safest among all securities.

6. Debenture Trustee

It is a person or entity that serves as the holder of debenture stock for the benefit of another party. When a company is looking to raise capital, one method of accomplishing this is by issuing stock as a form of debt with the obligation to repay the debt at a specific interest rate.

MODULE IV

THE SECOUNDARY MARKET STOCK EXCHANGE

Introduction

Secondary market is a market for old issues. It deals with the buying and selling existing securities i.e. securities already issued. In other words, securities already issued in the primary market are traded in the secondary market. Secondary market is also known as stock market. The secondary market operates through 'stock exchanges'.

In India, stock market consists of recognised stock exchanges. In the stock exchanges, securities issued by the central and state governments, public bodies, and joint stock companies are traded.

Meaning of Secondary market:

A secondary market is a market where investors purchase securities or assets from other investors, rather than from issuing companies themselves. The national exchanges - such as the New York Stock Exchange and the NASDAQ are secondary markets.

Secondary markets exist for other securities as well, such as when funds, investment banks, or entities such as Fannie Mae purchase mortgages from issuing lenders. In any secondary market trade, the cash proceeds go to an investor rather than to the underlying company/entity directly.

Different between Secondary market and Primary Market

Primary Market: The primary market is the part of the capital market that deals with issuing of new securities. Companies, governments or public sector institutions can obtain funds through the sale of a new stock or bond issues through primary market

Secondary Market: A secondary market is a market where investors purchase securities or assets from other investors, rather than from issuing companies themselves

Secondary market vs primary market

Secondary Market	Primary market
It is a market for existing or second hand securities	It is a market for new securities.
Its indirectly promote capital formation	It is directly promotes capital formation
Investors can only buy securities. They cannot sell them.	Both buying and selling of securities takes place
There is no fixed geographical location.	There is a fixed geographical location (stock exchanges)
Securities need not be listed.	Only listed securities can be bought and sold
It enables the borrowers to raise capital	It enables the investors to invest money in securities and sell and encash as they need money

The Stock Exchange

The stock exchange is the market where stock shares and other securities are bought and sold. It is the market where the owners may dispose of their securities as and when they like In a modern capitalist economy, almost all commodities, even the smallest, are produced on a large scale; and large-scale production implies large amounts of capital.

The joint stock company or the corporate form of organisation is ideally suited to secure large amounts of capital from all those who have surplus funds and who are willing to take risks in investing companies. It issues stocks and bonds and enables those with surplus funds to invest them profitably in either of them, according to their convenience and temperament. An investor who puts his savings in a company by buying its securities cannot get the amount back from the company directly. The only way the capital invested in stocks and shares of a joint stock company may be realized by its owner is through the sale of those stocks and shares to others. The stock market or exchange is a place where stocks and shares and other long-term commitments or investments are bought and sold. For the existence of the capitalist system of economy and for the smooth functioning of the corporate form of organisation, therefore the stock exchange is an essential institution.

Definition

According to Pyle, “Security exchanges are market places where securities that have been listed thereon may be bought and sold for either investment or speculation”.

History of Stock Exchanges in India

The first organised stock exchange in India was started in Bombay when the Native Share Stock Brokers' Association--known as the Bombay Stock Exchange- was formed by the brokers in Bombay. In 1894, the Ahmedabad Stock Exchange was started to facilitate dealings in the shares of textile mills there. The Calcutta Stock Exchange was started in 1908 to provide a market for shares of plantations and jute mills. The Second World War saw great speculative activity in the country and the number of stock exchanges rose from 7 in 1939 to 21 in 1945 Besides these organised exchanges, there were a number of unorganised and unrecognised exchanges known as kerb markets which functioned under a set of usages and conventions and did not have any set of rules which could be enforced in courts of law. Under the Securities Contract (Regulation) Act of 1936, the Government of India has so far recognised 23 stock, exchanges Bombay is the premier exchange in the country and nearly 70 per cent of all transactions in the country are done in that exchange

Characteristics of a Stock Exchange

1) It is an organized capital market.
2) It may be incorporated or non-incorporated body (association or body of individuals).
3) t is an open market for the purchase and sale of securities.
4) Only listed securities can be dealt on a stock exchange.
5) It works under established rules and regulations.
6) The securities are bought and sold either for investment or for speculative purpose.

Economic Functions of Stock Exchange

The stock exchange performs the following essential economic functions:

1) **Ensures liquidity to capital:** The stock exchange provides a place where shares and stocks are converted into cash. People with surplus cash can invest in securities (by

buying securities) and people with deficit cash can sell their securities to convert them into cash.

2) **Continuous market for securities:** It provides a continuous and ready market for buying and selling securities. It provides a ready market for those who wish to buy and sell securities
3) **Mobilisation of savings:** It helps in mobilizing savings and surplus funds of individuals, firms and other institutions. It directs the flow of capital in the most profitable channel.
4) **Capital formation:** The stock exchange publishes the correct prices of various securities. Thus the people will invest in those securities which yield higher returns. It promotes the habit of saving and investment among the public. In this way the stock exchange facilitates the capital formation in the country.
5) **Evaluation of securities:** The prices at which transactions take place are recorded and made public in the forms of market quotations. From the price quotations, the investors can evaluate the worth of their holdings.
6) **Economic developments:** It promotes industrial growth and economic development of the country by encouraging industrial investments. New and existing concerns raise their capital through stock exchanges.
7) **Safeguards for investors:** Investors' interests are very much protected by the stock exchange. The brokers have to transact their business strictly according to the rules prescribed by the stock exchange. Hence they cannot overcharge the investors.
8) **Barometer of economic conditions:** Stock exchange reflects the changes taking place in the country's economy. Just as the weather clock tells us which way the wind is blowing, in the same way stock exchange serves as an indicator of the phases in business cycle-boom, depression, recessions and recovery.
9) **Platform for public debt:** The govt. has to raise huge funds for the development activities. Stock exchange acts as markets of govt. securities. Thus stock exchange provides a platform for raising public debt.
10) **Helps to banks:** Stock exchange helps the banks to maintain liquidity by increasing the volume of easily marketable securities.
11) **Pricing of securities**: New issues of outstanding securities in the primary market are based on the prices in the stock exchange. Thus, it helps in pricing of securities. Thus stock exchange is of great importance to a country. It provides necessary mobility to capital. It directs the flow of capital into profitable and successful enterprises. It is indispensable for the proper functioning of corporate enterprises. Without stock exchange, even govt. would find it difficult to borrow for its various schemes. It helps the traders, investors, industrialists and the banker. Hence, it is described as the business of business.

Listing of Securities

Listing of securities means permission to quote shares and debentures officially on the trading floor of the stock exchange. Listing of securities refers to the sanction of the right to trade the securities on the stock exchange. In short, listing means admission of securities to be traded on the stock exchange. If the securities are not listed, they are not allowed to be traded on the stock exchange.

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Advantages of Listing

A. **Advantages to Company:**

- It provides continuous market for securities (securities include shares, debentures, bonds etc.)
- It enhances liquidity of securities.
- It enhances prestige of the company.
- It ensures wide publicity.
- Rising of capital becomes easy.
- It gives some tax advantage to the company.

B. Advantages to Investors:

- It provides safety of dealings.
- It facilitates quick disposal of securities in times of need. This means that listing enhances the liquidity of securities.
- It gives some tax advantage to the security holder.
- Listed securities command higher collateral value for the purpose of bank loans.
- It provides an indirect check against manipulation by the management.

Disadvantages of Listing

- It leads to speculation
- Sometimes listed securities are subjected to wide fluctuations in their value. This may degrade the company’s reputation.
- It discloses vital information such as dividends and bonus declared etc. To competitors.
- Company has to spend heavily in the process of placing the securities with public

Procedure for Dealing at Stock Exchange (Trading Mechanism or Method of Trading on a Stock Exchange)

Placing an order with a broker:

In a stock exchange, only members are entitled to transact business and outsiders must get the transactions carried out through a member-broker. The intending client should furnish bank or other references regarding his financial position, honesty and integrity and also open an account with the broker. The client will place his order with the broker either to buy or to sell or both at fixed prices or at best market prices. In fact, there are many types of orders such as: "fixed orders", "limit orders", "immediate or cancel orders", "stop loss orders", and so on. Each order has a clear cut and definite meaning and the broker has to execute the orders as given by the clients. For instance." a fixed order" is an order, which must be executed by the broker at the price indicated by the client, or below it if is for buying and above it ii if is for selling. "Limit orders", on the other hand, fix definite limits beyond which brokers are not to go.

Execution of the order:

As soon as an order is received from a client, the broker or his authorized clerk approaches that part of the stock exchange in which the particular share is traded. He asks for a quotation or may quote his own price. The bargain is struck by word of mouth and only short notes are made in pencil in a small note-book as regards the number, description of shares and the name of the party from whom the shares are bought or to whom the shares are sold. The bargain will appear in the Stock Exchange Daily Official List which will include the number and price of shares which exchanged hands.

Reporting the deal to the client:

As soon as the deal is transacted, the details of the transaction are recorded in the books of the brokers, after which a contract note is prepared and sent to the client. The contract note gives details of the security bought or sold, the price, the broker's commission, the cost of the revenue stamp and the date of settlement (unless the bargain is for cash).

Settlement of transactions: There are two methods of settlement of transactions depending upon the nature of the transaction. In the case of ready delivery (or cash) transactions, payment has to be made immediately on the transfer of the securities or within a period of one to seven days. The settlement may be made either through the clearing house or by hand delivery between the members without the intervention of the clearing house. Usually, ready delivery contracts are entered into by outsiders or genuine investors. In the case of forward delivery contracts, the settlement is made on a fixed day- -it is generally fortnightly, though in some stock exchanges like Chennai, it is weekly. All forward contracts are cleared through the clearing house which simplifies payment for, and delivery of, securities. If, at the time of settlement, the transactions of two members of a stock exchange are equal, they are crossed out; if, however, they are not equal, the net balance alone is paid for or received. Moreover, there is the system of •'carry over" or "carry forward" to the next settlement if agreed upon by the two parties

Members in a Stock Exchange

Only members of the exchange are allowed to do business of buying and selling of securities at the floor of the stock exchange. A non-member (client) can buy and sell securities only through a broker who is a member of the stock exchange. To deal in securities on recognised stock exchanges, the broker should register his name as a broker with the SEBI.

Types of Members in a Stock Exchange

1) **Jobbers:** They are dealers in securities in a stock exchange. They cannot deal on behalf of public. They purchase and sell securities on their own names. Their main job is to earn profit due to price variations.
2) **Commission brokers:** They are nothing but brokers. They buy and sell securities no behalf of their clients for a commission. They are permitted to deal with non-members directly. They do not purchase or sell in their own name.
3) **Tarawaniwalas:** They are like jobbers. They handle transactions on a commission basis for their brokers. They buy and sell securities on their own account and may act as brokers on behalf of the public.
4) **Sub-brokers:** Sub brokers are agents of stock brokers. They are employed by brokers to obtain business. They cannot carry on business in their own name.

5) **Arbitrageurs**: They are brokers. They buy security in one market and sell the same in another market to get opportunistic profit.
6) **Authorised clerks:** Authorised clerks are those who are appointed by stock brokers to assist them in the business of securities trading.

Speculation

Speculation takes place in the forward market. Speculation means buying and selling of financial instruments (including foreign exchange) with the expectation of a profit from anticipated changes in the price of securities or foreign exchange rates. It simply means taking a foreign exchange risk in hope of making profit. One who is engaged in speculation is called speculator. His success or failure depends upon how correctly he is able to anticipate the exchange rate variations.

Physical shares:

A physical share is an equity security wholly owned by whoever holds the physical stock certificate. The issuing firm neither registers the owner of the stock nor tracks transfers of ownership.

Demat Share:

The conversion of Physical Shares into Electronic form of shares these kinds of shares called demat shares or dematerialised shares .Today, when you buy or sell shares, brokers insist on dealing only in dematerialised shares. To get your shares dematerialised you have to open a demat account and get into an agreement with a depository participant. You need to surrender your physical share certificates to the company which issued them, informing them and giving details of your agreement with your depository participant.

On the basis of this, the company would cancel your certificates and register your shareholdings in the name of your depository participant, as the registered owner of those shares and intimate this registration through a notice to your depository participant.

On receipt of the aforesaid notice from the company, the depository participant would register you as the beneficial owner of those shares. Remember, as a registered owner your depository participant has no rights of benefits from those shares. All rights would lie with you as the beneficial owner.

Depository Participant (DP)

It is described as an agent of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act. In a strictly legal sense, a DP is an entity who is registered as such with SEBI under the sub section 1A of Section 12 of the SEBI Act. As per the provisions of this Act, a DP can offer depository-related services only after obtaining a certificate of registration from SEBI

Depository is an institution or a kind of organization which holds securities with it, in which trading is done among shares, debentures, mutual funds, derivatives, F&O and commodities. The intermediaries perform their actions in variety of securities at Depository on behalf of their clients. These intermediaries are known as Depositories Participants. Fundamentally, there are two sorts of depositories in India. One is the National Securities Depository Limited (NSDL) and the other is the Central Depository Service (India) Limited

(CDSL). Every Depository Participant (DP) needs to be registered under this Depository before it begins its operation or trade in the market.

Service provide by Depositories

- Dematerialisation (usually known as demat) is converting physical certificates of Securities to electronic form
- Re materialisation, known as remat, is reverse of demat, i.e. getting physical certificates from the electronic securities
- Transfer of securities, change of beneficial ownership
- Settlement of trades done on exchange connected to the Depository
- Pledging and Unpledging of Securities for loan against shares
- Corporate action benefits directly transfer to the Demat and Bank account of customer

Major stock exchanges in India

1) Bombay Stock Exchange (BSE)

BSE is the leading and the oldest stock exchange in India as well as in Asia. It was established in 1887 with the formation of "The Native Share and Stock Brokers' Association". BSE is a very active stock exchange with highest number of listed securities in India. Nearly 70% to 80% of all transactions in the India are done alone in BSE. Companies traded on BSE were 3,049 by March, 2006. BSE is now a national stock exchange as the BSE has started allowing its members to set-up computer terminals outside the city of Mumbai (former Bombay). It is the only stock exchange in India which is given permanent recognition by the government.

Some important facts about BSE:

- BSE exchange was the first in India to launch Equity Derivatives, Free Float Index, USD adaptation of BSE SENSEX and Exchange facilitated Internet buying and selling policy
- BSE exchange was the first in India to acquire the ISO authorization for supervision, clearance & Settlement
- BSE exchange was the first in India to have launched private service for economic training
- Its On-Line Trading System has been felicitated by the internationally renowned standard of Information Security Management System.

BSE SENSEX

The S&P BSE SENSEX (S&P Bombay Stock Exchange Sensitive Index), also-called the BSE 30 or simply the SENSEX, is a free-float market-weighted stock market index of 30 well-established and financially sound companies listed on Bombay Stock Exchange . The 30 component companies which are some of the largest and most actively traded stocks are representative of various industrial sectors of the Indian economy. Published since 1 January 1986, the S&P BSE SENSEX is regarded as the pulse of the domestic stock markets in India.

Bombay Online Trading System (BOLT)

BSE online trading was established in 1995 and is the first exchange to be set up in Asia. It has the largest number of listed companies in the world and currently has 4937 companies listed on the Exchange with over 7,700 traded instruments. BSE introduced online trading system

The only thing that an investor requires for online trading through BSE is an online trading account. The trading can then be done within the trading hours from any location in the world. In fact, BSE has replaced the open cry system with automated trading. Open cry system is a common method of communication between the investors at a stock exchange where they shout and use hand gestures to communicate and transfer information about buy and sell orders. It usually takes place on the 'pit' area of the trading floor and involves a lot of face to face interaction.

However, with the use of electronic trading systems trading is easier, faster and cheaper; and is less prone to manipulation by market makers and brokers/dealers.

2) National Stock Exchange (NSE)

NSE was incorporated in 1992 but started its operations in 1994 with trading in the wholesale debt market segment. In November 1994, it launched the capital market segment as a trading platform for equities. Further, in June 2000, it entered futures and options segment for various derivative instruments.

A nationwide fully automated screen based trading system has since been set up at NSEI. In a nutshell, we can say that it’s the latest, most modern and technology driven exchange. The NSE was established by banks, insurance companies, financial institutions and other financial intermediaries. The board of members of NSE consist of senior executives from promoter institutions and professionals who do not directly or indirectly trade on the exchange.

NIFTY: The Nifty, similarly SENSEX, is an indicator of the 50 top major companies on the National Stock Exchange (NSE).

Objectives of NSE:

Following are the main objectives of NSE:

- To ensure equal access for investors all over the country with the help of appropriate communication network.
- To provide fair, efficient and transparent trading of securities through electronic system.
- To set up a nationwide trading facility for all types of securities.
- To enable book entry settlement and short settlement cycles.
- To meet international benchmarks and standards.

Market Segments of NSE:

NSE trades in the following two segments:

1) Whole Sale Debt Market Segment:

This segment refers to the trading platform for a wide range of fixed income securities like central government securities, bonds issued by public sector undertakings, zero coupon bonds, treasury bills, commercial papers, certificates of deposit, mutual funds, corporate debentures etc.

2) Capital Market System:

This segment of NSE provides a platform for transparent and fair trading of equity, preference shares, debentures, exchange traded funds as well as retail Government securities.

ABOUT NSDL (National Securities Depository Limited)

NSDL is the primary electronic depository of securities in India that came into existence in the year 1996, based in Mumbai, Maharashtra. The promotion of NSDL is done by the country's largest banks and institutions, i.e. IDBI, UTI and Bombay Stock Exchange. Further, India's leading banks hold stake in NSDL. There are more than 1.4 crore active investor's accounts and above 9 lacs accounts having debt instruments in NSDL. There are around 26000 service centers covering 1900 (approx) cities. Demat custody includes shares, debenture, bonds, commercial papers and so on.

Basic services provided by NSDL include account maintenance, settlement of trade, dematerialization, re materialization. It also facilitates off market transfers and inter-depository transfers, pledge and hypothecation of securities, stock lending and so on.

ABOUT CDSL (Central Depository Services Limited)

CSDL is a depository that holds securities in dematerialized form and facilitates trading and settlement of securities to be processed by book entry. It is the second largest central depository of securities in India, based in Mumbai, Maharashtra. The depository began its operations in February 1999. It is promoted by Bombay Stock Exchange in association with prominent banks of the nation, i.e. State Bank of India, Union Bank of India, Bank of Baroda, Bank of India, Standard Chartered Bank.

Securities available for demat includes equity, debentures, bonds, commercial papers, government securities, certificate of deposit, mutual funds and so on. The total number of client accounts in CDSL is over 1.06 crores as to Feb 2016. There are 581 depository participants and 161 branches.

DIFFRENCE BETWEEN NSDL AND CSDL

	NSDL	CSDL
Expands To	National Securities Depository Limited	Central Depository Services Limited
Meaning	NSDL is the first depository established in India, which ensures trading and settlement of securities in electronic form.	CDSL is the second largest depository in India, which facilitated book entry transfer of securities.
Key Promoters	IDBI, UTI and NSE	BOB, BOI, SBI, HDFC and BSE
Market	National Stock Exchange (NSE)	Bombay Stock Exchange (BSE)
Active Investor Accounts	1.44 crores	1.06 crores