PGCM S4 02
Exam Code : FMS

FINANCIAL MARKETS AND SERVICES

SEMESTER - 4

MASTER OF COMMERCE

(Finance and Accounting Specialisation)

BLOCK - 1



KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

Subject Experts

Prof. Nripendra Narayan Sarma, Maniram Dewan School of Management, KKHSOU.

Profesor Nayan Barua, Retd. Professor, Dept of Commerce, Gauhati University

Profesor H. C. Gautam,Retd. Professor, Dept of Commerce, Gauhati University

Course Co-ordinator : Dipankar Malakar, Ph.D, Asst. Prof., KKHSOU

UNITS	CONTRIBUTORS
8-15	Dr. Gobinda Deka, KKHSOU

Editorial Team

Content :

8-15	Dipankar Malakar, Ph.D. KKHSOU
Structure, Format & Graphics:	Dipankar Malakar, Ph.D., KKHSOU
	Devajeet Goswami, Ph.D., KKHSOU

April, 2022

ISBN : 978-93-91026-03-5

 This Self Learning Material (SLM) of the Krishna Kanta Handiqui State Open University is made available under a Creative Commons Attribution-Non Commercial-Share Alike 4.0 License (international): http://creativecommons.org/licenses/by-nc-sa/4.0/

Printed and published by Registrar on behalf of the Krishna Kanta Handiqui State Open University.

Headquarter : Patgaon, Rani Gate, Guwahati - 781017
City Office : Resham Nagar, Khanapara, Guwahati-781022; Website: www.kkhsou.in

MASTER OF COMMERCE

FINANCIAL MARKETS AND SERVICES

Block 1

DETAILED SYLLABUS

Page No. :

UNIT 1: INDIAN FINANCIAL SYSTEM AND MARKETS 5-23

Meaning and Nature of Financial System; Elements of Financial System; Functions of Financial System; Role of Financial System in economic development Financial Markets; Difference between Primary Market and Secondary Market Overview of Indian Financial System; Growth and Development of Indian Financial System Weaknesses of Indian Financial System

UNIT 2 : MONEY MARKET 24-57

Meaning and Definitions Money market; Features of Money Market; Functions of Money Market; Importance of a Developed Money Market; Characteristics of a Developed Money Market; Components/Compositions/Structure of Money Market; Role of Central Bank in Money Market; Indian Money Market; Structure of Indian Money Market; Participants of Indian Money Market; Money Market Instruments; Characteristics of Indian Money Market; Defects of Indian Money Market; Recent Development in Indian money market; Let Us Sum Up; Further Reading; Answers to Check Your Progress; Possible Questions

UNIT 3 : CAPITAL MARKET IN INDIA-I 58-93

Meaning of Capital Market; Functions of Capital Market; Subsidiaries of capital market; Primary / New issue Market; Functions of New Issue Market; Methods of Floatation in Primary Market; Abuses in New Issues Market; Problems of New Issues Market; Initial Public Offering (IPOs); On-Line IPOs; Investor Protection in Primary Market Recent; Trends in Primary Market; Book-Building Mechanism; SEBI Measures for Primary Market; Regulatory Measures of SEBI; Let Us Sum Up; Further Readings; Answers to Check Your Progress; Possible Questions

UNIT 4 : CAPITAL MARKET IN INDIA-II **94-118**

Meaning and Nature of Secondary Market; Functions of Secondary Market/Stock Exchange ; Stock Exchange; Characteristics of a Stock Exchange; Advantages/Benefits of Stock Exchanges; Organisation and Working of Stock Exchange; Stock Exchanges in India; List of Indian Stock Exchanges; Major Weaknesses of Stock Exchange; Measures Suggested For Reform of Stock Exchange; Regulations of Stock Exchanges In India; Role of SEBI in Regulating Stock Exchanges; Internet Trading; Let Us Sum Up; Further Readings; Answers to Check Your Progress; Possible Questions

UNIT-5 : LISTING OF SECURITIES **119-146**

Meaning of Listing; Types of Listing of Securities; Listing Requirements; Formalities for Listing; Listing Procedure at the Stock Exchange; Conditions for Listing; Criteria for Listing of Securities; Advantages of Listing; Disadvantages of Listing; Listing Fee; Listing of Right Issue; Listing of Bonus Issue; Differences between Right Issue and Bonus Issue; Listing of Further Issues; Delisting Of Securities; Listing Conditions in BSE; Listing Requirements for NSE; Let Us Sum Up; Further Readings; Answers to Check Your Progress; Possible Questions

UNIT-6 : MERCHANT BANKING **147-161**

Nature and Characteristics of Merchant Banking; Classification of Merchant Banks; Functions/Services Offered by Merchant Bankers; Qualities Required of Merchant Bankers; Merchant Banking in India; Regulation of Merchant Banking in India; Registration/Pre-requisites for Merchant Bankers; Scope for Merchant Banking in India; Let Us Sum Up; Further Readings; Answers to Check Your Progress; Possible Questions

UNIT 7 : TRADING AND SETTLEMENT SYSTEM IN STOCK EXCHANGES **162-184**

Meaning of Stock Exchange; Functions of Stock Exchange; Features of Stock Exchange; Bombay Stock Exchange (BSE); BSE-BOLT System; Bad Delivery; Short Delivery; Auction of Shares; National Stock Exchange (NSE); Order Types and Books; Demat Settlement; Physical Settlement; Institutional Segments; Funds Settlement; Valuation Debit; Valuation Price; Let Us Sum Up; Further Readings; Answers to Check Your Progress; Possible Questions

COURSE INTRODUCTION

This is the second course of M.Com. Programme of fourth semester Finance and Accounts specialisation . This course “Financial Markets and Services” of M. Com. 4th semester has been structured to give the learners a broad idea about the financial markets and services.The course is designed keeping in mind the present changes in the financial system.

The course has 15 units and is divided into two blocks: Block 1 and Block 2.

Block 1 consist of 7 units discussing the basics of Indian financial system, money market, capital market, listing of securities, merchant banking services and trading and settlement system in stock exchange.

Block 2 concentrates on OTCEI, stock market indices, SEBI, new instruments and participants in Indian stock market, derivative market, NBFIs and Microfinance.

Each unit of these blocks includes some along-side boxes to help you know some of the difficult, unseen terms. You may find some boxes marked with: “LET US KNOW”. These boxes will provide you with some additional interesting and relevant information. Again, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your progress of study. It will be helpful for you if you solve the problems put in these boxes immediately after you go through the sections of the units and then match your answers with “ANSWERS TO CHECK YOUR PROGRESS” given at the end of each unit. This will help you in making your learning more active and efficient. And, at the end of each section, you will get “CHECK YOUR PROGRESS” questions. These have been designed to self-check your understanding.

UNIT-1 : INDIAN FINANCIAL SYSTEM AND MARKETS

UNIT STRUCTURE

1.1 Learning Objectives

1.2 Introduction

1.3 Meaning and Nature of Financial System

1.4 Elements of Financial System

1.5 Functions of Financial System

1.6 Role of Financial System in economic development

1.7 Financial Markets

1.8 Difference between Primary Market and Secondary Market

1.9 Overview of Indian Financial System

1.10 Growth and Development of Indian Financial System

1.11 Weaknesses of Indian Financial System

1.12 Let us Sum Up

1.13 Further Reading

1.14 Answers to Check Your Progress

1.15 Possible Questions

1.1 LEARNING OBJECTIVES

After going through this unit you will able to:

- state the meaning of financial system
- describe needs of financial system
- interpret money market and capital market
- identify elements of financial system
- enumerate composition of financial markets
- explain functions and role of financial system
- discuss major participants of financial system

1.2 INTRODUCTION

The economic development of a country depends on a great extent on the well organized financial system. The financial system is the most important institutional arrangement for the economic transformation in particular and economic development in general. The production of goods and services needs financial inputs which come from the financial system, which in turn determines the well being and the overall standard of living of the people. This chapter will discuss about the meaning, nature and role of financial system. It will also discuss about the meaning of financial markets as well as the relation between financial system and financial markets. After completion of this unit you will be able to understand the role of financial system in economic development of a country. This chapter tries to give an overview of Indian financial system.

1.3 MEANING, NATURE AND DEFINITIONS OF FINANCIAL SYSTEM

Financial system functions as an intermediary between savers and investors. It facilitates the flow of funds from the areas of surplus to the areas of deficit. It is concerned about the money, credit and finance. These three parts are very closely interrelated with each other and depend on each other. Financial system comprises of set of subsystems of financial institutions, financial markets, financial instruments and services which helps in the formation of capital. It provides a mechanism by which savings are transformed to investment.

Financial system of any country consists of financial markets, financial intermediation and financial instruments or financial products. 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. The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. A financial system consists of financial market, financial instruments and financial intermediation.

The word 'system', in the term 'financial system', implies a set of complex and closely connected or interlinked institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit and finance. These three terms are intimately related yet are somewhat different from each other.

In the worlds of Van Horne, *"financial system allocates savings efficiently in an economy to ultimate users either for investment in real assets or for consumption".*

According to Robinson, the primary function of the financial system is "*to provide a link between savings and investments for the creation of new wealth and to permit portfolio adjustment in the composition of the existing wealth.*"

According to Prasanna Chandra, *"financial system consists of a variety of institutions, markets and instruments related in a systematic manner and provide the principal means by which savings are transformed into investments".*

According to L. M. Bhole, "*the financial system of any country consists of specialized and non-specialized financial institutions, of organized and unorganized financial markets, of financial instruments and services which facilitate the transfer of funds. Procedures and practices adopted in the markets and financial interrelationships are also part of the system.*"

According to S. B. Gupta, "*the financial system is set of institutional arrangements through which financial surpluses available in the economy are mobilized*."

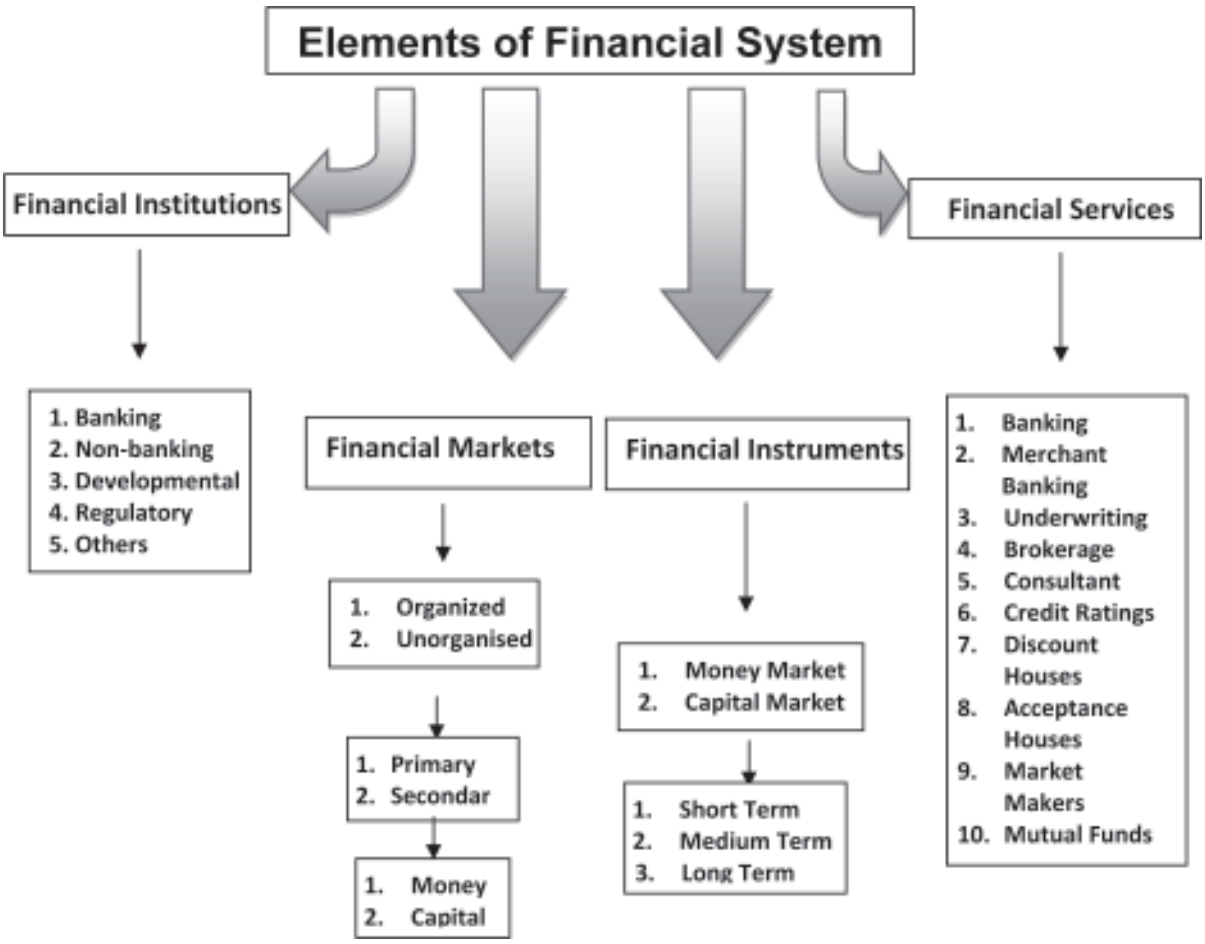
According to Christy the objective of the financial system is to "*supply funds to various sectors and activities of the economy in ways that promote the fullest possible utilization of resources without the destabilizing consequences of price level changes or unnecessary interference with individual desires*."

Thus financial system is a set of complex and closely interlinked financial institutions, financial markets, financial instruments and services which facilitate the transfer of funds. Financial institutions mobilise funds from sup-

pliers and provide these funds to those who demand them. Similarly, the financial markets are also required for movement of funds from savers to intermediaries and from intermediaries to investors. In short, financial system is a mechanism by which savings are transformed into investments.

1.4 ELEMENTS OF FINANCIAL SYSTEM

Financial system is the set of complex and closely connected financial institutions of an economy. It is an institutional arrangement through which financial surpluses are mobilized from the units generating surplus income and transferring them to the others in need of them. Financial system of every country including India has several interrelated parts, which works harmoniously to achieve certain objectives. The major elements/components of financial system may be shown with the help of the following diagram:



1.5 FUNCTIONS OF FINANCIAL SYSTEM

The financial system of a country performs certain valuable functions for the economic growth of that country. According to Robert Merton the financial system performs the following functions in the modern economy:

- It provides a payment system for the exchange of goods and services
- It enables the pulling of funds for undertaking large scale enterprises
- It provides a mechanism for spatial and temporal transfer of resources
- It provides a way for managing uncertainty and controlling risk
- It generates information that helps in coordinating decentralized decision making
- It helps in dealing with the problem of informational symmetry

The general main functions of a financial system may be briefly discussed as below:

1. Saving Function: An important function of a financial system is to mobilize savings and channelize them into productive activities. It is through financial system the savings are transformed into investments. The financial system has to offer attractive incentives to mobilize savings and make them available for productive purposes. The banks and other financial institutions mobilize savings and help allocation of resources for investment purposes. In this way financial institution helps capital formation and production process by channelizing the funds from the savers to the investors engaged in production.

2. Liquidity Function: The most important function of a financial system is to provide money and monetary assets for the production of goods and services. Monetary assets are those assets which can be converted into cash or money easily without loss of value. All activities in a financial system are related to liquidity-either provision of liquidity or trading in liquidity.

3. Payment Function: The financial system offers a very convenient mode of payment for goods and services. It ensures that the transactions of buying and selling are carried out safely and swiftly. It is important that both

buyers and sellers of goods and services have the confidence that the instruments used to make payments will be accepted and honoured by all the parties. Banks and other financial institutions ensure the efficient functioning of the payment system mechanism. The cheque system, credit card system and electronic payment system are the easiest methods of payment in the economy. The cost and time of transactions are considerably reduced.

4. Risk Function: Risk and uncertainty pertain to future events which are unknown and difficult to predicate every time. Different financial institutions like banks and financial intermediaries provide services which are both complementary and competitive to each other. They distribute risk through diversification and thereby reduce it for savers. The financial markets provide protection against life, health and income risks. These are accomplished through the sale of life, health insurance and property insurance policies.

5. Information Function: The financial institutions have enlarged their scope with the emergence of variety of institutions and dealing in diverse activities. Under the circumstances right information pertaining to opportunities and options available for lending and borrowing of funds is very essential. A financial system with the development in communication technology makes available price-related information. This is a valuable help to those who need to take economic and financial decisions. Financial markets disseminate information for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment or holding a particular asset.

6. Transfer Function: A financial system provides a mechanism for the transfer of the resources across geographic boundaries. It transfers funds from those who have a surplus and lends them to those who are in deficit and who need to borrow. The transfer of resources can be done directly or indirectly. It is direct when the savers having surplus, buy securities released as capital issues by the production units and it is indirect when banks and financial institutions and intermediaries mobilize resources from the savers and provide them for investment.

7. Reformatory Functions: A financial system undertaking the functions of developing, introducing innovative financial assets/instruments ser-

vices and practices and restructuring the existing assts, services etc, to cater the emerging needs of borrowers and investors (financial engineering and re engineering).

8. Other Functions: It assists in the selection of projects to be financed and also reviews performance of such projects periodically. It also promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

1.6 ROLE OF FINANCIAL SYSTEM IN ECONOMIC DEVELOPMENT

- Financial system 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.
- It helps to monitor corporate performance.
- It provides a mechanism for managing uncertainty and controlling risk.
- It provides a mechanism for the transfer of resources across geographical boundaries.
- It offers portfolio adjustment facilities (provided by financial markets and financial intermediaries).
- It helps in lowering the transaction costs and increase returns. This will motivate people to save more.
- It promotes the process of capital formation.
- 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.

1.7 FINANCIAL MARKETS

Financial markets are another part or component of financial system. Efficient financial markets are essential for speedy economic development.

The vibrant financial market enhances the efficiency of capital formation. It facilitates the flow of savings into investment. Financial markets bridge one set of financial intermediaries with another set of players. Financial markets are the backbone of the economy. This is because they provide monetary support for the growth of the economy. The growth of the financial markets is the barometer of the growth of a country's economy.

Financial markets are a mechanism enabling participants to deal in financial claims. Money market and capital market are the organized financial markets in India. Money market is for short term securities while capital market is for long term securities. Primary market deals in new issues, the secondary market is meant for trading in outstanding or existing securities.

Financial markets deal in financial securities (or financial instruments) and financial services. Financial markets are the centres or arrangements that provide facilities for buying and selling of financial claims and services. These are the markets in which money as well as monetary claims is traded in. Financial markets exist wherever financial transactions take place. Financial transactions include issue of equity stock by a company, purchase of bonds in the secondary market, deposit of money in a bank account, transfer of funds from a current account to a savings account etc.

The participants in the financial markets are corporations, financial institutions, individuals and the government. These participants trade in financial products in these markets. They trade either directly or through brokers and dealers. In short, financial markets are markets that deal in financial assets and credit instruments.

Functions of Financial Markets

The main functions of financial markets are outlined as below:

- To facilitate creation and allocation of credit and liquidity
- To serve as intermediaries for mobilisation of savings
- To help in the process of balanced economic growth
- To provide financial convenience
- To provide information and facilitate transactions at low cost
- To cater to the various credits needs of the business organisations

Classification of Financial Markets

1. **Money Market**: Money market is a market for dealing with financial assets & securities which have a maturity period of up to one year. The money market is a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions. Money market consists of:
   - **Call Money Market:** Call money market is a market for extremely short period loans say one day to fourteen days. It is highly liquid.
   - **Commercial Bills Market:** It is a market for bills of exchange arising out of genuine trade transactions. In the case of credit sale, the seller may draw a bill of exchange on the buyer. The buyer accepts such a bill promising to pay at a later date the amount specified in the bill. The seller need not wait until the due date of the bill. Instead, he can get immediate payment by discounting the bill.
   - **Treasury Bills Market:** It is a market for treasury bills which have 'short-term' maturity. A treasury bill is a promissory note or a finance bill issued by the government. It is highly liquid because its repayment is guaranteed by the government.
   - **Short-term Loan Market:** It is a market where short- term loans are given to corporate customers for meeting their working capital requirements. Commercial banks play a significant role in this market.
2. **Capital Market**: The capital market is the market for long term securities, that is, securities having a maturity period of one year or more. The capital market is a market for financial assets which have a long or indefinite maturity. This market is designed to finance the long-term investments. The transactions taking place in this market will be for periods over a year. Components of Capital market:
   - **Industrial Securities Market:** It is a market for industrial securities namely equity shares or ordinary shares, preference shares and debentures or bonds. It is a market where industrial concerns raise their capital

or debt by issuing appropriate instruments. It can be further subdivided into primary and secondary market.

- **Government Securities Market:** It is otherwise called gilt-edged securities market. It is a market where government securities are traded. In India there are many kinds of govt. securities- short-term and long-term. Long-term securities are traded in this market while short term securities are traded in the money market.
- **Long-term Loans Market:** Development banks and commercial banks play a significant role in this market by supplying long term loans to corporate customers. Long-term loans market may further be classified into- term loans market, mortgages market and financial guarantees market.

3. Forex Market: The Forex market deals with the multicurrency requirements, which are met by the exchange of currencies. 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.

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

1.8 DIFFERENCE BETWEEN PRIMARY MARKET AND SECONDARY MARKET

The main points of distinction between the primary market and secondary market are as follows:

1. Function: While the main function of primary market is to raise long-term funds through fresh issue of securities, the main function of secondary market is to provide continuous and ready market for the existing long-term securities.

2. Participants: While the major players in the primary market are financial institutions, mutual funds, underwriters and individual investors, the major players in secondary market are all of these and the stockbrokers who are members of the stock exchange.

3. Listing Requirement: While only those securities can be dealt within the secondary market, which have been approved for the purpose (listed), there is no such requirement in case of primary market.

4. Determination of prices: In case of primary market, the prices are determined by the management with due compliance with SEBI requirement for new issue of securities. But in case of secondary market, the price of the securities is determined by forces of demand and supply of the market and keeps on fluctuating.



CHECK YOUR PROGRESS

1. Fill in the blanks:

a) ———— functions as an intermediary between savers and investors.

b) Financial markets are markets that deal in ———— and credit instruments.

c) The market for extremely short period loan is called ————.

d) _____ facilitate the transfer of funds from savers to the borrowers.

e) Financial institutions are also known as ————.

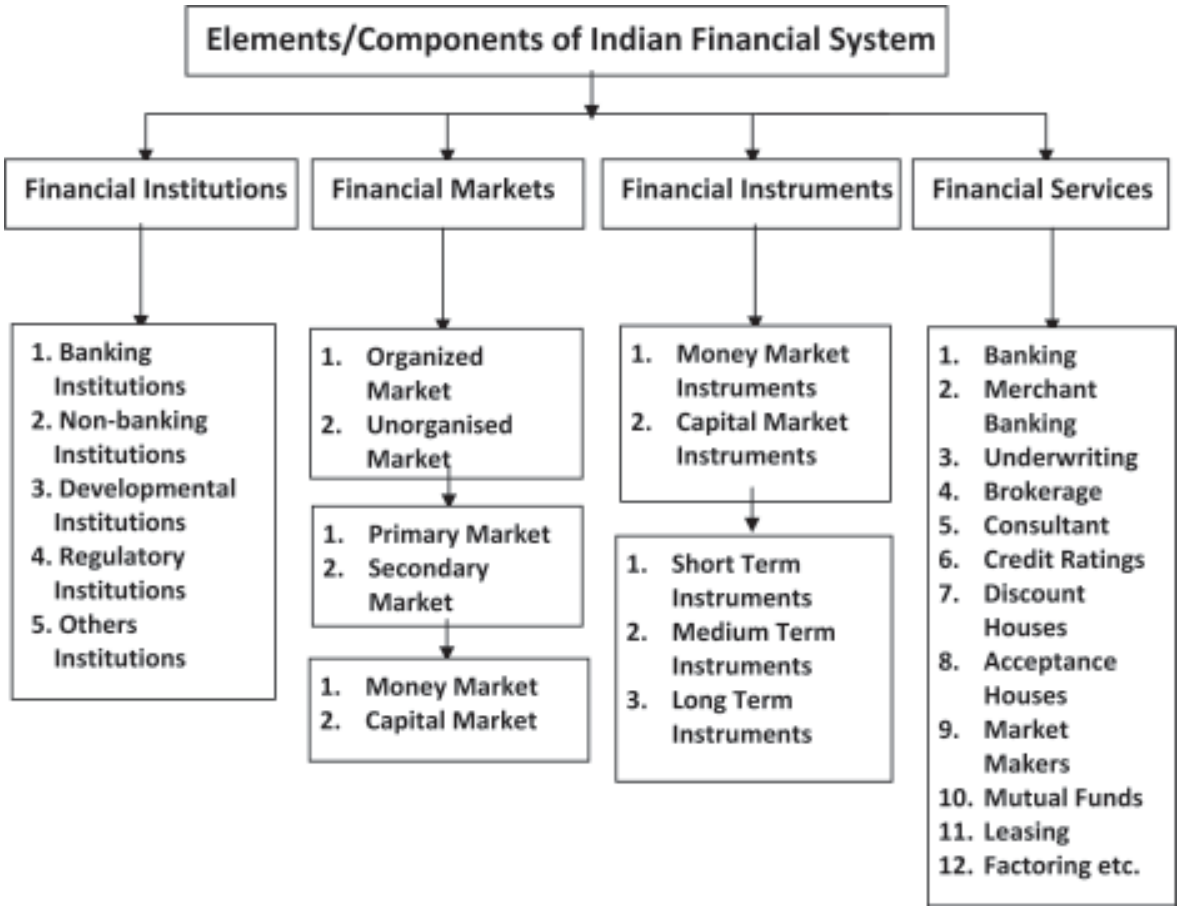
1.9 OVERVIEW OF INDIAN FINANCIAL SYSTEM

Indian Financial system comprises of set of subsystems of financial institutions, financial markets, financial instruments and services which helps in the formation of capital. It provides a mechanism by which savings are transformed to investment. The financial system is possibly the most important institutional and functional vehicle for economic transformation. Finance is a bridge between the present and the future and whether the mobilization of savings or their efficient, effective and equitable allocation for investment, it the access with which the financial system performs its functions that sets the pace for the achievement of broader national objectives. The primary function of the system is to provide a link between savings and investment.

Structure of Indian Financial System

Financial structure refers to shape, components and their order in the financial system. The Indian financial system can be broadly classified into formal (organised) financial system and the informal (unorganised) financial

system. The formal financial system comprises of Ministry of Finance (MOF), Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) and other regulatory bodies. The informal financial system consists of individual money lenders, groups of persons operating as funds or associations, partnership firms consisting of local brokers, pawn brokers, and non-banking financial intermediaries such as finance, investment and chit fund companies.



The informal financial system consists of (i) Individual money lenders such as neighbors, relatives, land lords, traders, store owners and so on, (ii) Groups of persons operating as funds or 'associations'. These groups function under a system of their own rules, and (iii) Partnership firms consisting of local brokers, pawn brokers and non banking financial intermediaries such as finance, investment and chit fund companies.

1.10 GROWTH AND DEVELOPMENT OF INDIAN FINANCIAL SYSTEM

At the time of independence in 1947, there was no strong financial institutional mechanism in the country. The industrial sector had no access to the savings of the community. The capital market was primitive and shy. The private and unorganised sector played an important role in the provision of liquidity. On the whole, there were chaos and confusions in the financial system.

After independence, the government adopted mixed economic system. A scheme of planned economic development was evolved in 1951 with a view to achieve the broad economic and social objective. The government started creating new financial institutions to supply finance both for agricultural and industrial development. It also progressively started nationalizing some important financial institutions so that the flow of finance might be in the right direction. The following developments took place in the Indian financial system:

1. Nationalisation of Financial Institutions: RBI, the leader of the financial system, was established as a private institution in 1935. It was nationalized in 1949. This was followed by the nationalisation of the Imperial bank of India. One of the important mile stone in the economic growth of India was the nationalisation of Life Insurance Corporation in 1956. As a result, Life Insurance Corporation of India came into existence on 1st September, 1956. Another important development was the nationalisation of 14 major commercial banks in 1969. In 1980, 6 more banks were nationalized. Another landmark was the nationalisation of general insurance business and setting up of General Insurance Corporation in 1972.

2. Establishment of Development Banks: Another landmark in the history of development of Indian financial system is the establishment of new financial institutions to supply institutional credit to industries. In 1949, RBI undertook a detailed study to find out the need for specialized institutions. The first development bank was established in 1948. That was Industrial Finance Corporation of India (IFCI). In 1951, Parliament passed State Financial Corporation Act. Under this Act, State Governments could establish financial

corporation's for their respective regions. The Industrial Credit and Investment Corporation of India (ICICI) were set up in 1955. It was supported by Government of India, World Bank etc. The UTI was established in 1964 as a public sector institution to collect the savings of the people and make them available for productive ventures. The Industrial Development Bank of India (IDBI) was established on 1st July 1964 as a wholly owned subsidiary of the RBI.

On February 16, 1976, the IDBI was delinked from RBI. It became an independent financial institution and started coordinating the activities of all other financial institutions. In 1971, the IDBI and LIC jointly set up the Industrial Reconstruction Corporation of India with the main objective of reconstruction and rehabilitation of sick industrial undertakings. The IRCI was converted into a statutory corporation in March 1985 and renamed as Industrial Reconstruction Bank of India. Now its new name is Industrial Investment Bank of India (IIBI).

In 1982, the Export-Import Bank of India (EXIM Bank) was set up to provide financial assistance to exporters and importers. On April 2, 1990 the Small Industries Development Bank of India (SIDBI) was set up as a wholly owned subsidiary of IDBI. The SIDBI has taken over the responsibility of administrating the Small Industries Development Fund and the National Equity Fund.

3. Establishment of Institution for Agricultural Development: In 1963, the RBI set up the Agricultural Refinance and Development Corporation (ARDC) to provide refinance support to banks to finance major development projects, minor irrigation, farm mechanization, land development etc. In order to meet credit needs of agriculture and rural sector, National Bank for Agriculture and Rural Development (NABARD) was set up in 1982. The main objective of the establishment of NABARD is to extend short term, medium term and long term finance to agriculture and allied activities.

4. Establishment of Institution for Housing Finance: The National Housing Bank (NHB) has been set up in July 1988 as an apex institution to

mobilize resources for the housing sector and to promote housing finance institutions.

5. Establishment of Stock Holding Corporation of India (SHCIL): In 1987, another institution, namely, Stock Holding Corporation of India Ltd. was set up to strengthen the stock and capital markets in India. Its main objective is to provide quick share transfer facilities, clearing services, support services etc. to investors.

6. Establishment of Mutual Funds and Venture Capital Institutions: Mutual funds refer to the funds raised by financial service companies by pooling the savings of the public and investing them in a diversified portfolio. They provide investment avenues for small investors who cannot participate in the equities of big companies. Venture capital is a long term risk capital to finance high technology projects. The IDBI venture capital fund was set up in 1986. The ICICI and the UTI have jointly set up the Technology Development and Information Company of India Ltd. in 1988 to provide venture capital.

7. New Economic Policy of 1991: Indian financial system has undergone massive changes since the announcement of new economic policy in 1991. Liberalisation, Privatisation and Globalisation has transformed Indian economy from closed to open economy. The corporate industrial sector also has undergone changes due to delicensing of industries, financial sector reforms, capital markets reforms, disinvestment in public sector undertakings etc.

Since 1990s, Government control over financial institutions has diluted in a phased manner. Public or development financial institutions have been converted into companies, allowing them to issue equity/bonds to the public. Government has allowed private sector to enter into banking and insurance sector. Foreign companies were also allowed to enter into insurance sector in India.

1.11 WEAKNESSES 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 inactive. 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:

- Banks and Financial Institutions have high level of NPA
- Government burdened with high level of domestic debt
- Cooperative banks are labeled with scams
- Investors' confidence reduced in the public sector undertaking etc.
- Financial illiteracy



CHECK YOUR PROGRESS

(Fill in the blanks)

2. Indian financial system comprises of both organised and _____ sector.
3. Write true or false:
   a) The market regulator of Indian Capital Market is SEBI.
   b) The Indian money market does not deal in cash or money but in promissory notes, government paper.



1.12 LET US SUM UP

We have discuss the following points in this unit:-

- Financial system functions as an intermediary between savers and investors.
- Financial system comprises of set of subsystems of financial institutions, financial markets, financial instruments and services which helps in the formation of capital.

- The Indian financial system can be broadly classified into formal (organised) financial system and the informal (unorganised) financial system.
- The financial system of a country performs functions like saving, liquidity, payment, risk and information functions for the economic growth of that country.
- Financial markets deal in financial securities (or financial instruments) and financial services.
- Financial markets are broadly classified into money and capital market.
- Though Indian financial system is more developed today, it suffers from certain weaknesses.



1.13 FURTHER READING

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services – By M. P. Tripathy



1.14 ANSWERS TO CHECK YOUR PROGRESS

1. (a) Financial system (b) Financial assets (c) Call money market (d) Financial markets (e) Financial intermediaries
2. un-organised
3. (a) True (b) False



1.15 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Financial Services
   b) Financial Intermediation
   c) Financial Instruments

d) Financial Institutions

e) Financial Markets

2. What do you mean by financial system? Discuss the components of Financial System.
3. Discuss the importance of regulators to make financial system of a country stronger.
4. What is the importance of financial system in promoting economic growth?
5. Define financial system. Discuss the present structure of Indian Financial System.
6. Discuss the India financial system by highlighting its features and weaknesses.
7. Discuss about the functions of Indian Financial System in the economic development of the country.
8. Give an overview of the Indian financial system. What are the essential elements of Indian financial system? Explain them briefly.
9. Write a brief note on growth and development of Indian financial system.

UNIT 2 : MONEY MARKET

UNIT STRUCTURE

2.1 Learning Objectives

2.2 Introduction

2.3 Meaning and Definitions Money market

2.4 Features of Money Market

2.5 Functions of Money Market

2.6 Importance of a Developed Money Market

2.7 Characteristics of a Developed Money Market

2.8 Components/Compositions/Structure of Money Market

2.9 Role of Central Bank in Money Market

2.10 Indian Money Market

2.11 Structure of Indian Money Market

2.12 Participants of Indian Money Market

2.13 Money Market Instruments

2.14 Characteristics of Indian Money Market

2.15 Defects of Indian Money Market

2.16 Recent Development in Indian money market

2.17 Let Us Sum Up

2.18 Further Reading

2.19 Answers to Check Your Progress

2.20 Possible Questions

2.1 LEARNING OBJECTIVES

After going through this unit you will able to:

- state the meaning and functions of money market
- describe the characteristics and importance of a developed money market in the economy
- interpret features of developed money market
- enumerate the components and structure of money market
- explain the structure and functions of Indian money market
- discuss the various instruments used in Indian money market

- discuss the characteristics and defects of Indian money market
- enumerate the recent trends and development of Indian money market

2.2 INTRODUCTION

Financial market deals in financial instruments (securities) and financial services. Financial markets are classified into two, namely, money market and capital market**.** Money market is a segment of financial market. It is a market for short term funds. It deals with all transactions in short term securities. These transactions have a maturity period of one year or less. This unit will discuss the meaning, characteristics, constituents, functions and instruments of money market. It will also discuss about the recent trends of Indian Money market as well as the importance of a developed money market in the economy.

2.3 MEANING AND DEFINITIONS MONEY MARKET

Money market is a segment of financial market. It is a market for short term funds. It deals with all transactions in short term securities. These transactions have a maturity period of one year or less. Examples are bills of exchange, treasury bills etc. These short term instruments can be converted into money at low transaction cost and without much loss. Thus, money market is a market for short term financial securities that are equal to money.

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is up to one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement.

Money market does not imply to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to

borrowers. Most of the money market transactions are taken place on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialized financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

According to Crowther, ***"****Money market is a collective name given to various firms and institutions that deal in the various grades of near money*". Money market is not a place. It is an activity. It includes all organizations and institutions that deal in short term financial instruments. However, sometimes geographical names are given to the money market according to the location, e.g. Mumbai Money Market.

2.4 FEATURES OF MONEY MARKET

The following are the characteristics of money market:

- It is a market for short term financial assets that are close substitutes of money.
- It is basically an over the phone market.
- It is a wholesale market for short term debt instruments.
- It is not a single market but a collection of markets for several instruments.
- It facilitates effective implementation of monetary policy of a central bank of a country.
- Transactions are made without the help of brokers.
- It establishes the link between the central bank and other banks.
- The players in the money market are central bank(s) of the country, governments, commercial banks, brokers and other companies/organizations relating to short term funds.

2.5 FUNCTIONS OF MONEY MARKET

Money market performs the following functions:

- Facilitating adjustment of liquidity position of commercial banks, business undertakings and other non-banking financial institutions

- Enabling the central bank to influence and regulate liquidity in the economy through its intervention in the market
- Providing a reasonable access to users of short term funds to meet their requirements quickly at reasonable costs
- Providing short term funds to government institutions
- Enabling businessmen to invest their temporary surplus funds for short period
- Facilitating flow of funds to the most important uses
- Serving as a coordinator between borrowers and lender of short term funds
- Helping in promoting liquidity and safety of financial assets

2.6 IMPORTANCE OF A DEVELOPED MONEY MARKET

A well-developed money market is essential for the development of a country. It supplies short term funds adequately and quickly to trade and industry. A developed money market helps the smooth functioning of the financial system in any economy in the following ways:

1. Development of Trade and Industry: Money market is an important source of finance to trade and industry. Money market finances the working capital requirements of trade and industry through bills, commercial papers etc. It influences the availability of finance both in the national and international trade.

2. Development of Capital Market: Availability funds in the money market and interest rates in the money market will influence the resource mobilisation and interest rate in the capital market. Hence, the development of capital market depends upon the existence of a developed money market. Money market is also necessary for the development of foreign exchange market and derivatives market.

3. Helpful to Commercial Banks: Money market helps commercial banks for investing their surplus funds in easily realisable assets. The banks get back the funds quickly in times of need. This facility is provided by money market. Further, the money market enables commercial banks to meet the

statutory requirements of CRR and SLR. In short, money market provides a stable source of funds in addition to deposits.

4. Helpful to Central Bank: Money market helps the central bank of a country to effectively implement its monetary policy. Money market helps the central bank in making the monetary control effective through indirect methods (repos and open market operations). In short, a well-developed money market helps in the effective functioning of a central bank.

5. Formulation of Suitable Monetary Policy: Conditions prevailing in a money market serve as a true indicator of the monetary state of an economy. Hence, it serves as a guide to the government in formulating and revising the monetary policy. In short, the government can formulate the monetary policy after taking into consideration the conditions in the money market.

6. Helpful to Government: A developed money market helps the government to raise short term funds through the treasury bill floated in the market. In the absence of a developed money market, the government would be forced to issue more currency notes or borrow from the central bank. This will raise the money supply over and above the needs of the economy. Hence, the general price level will go up (inflationary trend in the economy). In short, money market is a device to the government to balance its cash inflows and outflows. Thus, a well-developed money market is essential for economic growth and stability.

2.7 CHARACTERISTICS OF A DEVELOPED MONEY MARKET

In every country many types of money market exist. Some of them are highly developed while others are not well developed. A well developed and efficient money market is necessary for the development of any economy. The following are the characteristics or prerequisites of a developed and efficient money market:

1. Highly Developed Commercial Banking System: Commercial banks are the centre of the whole short term funds. They serve as a vital link

between the central bank and the various segments of the money market. When the commercial banking system is developed or organized, the money market will be developed.

2. Presence of a strong Central Bank: In a developed money market, there always exists a central bank. The central bank is necessary for direction and control of money market. Central bank absorbs surplus cash during off-seasons and provides additional funds in busy seasons. This is done through open market operations. Being the bankers' bank, central bank keeps the reserves of commercial banks and provides them financial accommodation in times of need. If the central bank cannot influence the money market it means the money market is not developed. In short, without the support of a central bank a money market cannot function.

3. Existence of Sub-markets: Money market is a group of various sub-markets. Each sub market deals in instruments of varied maturities. There should be large number of sub-markets. The larger the number of sub markets, the broader and more developed will be the structure of money market. Besides, the sub-market must be interrelated and integrated with each other. If there is no co-ordination and integration among them, different interest rates will prevail in the submarkets.

4. Availability of Credit Instruments: The continuous availability of readily acceptable negotiable securities (near money assets) is necessary for the existence of a developed money market. In addition to variety of instruments or securities, there should be a number of dealers (participants) in the money market to transact in these securities. It is the dealers in securities who actually infuse life into the money market.

5. **Existence of Secondary Market**: There should be active secondary market in these credit instruments. The success of money market always depends on the secondary market. If the secondary market develops, then there will be active trading of the instruments.

6. **Availability of Ample Resources**: There must be availability of sufficient funds to finance transactions in the sub markets. These funds may

come from within the country and outside the country. Under developed money markets do not have ample funds. Thus availability of sufficient funds is essential for the smooth and efficient functioning of the money market.

7. **Demand and Supply of Funds:** Money market should have a large demand and supply of funds. This depends upon the number of participants and also the government policies in encouraging the investments in various sectors and monetary policy of RBI.

8. **Other Factors:** There are some other factors that also contribute to the development of a money market. These factors include industrial development, volume of international trade, political stability, trade cycles, foreign investment, price stabilisation etc.

2.8 COMPONENTS/COMPOSITION/STRUCTURE OF MONEY MARKET

Money market consists of a number of sub-markets. All sub-markets collectively constitute the money market. Each sub-market deals in a particular financial instrument. The main components or constituents or sub-markets of money markets are as follows:

- Call money market
- Commercial bill market
- Treasury bill markets
- Certificates of deposits market
- Commercial paper market
- Acceptance market
- Collateral loan market

2.8.1. Call Money Market

Call money is required mostly by banks. Commercial banks borrow money without collateral from other banks to maintain a minimum cash balance known as cash reserve ratio (CRR). This interbank borrowing has led to the development of the call money market. Call money market is the market for very short period loans. If money is lent for a day, it is called call money. If

money is lent for a period of more than one day and up to 14 days is called short notice money. Thus call money market refers to a market where the maturity of loans varies from 1 day to 14 days. In the call money market, surplus funds of financial institutions and banks are traded. There is no demand for collateral security against call money. In India call money markets are mainly located in big industrial and commercial centres like Mumbai, Kolkata, Chennai, Delhi and Ahmadabad. Participants or players in the Call Money Market are:

- Scheduled commercial banks and RBI
- Non-Scheduled commercial banks
- Co-operative banks
- Foreign banks
- Discount and Finance House of India
- Primary dealers

The above players are permitted to operate both as lenders and borrowers. On the other hand participants like LIC, UTI, GIC, IDBI, NABARD, Specific mutual funds, etc. are permitted to operate as lenders.

2.8.2. Commercial Bill Market

Commercial bill market is another segment of money market. It is a market in which commercial bills (short term) are bought and sold. Commercial bills are important instruments. They are widely used in both domestic and foreign trade to discharge the business obligations (or to settle business obligations). Discounting is the main process in this market. Hence commercial bill market is also known as discount market. There are specialized institutions known as discount houses for discounting commercial bills accepted by reputed acceptance houses. In India, RBI has permitted the financial institutions, mutual funds, commercial banks and cooperative banks to enter in the commercial bill market.

2.8.3. Treasury Bills Market

Treasury bill market is a market which deals in treasury bills. In this market, treasury bills are bought and sold. Treasury bill is an important instrument of short term borrowing by the government. These are the promissory

notes or a kind of finance bill issued by the government for a fixed period not extending beyond one year. Treasury bill is used by the government to raise short term funds for meeting temporary government deficits. Thus it represents short term borrowings of the government.

Advantages or importance of Treasure Bill Market:

Advantages to the Issuer/Government*:*

- The government can raise short term funds for meeting temporary budget deficit.
- The government can absorb excess liquidity in the economy through the issue of bills in the market.
- It does not lead to inflationary pressure.

Advantages for the Purchaser/Investor*:*

- It is a ready market for purchasers or investors.
- It is a safety instrument to invest.
- Treasury bills are eligible securities for SLR requirement.
- The market provides hedging facility.

2.8.4. Certificates of Deposits (CD) Market

CD market is a market which deals in Certificate of Deposits (CDs). CDs are short term deposit instruments to raise large sums of money. These are short term deposits which are transferable from one party to another. Banks and financial institutions are major issuers of CDs. These are short term negotiable instruments.

Advantages of CD Market:

- It enables the depositors to earn higher return on their short term surplus.
- The market provides maximum liquidity.
- The bank can raise money in times of need. This will improve their lending capacity.
- The market provides an opportunity for banks to invest surplus funds.
- The transaction cost of CDs is lower.

2.8.5. Commercial Paper Market

Commercial Paper Market is another segment of money market. It is a market which deals in commercial papers. Commercial papers are unsecured

short term promissory notes issued by reputed, well established and big companies having high credit rating. These are issued at a discount. Commercial papers can now be issued by primary dealers and all India financial institutions. They can be issued to (or purchased by) individuals, banks, companies and other registered Indian corporate bodies.

The Working Group on Money Market (Vaghul Committee) in 1987 suggested the introduction of the Commercial Paper (CP) in India. As per the recommendation of the committee, the RBI introduced commercial papers in January 1990. The Committee suggested the following:

- CP should be issued to investors directly or through bankers.
- The CP issuing company must have a net worth of not less than Rs. 5 crores.
- The issuing company's shares must be listed in the stock exchange.
- The minimum amount of issue should be Rs. 1 crore and the minimum denomination of Rs. 5 lakhs
- The CPs issuing cost should not exceed 1% of the amount raised.
- RBI is the sole authority to decide the size of issue and timing of issue.
- The instrument should not be subject to stamp duty at the time of issue and there should not be any tax deduction at source.
- The interest on CP shall be a market determined.
- The issuing companies should get certification of credit rating for every six months and 'A' grading enterprises may be permitted to enter the market.

2.8.6. Acceptance Market

Acceptance Market is another component of money market. It is a market for banker's acceptance. The acceptance arises on account of both home and foreign trade. Banker's acceptance is a draft drawn by a business firm upon a bank and accepted by that bank. It is required to pay to the order of a particular party or to the bearer, a certain specific amount at a specific date in

future. It is commonly used to settle payments in international trade. Thus acceptance market is a market where the bankers' acceptances are easily sold and discounted.

2.8.7. **Collateral Loan Market**

Collateral loan market is another important sector of the money market. The collateral loan market is a market which deals with collateral loans. Collateral means anything pledged as security for repayment of a loan. Thus collateral loans are loans backed by collateral securities such as stock, bonds etc. The collateral loans are given for a few months. The collateral security is returned to the borrower when the loan is repaid. When the borrower is not able to repay the loan, the collateral becomes the property of the lender. The borrowers are generally the dealers in stocks and shares.

2.9 ROLE OF CENTRAL BANK IN MONEY MARKET

Central bank is the leader, guide, controller and policy maker of the banking system of a country. If a nation's economy is a human body, then its heart would be the central bank. And just as the heart works to pump life-giving blood throughout the body, the central bank pumps money into the economy to keep it healthy and growing. Sometimes economies need less money, and sometimes they need more. The methods central banks use to control the quantity of money vary depending on the economic situation and power of the central bank.

The central bank is at the peak of all financial institutions in the money market. No money market can exist without the central bank. As a guardian of the money maker, it takes all necessary steps. To make a powerful and sound money market, central bank control and direct the money market. It decides the interest rates, bank rates, repo rate, CRR and SLR ratio; and also creates balance between inflation and deflation of the nation. The central bank is the lender of the last resort of the money market. Central bank works for commercial banks as the shade in summer. It does the following activities as the controller of the money market:

- Policy making, planning development, and implementing to create a powerful and sound money market.
- Acts as a regulator and supervisor of the money market
- It helps in case of establishment of financial institutions.
- Establishing the stability of the value of currency through credit control.
- To keep the balance between local currency with foreign currency control, bank select the suitable rate of exchange.
- Circulation of money is kept at an optimum level to reduce inflation.
- Give advice and information to the government in case of economic decision making.
- Taking necessary steps to control default at culture.
- Accelerating export and discouraging import.
- Creating and imposing of law for the purpose of public welfare.
- Trying to speed-up and updating economy in comparison to the developed country.



CHECK YOUR PROGRESS

1. Write True or False:

a) The Indian money market does not deal in cash or money but in promissory notes, government paper.

b) Money market supplies funds for financing working capital of industries.

c) 'Ad hoc' treasury bills are always issued in favour of the RBI only.

2. Fill in the gap:

a) The market for extremely short period is called _____.

b) _____ are drawn by contractors on the Government Departments for the goods supplied to them. (Fill in the gap)

c) The bill which does not require any acceptance is called _____.

d) _____ has been set up mainly to provide a secondary market in Government securities.

3. Choose the correct answer from the given alternatives:

a) The market for short term loans is called _____.

i) Call money market

ii) Treasury bill market

iii) Money market

iv) Acceptance market

b) Bills drawn and accepted payables after three months are called _____.

i) Indigenous bills

ii) Usance bills

iii) Clean bills

iv) Supply bills

c) The market which helps commercial banks to maintain their SLR requirements is _____.

i) Call loan market

ii) Discount market

iii) Acceptance market

iv) Commercial bill market

d) The certificate which evidences an unsecured corporate debt of short-term maturity is _____.

i) Short-term loan certificate

ii) Certificate of deposit

iii) Inter-bank participation certificate

iv) Commercial paper

2.10 INDIAN MONEY MARKET

Money market is that segment of financial markets where borrowing and lending of the short-term funds takes place. The maturity of the money market instruments is one day to one year. In India, money market is regulated by RBI. Indian money market is divided into organized and unorganized segments. Unorganized market is old indigenous market mainly made of indig-

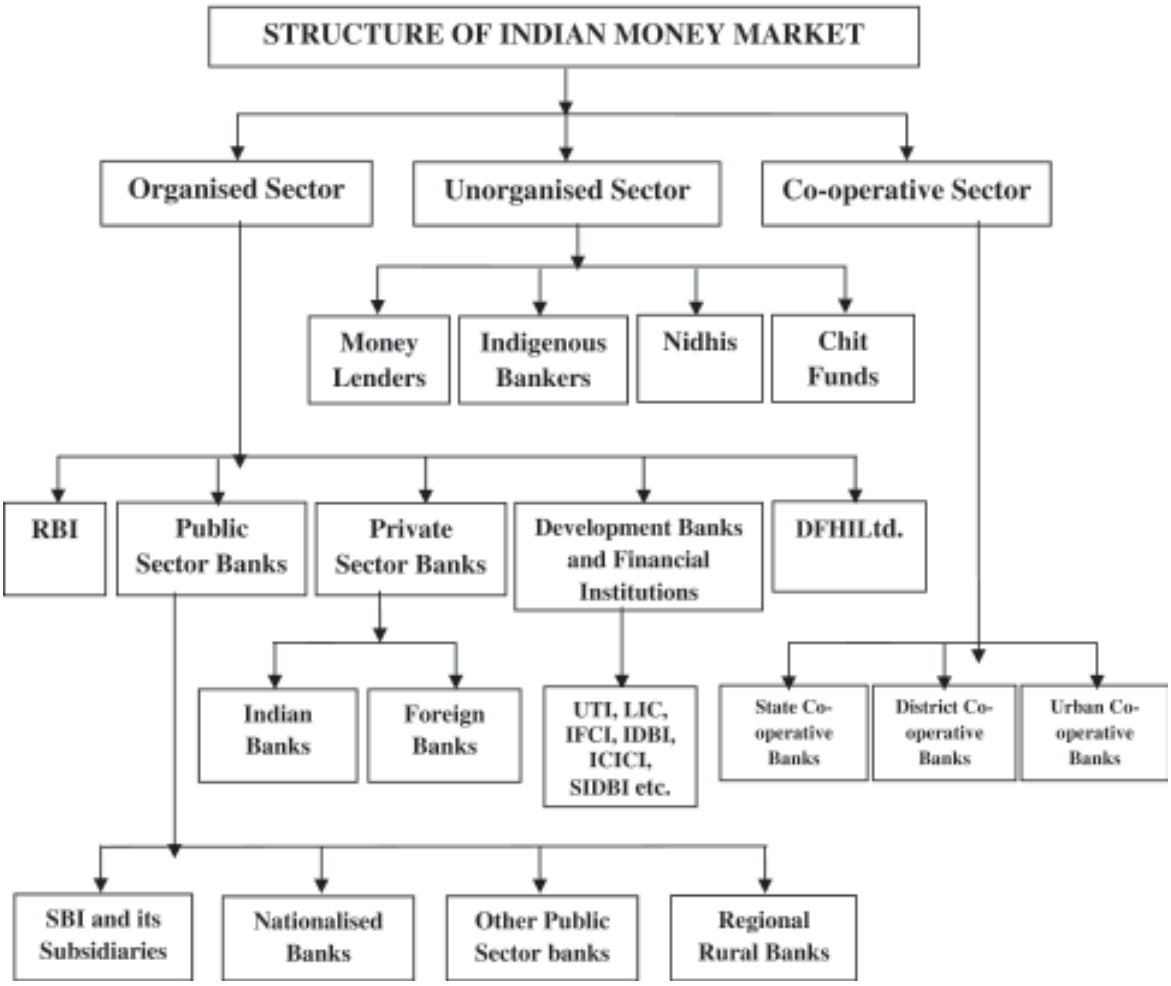
enous bankers, money lenders etc. Organized market is that part which comes under the regulatory purview of RBI and SEBI. The nature of the money market transactions is such that they are large in amount and high in volume. Thus, the entire market is dominated by small number of large players. At the same time, the money market in India is yet underdeveloped. The key players in the organized money market include Governments (Central and State), Discount and Finance House of India (DFHI), Mutual Funds, Corporate, Commercial/ Cooperative Banks, Public Sector Undertakings (PSUs), Insurance Companies and Financial Institutions and Non-Banking Financial Companies (NBFCs).

The RBI controls the entire operation of the organized sector of the Indian money market. Over the years both commercial banks and co-operative banks have come to depend more and more on the rediscounting and borrowing facilities provided by RBI, especially during the busy season. Moreover, the RBI supervises their lending policies from time to time.

A large portion of India's money market remains unorganized even today. They also do not always specify the purposes of finance, that is, whether finance is required for genuine productive purposes or for indulging in speculative activities. The unorganized sector of India's money market consists of a wide range of non-banking financial institutions. Such institutions resemble banks very closely and compete with banks in attracting public deposits. But they are not under the control of the RBI. So their presence reduces the effectiveness of the RBIs control over the money market.

2.11 STRUCTURE OF INDIAN MONEY MARKET

In the Indian money market RBI occupies a key role. It is the nerve centre of the monetary system of our country. It is the leader of the Indian money market. The Indian money market is highly disintegrated and unorganized. The Indian money market can be divided into two sectors-unorganized and organised. In between these two, there exists the co-operative sector. It can be included in the organised sector.



The organised sector comprises of RBI, SBI group of banks, public sector banks, private sector banks, development banks and other financial institutions. The unorganised sector comprises of indigenous bankers, money lenders, chit funds etc. These are outside the control of RBI. This is the reason why Indian money market remains underdeveloped.

2.12 PARTICIPANTS OF INDIAN MONEY MARKET

The following are the players in the Indian money market:

- Governments
- RBI, the central bank
- Commercial banks
- Co-operative banks

- Financial institutions like IFCI, IDBI, ICICI, SIDBI, UTI, LIC etc.
- Discount and Finance House of India
- Brokers
- Mutual funds
- Public sector undertakings
- Corporate units etc.

2.13 MONEY MARKET INSTRUMENTS

Money market is involved in buying and selling of short term instruments. It is through these instruments, the players or participants borrow and lend money in the money market. There are various instruments available in the money market. The important money market instruments are:

- Call and short notice money
- Commercial bills
- Treasury bills
- Certificate of deposits
- Commercial papers
- Repurchase agreements
- Money market mutual funds
- Depository Receipts (ADR/GDR/IDR)

These instruments are issued for short period. These are interest bearing securities. These instruments may be discussed in detail in the following:

2.13.1. Call and Short Notice Money

These are short term loans. Their maturity varies from one day to fourteen days. If money is borrowed or lent for a day, it is called call money or overnight money. When money is borrowed or lent for more than a day and up to fourteen days, it is called short notice money. Surplus funds of the commercial banks and other institutions are usually given as call money. Banks are the

borrowers as well as the lenders for the call money. Banks borrow call funds for a short period to meet the cash reserve ratio (CRR) requirements. Banks repay the call fund back once the requirements have been met. The interest rate paid on call loans is known as the call rate. It is a highly volatile rate. It varies from day to day, hour to hour, and sometimes even minute to minute.

Features of Call and Short Notice Money

- These are highly liquid
- The interest (call rate) is highly volatile
- These are repayable on demand
- Money is borrowed or lent for a very short period
- There is no collateral security demanded against these loans. This means they are unsecured
- The risk involved is high

2.13.2 Commercial Bills

When goods are sold on credit, the seller draws a bill of exchange on the buyer for the amount due. The buyer accepts it immediately. This means he agrees to pay the amount mentioned therein after a certain specified date. After accepting the bill, the buyer returns it to the seller. This bill is called trade bill. The seller may either retain the bill till maturity or due date or get it discounted from some banker and get immediate cash. When trade bills are accepted by commercial banks, they are called commercial bills. The bank discounts this bill by deducting a certain amount (discount) and balance is paid.

A bill of exchange contains a written order from the creditor (seller) to the debtor (buyer) to pay a certain sum, to a certain person after a certain period. According to Negotiable Instruments Act, 1881, a bill of exchange is 'an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument'.

Features of Commercial Bills

- These are negotiable instruments.
- These are generally issued for 30 days to 120 days. Thus these are short term credit instruments.
- These are self-liquidating instruments with low risk.
- These can be discounted with a bank. When a bill is discounted with a bank, the holder gets immediate cash. This means bank provides credit to the customers. The credit is repayable on maturity of the bill. In case of need for funds, the bank can rediscount the bill in the money market and get ready money.
- These are used for settling payments in the domestic as well as foreign trade.
- The creditor who draws the bill is called drawer and the debtor who accepts the bill is called drawee.

Types of Bills: Many types of bills are in circulation in a bill market. They may be broadly classified as follows:

- *Demand Bills and Time Bills*: Demand bill is payable on demand. It is payable immediately on presentation or at sight to the drawing. Demand bill is also known as *sight bill*. Time bill is payable at a specified future date. Time bill is also known as *usance bill*.
- *Clean Bills and Documentary Bills*: When bills have to be accompanied by documents of title to goods such as railway receipts, bill of lading etc. the bills are called documentary bills. When bills are drawn without accompanying any document, they are called clean bills. In such a case, documents will be directly sent to the drawee.
- *Inland and Foreign Bills*: Inland bills are bills drawn upon a person resident in India and are payable in India. Foreign bills are bills drawn outside India and they may be payable either in India or outside India.
- *Accommodation Bills and Supply Bills*: In case of accommodation bills, two parties draw bills on each other purely for the purpose of mutual

financial accommodation. These bills are then discounted with the bankers and the proceeds are shared among themselves. On the due dates, the parties make payment to the bank. Accommodation bills are also known as 'wind bills' or 'kite bills'. Supply bills are those drawn by suppliers or contactors on the Govt. departments for the goods supplied to them. These bills are not considered as negotiable instruments.

2.13.3 Treasury Bills

Treasury bills are short term instruments issued by RBI on behalf of the government. These are short term credit instruments for a period ranging from 91 to 364. These are negotiable instruments. Hence, these are freely transferable. These are issued at a discount. These are repaid at par on maturity. These are considered as safe investment. Thus treasury bills are credit instruments used by the Govt. to raise short term funds to meet the budgetary deficit. Treasury bills are popularly called T-bills. The difference between the amount paid by the tenderer at the time of purchase (which is less than the face value), and the amount received on maturity represents the interest amount on T-bills and is known as the discount.

Features of Treasury Bills

- They are negotiable securities
- They are highly liquid
- There is no default risk (risk free). This is because they are issued by the government
- They have an assured yield
- The cost of issue is very low. It does not involve stamp fee
- These are available for a minimum amount of ₹ 25000 and in multiples thereof

Types of Treasury Bills

There are two categories of T-Bills. They are:

1. Ordinary or Regular T-Bills: These are issued to the public, banks and other institutions to raise money for meeting the short term financial needs of the government. These are freely marketable. These can be bought and sold at any time.

2. Ad hoc T-Bills: These are issued in favour of the RBI only. They are not sold through tender or auction. They are purchased by the RBI on tap. The RBI is authorised to issue currency notes against there. On the basis of periodicity T-bills may be classified into four. They are as follows:

- *14-Day T-Bills*: To meet the cash management needs of various segments of the economy and to facilitate the emergence of a more comprehensive yield curve, a scheme for the sale of a new category of 14-day Treasury Bills on an auction basis was announced on May 20, 1997 and the first auction was held on June 6, 1997. The salient features of the 14-days Treasury Bills Scheme are: (a) it would be sold on a non-transferable basis for a minimum amount of Rs. 1,00,000 or in multiples thereof and would be issued only in book form; (b) the bills would be repaid/renewed at par on the expiry of 14 days from the date of issues; (c) the discount rate would be set at quarterly intervals such that effective yields of this instrument would be equivalent to the interest rate on WMA chargeable to Central government; (d) the bills would be rediscounted at 50 basis points higher than the discount rate. On discounting the bills would be extinguished.
- *91-Day T-Bills*: These have been the traditional instruments in the Indian money market. From January 1993, the government introduced the system of selling 91 days treasury bills through weekly auction. Here are two types of 91 days Treasury Bills, ordinary and adhoc. Ordinary Treasury Bills are issued for enabling the government to meet the temporary requirements for funds. Adhoc treasury bills are created in favour of RBI and are being phased out under an agreement with the RBI and the government of India because they get automatically monetised. From 1997-98 the system of Adhoc Treasury Bills was discontinued.

- *182-Day T-Bills*: These bills were introduced in November 1986 to provide short term investment opportunities to financial institutions and others. These were variable interest bills and were sold through fortnightly auctions. The yield of these long dated papers had become attractive for a highly liquid instrument. These bills are far superior to their loan assets and investments which cannot be easily liquidated in terms of need without incurring heavy losses.
- *364-Day T-Bills*: These bills were introduced at the end of April 1992. These have become an important instrument of government borrowing and also lending money market instrument in the sense that their yield is most reflective of market conditions. The basic objective of the government in floating treasury bills of varying maturities up to 364 days on an auction basis was to further develop the Treasury bill market (a) so as to meet the government needs directly from the market; and (b) to provide financial instruments to cater to the needs of different investors.

2.13.4 Certificate of Deposits (CDs)

With a view to give investor's greater flexibility in the development of their short term surplus funds, RBI permitted banks to issue Certificate of Deposits (CDs). CDs were introduced in June 1989. CDs are issued by the banks either directly to the investors or through the dealers. They represent bank deposit accounts which are transferable. CDs are documents of title to time deposits with the banks. They are interest bearing, maturity dated obligations of banks and are technically a part of bank deposits. CDs are in bearer form and can be headed in the secondary market. CDs are marketable or negotiable-short term instruments in bearer form and are known as Negotiable Certificates of Deposit.

CD is a certificate in the form of promissory note issued by banks against the short term deposits of companies and institutions, received by the bank. Simply stated, it is a time deposit of specific maturity and is easily transferable. It is a document of title to a time deposit. It is issued as a bearer instru-

ment and is negotiable in the market. It is payable on afixed date. It has a maturity period ranging from three to twelve months. It is issued at a discount rate varying from 13% to 18%. The discount rate is determined by the issuing bank and the market. All scheduled banks except Regional Rural Banks and scheduled co-operative banks are eligible to issue CDs to the extent of 7% of deposits. It can be issued to individuals, corporations, companies, trusts, funds and associations. CDs are issued by banks during period of tight liquidity, at relatively high interest rate. Banks rely on this source when the deposit growth is low but credit demand is high. They can be issued to individuals, companies, trusts, funds, associates, and others. The main difference between fixed deposit and CD is that CDs are easily transferable from one party to another, whereas FDs are non-transferable.

Features of CDs

- These are unsecured promissory notes issued by banks or financial institutions.
- These are short term deposits of specific maturity similar to fixed deposits.
- These are negotiable (freely transferable by endorsement and delivery).
- These are generally risk free.
- The rate of interest is higher than that on T-bill or time deposits.
- These are issued at discount.
- These are repayable on fixed date.
- These require stamp duty.

Guidelines for Issue of CDs

CDs are negotiable money market instruments. These are issued against deposits in banks or financial institutions for a specified time period. RBI has issued several guidelines regarding the issue of CDs. The following are the RBI guidelines:

- CDs can be issued by scheduled commercial banks (excluding RRBs and Local Area Banks) and select all-India financial institutions.
- Minimum of a CD should be Rs. 1 lakh i.e., the minimum deposit that could be accepted from a single subscriber should not be less than Rs. 1 lakh and in the multiples of Rs. 1 lakh thereafter.
- CDs can be issued to individuals, corporations, companies, trusts, funds, and associations. NRIs may also subscribe to CDs, but only on a repatriable basis.
- The maturity period of CDs issued by banks should not be less than 7 days and not more than one year. Financial institutions can issue CDs for a period not less than one year and not exceeding 3 years from the date of issue.
- CDs may be issued at a discount on face value. Bankers/FIs are also allowed to issue CDs on a floating rate basis provided that the rate is objective, transparent and market based.
- Banks have to maintain the appropriate CRR and SLR requirements, on the issue price of CDs.
- Physical CDs are freely transferable by endorsement and delivery. Dematted CDs can be transferred as per the procedure applicable to other demat securities. There is no lock in period for CDs.
- Bank/FIs cannot grant loans against CDs. They cannot buy back their own CDs before maturity.
- Bankers/FIs should issue CDs only in the dematerialised form. However, according to the depositories Act, 1996 investors have the option to seek a certificate in physical form.
- Since CDs are transferable, the physical certificate may be presented for payment by the last holder.

2.13.5 Commercial Papers (CPs)

Commercial paper was introduced into the market in 1989-90. It is a finance paper like Treasury bill. It is an unsecured, negotiable promissory note.

It has a fixed maturity period ranging from three to six months. It is generally issued by leading, nationally reputed credit worthy and highly rated corporations. It is quite safe and highly liquid. It is issued in bearer form and on discount. It is also known as *industrial paper* or *corporate paper.* CPs can be issued in multiples of Rs. 5 lakhs subject to the minimum issue size of Rs. 50 lakhs. Thus a CP is an unsecured short term promissory note issued by leading, creditworthy and highly rated corporates to meet their working capital requirements. In short, a CP is a short term unsecured promissory note issued by financially strong companies.

Advantages of Commercial Paper

- These are simple to issue.
- The issuers can issue CPs with maturities according to their cash flow.
- The image of the issuing company in the capital market will improve. This makes easy to raise long term capital
- The investors get higher returns
- These facilitate securitisation of loans. This will create a secondary market for CP.

Disadvantages of Commercial Papers

- It cannot be repaid before maturity.
- It can be issued only by large, financially strong firms.

2.13.6 Repurchase Agreements (REPO)

REPO is basically a contract entered into by two parties (parties include RBI, a bank or NBFC). In this contract, a holder of the government securities sells the securities to a lender and agrees to repurchase them at an agreed future date at an agreed price. At the end of the period the borrower repurchases the securities at the pre-determined price. The difference between the purchase price and the original price is the cost for the borrower. This cost of borrowing is called Repo Rate.

A transaction is called a Repo when viewed from the perspective of the seller of the securities and reverse when described from the point of view of the suppliers of funds. Thus whether a given agreement is termed Repo or

Reverse Repo depends largely on which party initiated the transaction. Thus Repo is a transaction in which a participant (borrower) acquires immediate funds by selling securities and simultaneously agrees to repurchase the same or similar securities after a specified period at a specified price. It is also called *ready forward contract*.

2.13.7 Money Market Mutual Funds (MMMFs)

Money Market Mutual Funds mobilise money from the general public. The money collected will be invested in money market instruments. The investors get a higher return. They are more liquid as compared to other investment alternatives. The MMMFs were originated in the US in 1972. In India the first MMMF was set up by Kothari Pioneer in 1997. But this did not succeed.

Advantages of MMMFs

- These enable small investors to participate in the money market
- The investors get higher return
- These are highly liquid
- These facilitate the development of money market

Disadvantage of MMMFs

- Heavy stamp duty
- Higher flotation cost
- Lack of investors' education

2.13.8 American Depository Receipt (ADR), Global Depository Receipt (GDR) and Indian Depository Receipt (IDR)

ADRs are instruments in the nature of depository receipt and certificate. These instruments are negotiable and represent publicly traded, local currency equity shares issued by non-American company. For example, an NRI can invest in Indian Company's shares without bothering dollar conversion and other exchange formalities. If the facilities extended globally, these instruments are called GDR. ADR are listed in American Stock Exchanges and GDR are listed in other than American Stock Exchanges, say Landon, Luxembourg, Tokyo etc.

Recently SEBI has issued guidelines for foreign companies who wish to raise capital in India by issuing Indian Depository Receipts (IDRs). Thus, IDRs will be transferable securities to be listed on Indian stock exchanges in the form of depository receipts. Such IDRs will be created by a Domestic Depositories in India against the underlying equity shares of the issuing company which is incorporated outside India. Each IDR will represent a certain number of shares of the foreign company. The shares will not be listed in India, but have to be listed in the home country. The IDRs will allow the Indian investors to tap the opportunities in stocks of foreign companies and that too without the risk of investing directly which may not be too friendly. Thus, now Indian investors will have easy access to international capital market.

2.14 CHARACTERISTICS OF INDIAN MONEY MARKET

1. Existence of Un-organised Segment: A major feature of Indian money market is the existence of dichotomy i.e. existence of two markets - organised money market and un-organised money market. Organised sector consists of RBI, commercial banks, and financial institutions etc. The un-organised sector consists of indigenous bankers, money lenders, chit funds, nidhis etc. The RBI does not have control over them and they do not follow the rules and regulations of the RBI. Besides, a higher rate of interest prevails in the un-organised market. It is difficult for RBI to integrate the organised and un-organised money markets. Several segments are loosely connected with each other. Thus there is dichotomy in Indian money market.

2. Seasonal Scarcity of Credit: Another important characteristic of Indian money market is the seasonal scarcity of loanable funds and the consequent high rates of interest during the busy season. But in the off-season, banks have surplus funds. So, they are eager to lend more and often reduce the rates of interest. This is why the RBI always attempts to lessen the seasonal fluctuations in the interest rates by pumping money into the money market during busy season and withdrawing funds during the slack season. This also explains why the RBI follows two types of credit policy; one for the busy season and another for the slack season.

3. Lack of Integration: Another feature of India's money market is that it has several segments. But the various parts or segments are not connected with one another. Each part of the money market- such as the SBI and its subsidiaries, the foreign exchange banks, the co-operative banks and indigenous banks carry on a particular type of banking business or provide a specific type of financial service. Each financial institution acts independently.

4. Absence of the Bill Market: The existence of an organized bill market is absolutely essential for linking various credit agreements with the RBI in an effective manner. No doubt there is a Treasury bill market in India. But the commercial bill market has not been fully developed. In 1970, the RBI has introduced a bill market scheme, known as the New Bill Market Scheme, under which the RBI rediscounts genuine trade bills.

5. Volatile Call Money Market: The inter-bank call money market is the market for short-term funds, known as 'money at call and short notice'. Two components of this market are the call market or overnight market and short notice market. The borrowing rate in this market is known as the call money rate. This rate is determined by the market forces, that is, by the forces of demand and supply. The demand or short-term funds originates from all types of banks -nationalized, private and foreign. Most bankers are either borrowers or lenders but most banks act as both. The major portion of funds in this market is supplied by non-banking financial institutions such as IDBI, LIC and GIC. These are also called term-lending institutions. Banks supply the balance amount of funds.

2.15 DEFECTS OF INDIAN MONEY MARKET

Indian money market is relatively underdeveloped when compared with advanced markets like New York and London Money Markets. The defects of the Indian money market are as follows:

1. **Existence of Un-organised Segment**: The most important defect of the Indian money market is the existence of un-organised segment. The un-organised segment comprises of indigenous bankers, money lenders etc. This un-organised sector does not follow the rules and

regulations of the RBI. Besides, a higher rate of interest prevails in the un-organised market.

2. **Lack of Integration:** Another important drawback of the Indian money market is that the money market is divided into different sections. Unfortunately, these sections are loosely connected to each other. There is no co-ordination between the organised and un-organised sectors. With the setting up of the RBI and the passing of the Banking Regulations Act, the conditions have improved.

3. **Disparities in Interest Rates**: Interest rates in different money markets and in different segments of money market still differ. Too many interest rates are prevailing in the market. For example, borrowing rates of government lending rate of commercial banks, the rates of co-operative banks and rates of financial institutions. This disparity in interest rates is due to lack of mobility of funds from one segment to another.

4. **Seasonal Diversity of Money Market**: The demand for money in Indian money market is of seasonal in nature. During the busy season from November to June, money is needed for financing the marketing of agricultural products, seasonal industries such as sugar, jaguar, etc. From July to October the demand for money is low. As a result, the money rates fluctuate from one period to another.

5. **Absence of Organized Bill Market:** A bill market refers to a mechanism where bills of exchange are purchased and discounted by banks in India. A bill market provides short term funds to businessmen. The bill market in India is not popular due to over dependence of cash transactions, high discounting rates, problem of dishonour of bills etc. The bill market in India is not well developed. There is a great paucity of sound commercial bills of exchange in our country. As a matter of habit, Indian traders resort to hundies rather than properly drawn bill of exchange.

6. **Shortage of Funds:** In Indian money market demand for funds exceeds the supply. There is shortage of funds in Indian money market an account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy etc. There is also vast amount of black money in the country which has caused shortage of funds. However, in recent years' development of banking has improved the mobilisation of funds to some extent.

7. **Inadequate Banking Facilities**: Though the commercial banks, have been opened on a large scale, yet banking facilities are inadequate in our country. The rural areas are not covered due to poverty. Their savings are very small and mobilisation of small savings is difficult. The involvement of banking system in different scams and the failure of RBI to prevent these abuses of banking system shows that Indian banking system is not yet a well organised sector.

8. **Inefficient and Corrupt Management**: One of the major problems of Indian money market is its inefficient and corrupt management. Inefficiency is due to faulty selection, lack of training, poor performance appraisal, faulty promotions etc. For the growth and success of money market, there is need for well trained and dedicated workforce in banks. However, in India some of the bank officials are inefficient and corrupt.

9. **Limited Instruments:** The supply of short term instruments like commercial bills, treasury bills etc. are very limited and inadequate.

10. **Limited Number of Participants**: The participants in the Indian money market are limited. Entry in the money market is tightly regulated.

11. **Restricted Secondary Market:** Secondary market for money market instruments is mainly restricted to rediscounting of commercial bills and treasury bills.

12. **No Contact with Foreign Money Markets**: Indian money market has little contract with money markets in other countries.

2.16 RECENT DEVELOPMENTS IN THE INDIANS MONEY MARKET

The recent developments in the Indian money market may be briefly explained as below:

- **Integration of un-organised sector with the organised sector:** RBI has taken many steps to bring the institutions in the un-organised sector within its control and regulation. These institutions are now slowly coming under the organised sector. They started availing of the rediscounting facilities from the RBI.
- **Widening of call money market: In** recent years, many steps have been taken to widen the call money market. The number of participants in the call money market is increasing. LIC, GIC, IDBI, UTI and specialised mutual funds have been permitted to enter into this market as lenders only. The DFHI and STCI have been permitted to operate both as lenders and borrowers.
- **Introduction of innovative instruments:** New financial instruments have been introduced in the money market. On the recommendation of the Chakkraborty Committee, the RBI introduced 192 days T-bills since 1986. A new instrument in the form of 364 days T-bills was introduced at the end of April 1992. Again, new instruments such as CDs, CPs, and interbank participation certificates have been introduced. Necessary guidelines also have been issued for the operation of these instruments.
- **Introduction of negotiable dealing system:** As negotiable dealing system has been introduced with a view to facilitating electronic bidding in auctions and secondary market transactions in Govt. securities and dissemination of information.
- **Offering of market rates of interest:** In order to popularise money market instruments, the ceiling on interest rate has been abolished. Call money rate, bill discounting rate, interbank rate etc. have been

freed. Thus, today Indian money market offers full scope for the play of market forces in determining the rates of interest.

- **Satellite system dealership:** The satellite system dealership was launched in 1996 to serve as a second tier to primary dealers in retailing of Govt. securities. RBI has decided to allow players such as provident funds, trusts to participate in government bond auctions, on a non-competitive basis.
- **Promotion of bill culture:** All attempts are being taken to discourage cash credit and overdraft system of financing and to popularise bill financing. Exemption from stamp duty is given on rediscounting of derivative usance promissory notes arising out of genuine trade bill transactions. This is done to promote bill culture in the country.
- **Introduction of money market mutual funds:** Recently certain private sector mutual funds and subsidiaries of commercial banks have been permitted to deal in money market instrument. This has been done with a view to expand the money market and also to develop secondary market for money market instruments.
- **Setting up of credit rating agencies:** Recently some credit rating agencies have been established. The important agencies are the Credit Rating Information Services of India Ltd (CRISIL), Investment Information and Credit Rating Agency of India (IICRA) and, Credit Analysis and Research Ltd. (CARE). These have been set up to provide credit information through financial analysis of leading companies and industrial sectors.
- **Adoption of suitable monetary policy:** In recent years the RBI is adopting a more realistic and appropriate monetary and credit policies. The main objective is to increase the availability of resources in the money market and make the money market more active.
- **Establishment of DFHI:** The DFHI was set up in 1988 to activate the money market and to promote a secondary market for all money market instruments.

- **Setting up of Securities Trading Corporation of India Ltd. (STCI):** The RBI has set p the STCI in May 1994. Its main objective is to provide a secondary market in Govt. securities. It has enlarged the T-bill market and the call market and provided an active secondary market for T-bills. Because of these recent developments, the Indian money market is developing.



CHECK YOUR PROGRESS

4. Write True or False:

a) LIC and UTI can act as both lenders and borrowers of call loans in India.

b) 91 days' treasury bills do not carry any fixed rate of discount.

c) Certificate of deposit can be issued only by commercial banks.

5. The Discount and Finance House of India was set up in the year _____. (Fill in the gaps)

6. The major player in the Indian money market is/are _____.

i) Co-operative banks ii) Indigenous banks

iii) Commercial banks iv) Reserve Bank of India

(Choose the correct answer)



2.17 LET US SUM UP

We have discuss the following points in this unit:-

- Money market is a market for short term funds. It deals with all transactions in short term securities. Maturity period of them are one year or less.
- Money market does not imply to any specific market place.
- Central bank is the leader, guide, controller and policy maker of the banking system of a country.

- The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialized financial institutions. The Reserve Bank of India is the controller of the money market in India.
- Money market consists of a number of sub-markets. All sub-markets collectively constitute the money market.
- The Indian money market can be divided into two sectors-unorganized and organised.



2.18 FURTHER READING

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services – By M. P. Tripathy



2.19 ANSWERS TO CHECK YOUR PROGRESS

1. (a) False, (b) True (c) True

2. (a) Call money market, (b) Supply bills, (c) Treasury bill, (d) STCI

3. (a) Money market (b) Usance bills (c) Call loan market (d) Commercial paper

4. (a) False (b) False (c) False

5. 1987

6. Commercial banks



2.20 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Call Money Market
   b) Call loan Market
   c) Non-performing Asset
   d) Instruments of Money Market
   e) Commercial Paper
2. What is Money Market? Discuss the role of money market in the Indian Financial System.
3. Give the structure of Indian money market and point out its deficiencies.
4. Discuss the role of RBI as a regulator of Indian Money Market.
5. Define money market. Explain the different sub-markets of money market.
6. Discuss the various components of money market and bring out their features.
7. What is meant by Instruments of Money Market? Discuss the role of money market in the Indian Financial System.
8. Explain the role of Indian money market in the Indian financial system. What are the essential characteristics of a develop money market?
9. What steps have been taken in recent years to make the Indian money market a developed one?

UNIT 3 : CAPITAL MARKET IN INDIA-I

UNIT STRUCTURE

3.1 Learning Objectives

3.2 Introduction

3.3 Meaning of Capital Market

3.4 Functions of Capital Market

3.5 Subsidiaries of capital market

3.6 Primary / New issue Market

3.7 Functions of New Issue Market

3.8 Methods of Floatation in Primary Market

3.9 Abuses in New Issues Market

3.10 Problems of New Issues Market

3.11 Initial Public Offering (IPOs)

3.12 On-Line IPOs

3.13 Investor Protection in Primary Market

3.14 Recent Trends in Primary Market

3.15 Book-Building Mechanism

3.16 SEBI Measures for Primary Market

3.17 Regulatory Measures of SEBI

3.18 Let Us Sum Up

3.19 Further Readings

3.20 Answers to Check Your Progress

3.21 Possible Questions

3.1 LEARNING OBJECTIVES

After reading this unit you will able to:

- state the meaning and functions of capital market
- describe the historical background of Indian capital market
- enumerate the functions of new issue market
- interpret the various types of sub-markets like debt market, equity market and derivatives market with their features and classification

- state the methods of floatation in primary market
- know about the SEBI measures for primary market
- understand the recent trends in primary market

3.2 INTRODUCTION

Transfer of resources from those with idle resources to others who have a productive need for them is perhaps most efficiently achieved through the capital market. Thus, capital market provides channels for reallocation of savings to investments and entrepreneurship and thereby decouples these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's abilities to invest and save respectively, which inevitably enhances savings and investment in the economy. This unit will include the meaning, definition, constituents, instruments, functions and role of capital marker especially primary market or new issue market in India.

3.3 MEANING OF CAPITAL MARKET

The capital market refers to the institutional arrangements which facilitate the lending and borrowing of long-term and medium-term funds. Capital market deals in medium-term and long-term loans. It is a market in which long-period securities (with a maturity of one year or more) are exchanged. Capital market is divided into two parts: a) The new securities market called New Issue Market which deals with the sale of new securities and shares and b) the secondary market or stock exchange which specialises in buying and selling of old securities, shares, stocks, bonds, debentures, etc. The new issue market attracts new capital investment, while the secondary market determines the ownership of existing securities, i.e. to which they are transferred.

In every economic system, some individuals or institutions are surplus units who are called savers, while others are deficit units, called spenders. Households are surplus units and corporate and government are deficit units. Through the platform of securities markets, the savings units place their surplus funds in financial claims or securities at the disposal of the spending community and in turn get benefits like interest, dividend, capital appreciation, bo-

nus etc. These investors and issuers of financial securities constitute two important elements of the securities markets. The third critical element of markets is the intermediaries who act as conduits between the investors and issuers. Regulatory bodies, which regulate the functioning of the securities markets, constitute another significant element of securities markets.

The process of mobilization of resources is carried out under the supervision and overview of the regulators. The regulators develop fair market practices and regulate the conduct of issuers of securities and the intermediaries. They are also in charge of protecting the interests of the investors. The regulator ensures a high service standard from the intermediaries and supply of quality securities and non-manipulated demand for them in the market. The most important elements of security markets are the investors. The history shows that retail investors are yet to play a substantial role in the market as long-term investors. An investor is the backbone of the capital market of any economy as he is the one lending his surplus resources for funding the setting up or expansion of companies, in return for financial gain.

3.4 FUNCTIONS OF CAPITAL MARKET

Capital market plays an important role in mobilising resources and diverting them in productive channels. It facilitates and promotes the process of economic growth in the country. The various functions and significances of capital market are discussed bellow:

1. **Link between Savers and Investors:** The capital market functions as a link between savers and investors. It plays an important role in mobilising the savings and diverting them in productive investment. In this way, capital market plays a vital role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the economy.
2. **Encouragement for Savings:** With the development of capital market, the banking and non-banking institutions provide facilities which encourage people to save more money. In the less developed countries, in the absence of capital market, there are very little savings and those who

save often invest their savings in unproductive and wasteful directions, in real estate (like land, gold and jewellery) and conspicuous consumption.

3. **Encouragement to Investment:** The capital market facilitates lending to the businessmen and the government, and thus encourages investment. It provides facilities through banks and non-bank financial institutions. Various financial assets, e.g. shares, securities, bonds, etc. Induce savers to lend to the government or invest in industries. With the development of financial institutions, capital becomes more mobile, interest rate falls and investment increases.
4. **Promotes Economic Growth:** The capital market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions of capital market, like non-bank financial intermediaries, allocate the resources rationally in accordance with the development needs for the country. The proper allocation of resources results in the expansion of trade and industry in both public and private sectors, thus promoting balanced economic growth in the country.
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 capital 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.

3.5 SUBDIVISIONS OF CAPITAL MARKET

3.5.1 DEBT MARKET:

Debt instruments represent contracts whereby one party lends money to another on pre-determined terms with regard to rate of interest to be paid by

the borrower to the lender, the periodicity of such interest payment, and the repayment of the principal amount borrowed. In the Indian securities markets, the term 'bond' is used for debt instruments issued by the Central and State governments and public sector organisations, and the term 'debentures' for instruments issued by private corporate sector. So, financial Instruments that have a fixed income claim and have a maturity of more than one year are traded in the debt market. The market for government securities is the most dominant part of the debt market in terms of outstanding securities, market capitalization, trading volume and number of participants.

The NSE started its trading operations in June 1994 by enabling the Wholesale Debt Market (WDM) segment of the Exchange. This segment provides a trading platform for a wide range of fixed income securities that includes central government securities, treasury bills (T-bills), state development loans (SDLs), bonds issued by public sector undertakings (PSUs), floating rate bonds (FRBs), zero coupon bonds (ZCBs), index bonds, commercial papers (CPs), certificates of deposit (CDs), corporate debentures, SLR and non-SLR bonds issued by financial institutions (FIs), bonds issued by foreign institutions and units of mutual funds (MFs).

To further encourage wider participation of all classes of investors, including the retail investors, the Retail Debt Market (RDM) segment was launched on January 16, 2003. This segment provides for a nationwide, anonymous, order driven, screen based trading system in government securities. In the first phase, all outstanding and newly issued central government securities were traded in the retail debt market segment. Other securities like state government securities, Treasury bills etc. were to be added in subsequent phases. In developed economies, bond markets tend to be bigger in size than the equity market.

In India however, corporate bond market is quite small compared to the size of the equity market. One of the main reasons for this is that a large part of corporate debt, being loan from financial intermediaries, is not securitized. The picture however is undergoing a sea change in the last few years. An increasingly larger number of companies are entering the capital market to

raise funds directly from the market through issue of convertible and non-convertible debentures. The deregulations on interest rates in the new liberalized environment are resulting in innovative instruments being used by companies to raise resources from the capital markets leading to the growth in the WDM.

Debt markets are pre-dominantly wholesale markets, with institutional investors being major participants. Banks, financial institutions, mutual funds, provident funds, insurance companies and corporates are the main investors in debt markets. Many of these participants are also issuers of debt instruments. Most debt issues are privately placed or auctioned to the participants. Secondary market dealings are mostly done on telephone, through negotiations. In some segments, such as the government securities market, market makers in the form of primary dealers have emerged, which enable a broader holding of treasury securities. Debt funds of the mutual fund industry, comprising of liquid funds, bond funds and gilt funds, represent a recent mode of intermediation of retail investments into the debt markets. The major market participants in the debt market are as follows:

- Central Government raises money through bond and T-bill issues to fund budgetary deficits and other short and long-term funding requirements.
- Reserve Bank of India, as investment banker to the government, raises funds for the government through dated securities and T-bill issues, and also participates in the market through open-market operations in the course of conduct of monetary policy. RBI also conducts daily repo and reverse repo to moderate money supply in the economy. RBI also regulates the bank rates and repo rates, and uses these rates as tools of its monetary policy. Changes in these benchmark rates directly impact debt markets and all participants in the market as other interest rates realign themselves with these changes.
- Primary Dealers (PDs), who are market intermediaries appointed by RBI, underwrite and make market in government securities by providing two-way quotes, and have access to the call and repo markets for funds. Their performance is assessed by RBI on the basis of their bidding commitments and the success ratio achieved at primary auctions.

- State governments, municipal and local bodies issue securities in the debt markets to fund their developmental projects as well as to finance their budgetary deficits.
- Public Sector Undertakings (PSUs) and their finance corporations are large issuers of debt securities. They raise funds to meet the long term and working capital needs. These corporations are also investors in bonds issued in the debt markets.
- Corporate issue short and long-term paper to meet their financial requirements. They are also investors in debt securities issued in the market.
- Development Financial Institutions (DFIs) regularly issue bonds for funding their financing requirements and working capital needs. They also invest in bonds issued by other entities in the debt markets. Most FIs hold government securities in their investment and trading portfolios.
- Banks are the largest investors in the debt markets, particularly the government securities market due to SLR requirements. They are also the main participants in the call money and overnight markets. Banks arrange CP issues of corporates and are active in the inter-bank term markets and repo markets for their short term funding requirements. Banks also issue CDs and bonds in the debt markets. They also issue bonds to raise funds for their Tier -II capital requirement.
- Mutual funds have emerged as important players in the debt market, owing to the growing number of debt funds that have mobilised significant amounts from the investors. Most mutual funds also have specialised debt funds such as gilt funds and liquid funds. Mutual funds are not permitted to borrow funds, except for meeting very short-term liquidity requirements.

3.5.2 EQUITY MARKET

This market is characterized by the exchange of equity instruments that offer ownership on the holder of the security. Equity implies ownership rights in the corporate entity that has issued the instruments to the public. The claim of the owners of these instruments is residual in nature and the securities have no maturity. Equity Market is the market in which shares are issued

and traded, either through exchanges or over the counter markets. Equity market is also known as Stock Market. Equity market has been divided into two parts: primary market and secondary market.The primary market is a market for new issues. It deals with raising of fresh capital in the form of equities. Secondary market deals with equities already issued.

Types of Equity Capital

Companies raise capital through equities, which can be classified into Ordinary Shares and Preference Shares.

a) Equity/Ordinary Shares : Equity shares are also known as Ordinary Shares. Every company has to issue equity shares. Equity capital is also known as Owned Capital or Risk Capital or Venture Capital. Indian Companies Act, 1956 defines equity shares as 'those shares which are not preference shares.' Ordinary shares have a face value in terms of price of each share. The price at which the equity shares are issued is the issued price. The rice at which equity shares are traded in stock market is their market value.

Features of Equity Shares

- Permanent Capital : Equity share capital represents the permanent capital of the company. They are irredeemable. There is no obligation on the part of the company to repay the capital during the life time of company.
- Fluctuating Dividend : Equity shares get fluctuating dividend as the rate of dividend depends upon the earnings of the company. There is no guarantee of minimum dividend.
- Limited Liability : Even though the equity holders share the ownership risk their liability is limited to the extent oftheir investment in the share capital of the company.
- Voting Rights : Equity shareholders enjoy normal voting rights. They can vote on all resolutions passed at the shareholder's meetings.
- Residual Share : Ordinary shareholder's claim on assets of the company is residual. Their claim would rank after the claims of creditors

and preference shareholders in the event of liquidation. If the liquidation value of assets is insufficient, their claims may remain unpaid.

- *Right to Control*: As owners of the company equity holders have the right to control the operations of the company. However, their control is indirect as major policies and decisions are approved by Board of directors. In actual practice their control is weak and ineffective.
- *Pre-Emotive Rights*: Ordinary shareholders have a legal right to be offered by the company, the first opportunity to purchase additional issues of equity capital in proportion to their current holdings.
- *Increases Shareholders Wealth*: Equity shares increases shareholders' wealth. This is due to regular dividend and issue of bonus shares. When share market is at boom, the share prices also increase considerably.

b) Preference Shares: Preference share capital is a type of long-term capital. It combines the features of equity shares and debentures. It is an ownership security like an ordinary share, but it carries fixed rate of dividend like debentures. The holders of preference shares are entitled to income after the claims of creditors of the company have been met, but before ordinary shareholders receive any income.

Features of Preference Shares

- *Fixed Dividend*: Preference shares are also called a fixed income security. Preference share dividends are fixed and expressed as a percentage of par values.
- *Voting Rights*: Ordinarily a preference share holder does not carry voting rights.
- *Convertibility*: Sometimes preference shares may be convertible partly or fully into equity shares or debentures at a certain ratio during a specified period.
- *Redeemability*: Preference share has a limited life after which it just be retired.
- *Cumulative Dividends*: Preference share is cumulative. All unpaid dividends are carried forward and payable before any ordinary dividend is paid.

- *Prior Claim on Income and Assets*: Preference shares have a prior claim (preference) over equity share both on the income and assets of the company.

Types of Preference Shares

- *Cumulative and Non-cumulative*: Cumulative preference shares are those in which if dividend is skipped (not given) in any period, it has to be paid subsequently. This is not required in case of non-cumulative preference shares.
- *Redeemable and Non-redeemable*: A redeemable preference share matures in a fixed period of time. For non-redeemable preference shares there is no fixed time limit.
- *Participating and Non-participating*: If the company makes good profits, the participating preference shareholders can earn a higher dividend than the fixed one. This is not in case of non-participating preference shareholders.
- *Convertible and Non-convertible*: Convertible preference shares can be converted into equity shares on terms and conditions fixed at the time of such issue. Non-convertible preference shares are not converted into equity shares.

The importance of preference shares has declined in recent years. The market for them is narrow and less active. Now-a-days they are mostly held by institutional investors.

3.5.3 DERIVATIVES MARKET

The term derivatives refer to a broad class of financial instruments which mainly include options and futures. These instruments derive their value from the price and other related variables of the underlying asset. They do not have worth of their own and derive their value from the claim they give to their owners to own some other financial assets or security. A simple example of derivative is butter, which is derivative of milk. The price of butter depends upon price of milk, which in turn depends upon the demand and supply of milk. The general definition of derivatives means to derive something from some-

thing else. According to Securities Contract Regulation Act (SCRA) 1956, derivatives may be defined as:

a) A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security;

b) A contract which derives its value from the prices, or index of prices, of underlying securities

Classifications of Derivatives

a) Forward Contract: A forward contract is an agreement between two parties to buy or sell an asset at a specified point of time in the future. In case of a forward contract the price which paid/received by the parties is decided at the time of entering into contract. It is the simplest form of derivative contract mostly entered by individuals in day today's life. Forward contract is a cash market transaction in which delivery of the instrument is deferred until the contract has been made. Although the delivery is made in the future, the price is determined on the initial trade date. One of the parties to a forward contract assumes a long position (buyer) and agrees to buy the underlying asset at a certain future date for a certain price. The other party to the contract known as seller assumes a short position and agrees to sell the asset on the same date for the same price. The specified price is referred to as the delivery price. The contract terms like delivery price and quantity are mutually agreed upon by the parties to the contract. No margins are generally payable by any of the parties to the other. Forwards contracts are traded over-the-counter and are not dealt with on an exchange unlike futures contract. Lack of liquidity and counter party default risks are the main drawbacks of a forward contract.

b) Futures Contract: Futures is a standardized forward contact to buy (long) or sell (short) the underlying asset at a specified price at a specified future date through a specified exchange. Futures contracts are traded on exchanges that work as a buyer or seller for the counterparty. Exchange sets the standardized terms in term of quality, quantity, price quotation, date and delivery place (in case of commodity). The features of a futures contract may be specified as follows:

- These are traded on an organised exchange like IMM, LIFFE, NSE, BSE, CBOT etc.
- These involve standardized contract terms viz. the underlying asset, the time of maturity and the manner of maturity etc.
- These are associated with a clearing house to ensure smooth functioning of the market.
- There are margin requirements and daily settlement to act as further safeguard.
- These provide for supervision and monitoring of contract by a regulatory authority.
- Almost ninety percent future contracts are settled via cash settlement instead of actual delivery of underlying asset.

c) Options Contract: In case of futures contact, both parties are under obligation to perform their respective obligations out of a contract. But an options contract, as the name suggests, is in some sense, an optional contract. An option is the right, but not the obligation, to buy or sell something at a stated date at a stated price. A 'call option' gives one the right to buy; a 'put option' gives one the right to sell. Options are the standardized financial contract that allows the buyer (holder) of the option, i.e. the right at the cost of option premium, not the obligation, to buy (call options) or sell (put options) a specified asset at a set price on or before a specified date through exchanges. Options contracts are of two types: call options and put options. Apart from this, options can also be classified as OTC (Over the Counter) options and exchange traded options. In case of exchange traded options contract, contracts are standardized and traded on recognized exchanges, whereas OTC options are customized contracts traded privately between the parties. A call options gives the holder (buyer/one who is long call), the right to buy specified quantity of the underlying asset at the strike price on or before expiration date. The seller (one who is short call) however, has the obligation to sell the underlying asset if the buyer of the call option decides to exercise his option to buy.

d) Swaps Contract: A swap can be defined as a barter or exchange. It is a contract whereby parties agree to exchange obligations that each of them have

under their respective underlying contracts or we can say, a swap is an agreement between two or more parties to exchange stream of cash flows over a period of time in the future. The parties that agree to the swap are known as counter parties. The two commonly used swaps are: i) Interest rate swaps which entail swapping only the interest related cash flows between the parties in the same currency, and ii) Currency swaps: These entail swapping both principal and interest between the parties, with the cash flows in one direction being in a different currency than the cash flows in the opposite direction.

Derivatives contracts are being bought and sold by a large number of individuals, business organizations, governments and others for a variety of purposes. On the basis of the purpose the traders in the derivatives market can be categorized as follows:

i) *Hedgers*: The prime aim of the introduction of futures markets is to allow for companies and individuals to protect themselves against future unfavourable changes in prices (for financial futures in particular changes in interest and exchange rates). As a result, the futures market serves as the way of reducing or even eliminating risk. This is achieved through hedging. An example of a case that requires hedging could be when someone is obliged to hold a large inventory of a commodity that cannot be sold until a later date. A futures contract would be used to hedge against any future price fluctuations (fix the price) by having the hedger going short the commodity futures (short hedging). If the price of the asset goes down the investor does not perform well on the sale of the asset, but makes a gain on the short futures position. If the price of the asset goes up, the investor gains from the sale of the asset, but makes a loss on the futures position. It is quite possible that the prices will fluctuate in such a way that the investor would have been better off if he/she had not undertaken the hedging strategy. However, the purpose of hedging is no other than to reduce the risk being faced or will be faced by making the outcome more certain. It does not necessarily improve the outcome.

ii) *Speculators*: The risk reduced by hedging is transferred to the counterparty to the trade, who may be another hedger with opposite re-

quirements or a speculator. Speculators expose themselves to risk by buying or selling in futures market in order to profit from the future price fluctuations (buy an asset when the price is low and sell it when it is high) and thus, provide liquidity to the market. They are classified according to their methods. Speculators seek to trade profitably based on price movements in the next few minutes. (they try to profit by a few ticks per trade on a large number of transactions). Day traders close out their futures positions on the same day that the positions were initiated, so as. to avoid large price movements when the market is closed. Position traders, keep a futures position for long periods of time (weeks or even months) so that price moves in a favourable way to their position.

iii) *Arbitrageurs*: Arbitrageurs are investors who exploit price discrepancies between markets by entering into transactions in two or more markets. When the opportunity emerges, an arbitrageur tries to take advantage of it by buying in one market at a particular 'price and simultaneously selling in the other market at a higher price. However, these price discrepancies can only be temporary since they can easily be eliminated by the arbitrage process itself. This is done, because the purchase in one market will drive prices up for that market, while the sale in the other will drive prices down. Consequently, arbitrage is very important for keeping futures and underlying spot prices in line.

3.6 PRIMARY MARKET / NEW ISSUE MARKET

The primary market is a market where new securities are issued to the public regularly. It is a market full of varied financial products and services, customized to the need of every individual from all income groups. These financial products are bought and sold on the capital market, which is divided into primary market and secondary market. Basically the primary market is the place where the shares are issued for the first time. So when a company is getting listed for the first time at the stock exchange and issuing shares -this process is undertaken at the primary market. The primary market is also known as the New Issue Market (NIM). Here, the transaction is conducted between

the issuer and the buyer. In short, the primary market creates new securities and offers them to the public. For instance, Initial Public Offering (IPO) is an offering of the primary market where a private company decides to sell stocks to the public for the first time. An important point to remember here is that in the primary market, securities are directly purchased from the issuer. Since the companies issue securities directly to the investors, it is responsible to issue the security certificates too.

The primary market acts as a doorway for corporate enterprises to enter the capital market. It provides opportunity to issuers of securities, Government as well as corporate, to raise resources to meet their requirements of investments and/or discharge some obligation. Primary market also known as New Issue Market deals with new securities which were not previously available and offered to the investing public for the first time. They may issue the securities at face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt etc. They may issue the securities in domestic market and/or international market. The primary market enjoys neither any tangible form nor any administrative organizational set-up and is not subject to any centralized control and administration for the execution of its business. It is recognized by the services that it renders to the lenders and borrowers of capital. The main function of primary market is to facilitate the 'transfer of resources'. The corporate that raise funds through primary market have to compulsorily list their securities in any of the recognized stock exchange for further trading. Listing on stock exchanges provides the qualifying companies with the broadest access to investors, the greatest market depth and liquidity, the highest visibility, the fairest pricing and investor benefits.

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. This is typically done through an investment bank or finance syndicate of securities dealers.

The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is an Initial Public Offering (IPO). Dealers earn a commission that is built into the price of the security offering, though it can be found in the prospectus. Primary markets create long term instruments through which corporate entities borrow from capital market. Here the buyers obtain new securities. In other words, companies issue securities directly to the investors. Companies obtain money and in turn issues certificates. Issue made of this type is known as primary issue. Once issued the securities typically trade on a secondary market such as a stock exchange, bond market or derivatives exchange.

The primary market consists of arrangements, which facilitate the procurement of long term funds by companies by making fresh issue of shares and debentures. We know that companies make fresh issue of shares and/or debentures at their formation stage and, if necessary, subsequently for the expansion of business. It is usually done through private placement to friends, relatives and financial institutions or by making public issue. In any case, the companies have to follow a well-established legal procedure and involve a number of intermediaries such as underwriters, brokers, etc. who form an integral part of the primary market. In India many Initial Public Offers (IPOs) made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and the private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on. The major players in the primary market are merchant bankers, mutual funds, financial institutions, and the individual investors.

3.7 FUNCTIONS OF NEW ISSUE MARKET

The main function of new issue market is to facilitate transfer of resources from savers to the users. The savers are individuals, commercial banks, insurance companies etc. The users are public limited companies and governments. The new issue market plays an important role of mobilizing funds from the savers and transfers them to borrowers for production purposes. It is not only a platform for raising finance to establish new enterprises but also for expansion/ diversification/modernization of existing units.

The main functions of a new issue market can be divided into a triple service functions:

- **Origination:** Origination refers to the work of investigation, analysis and processing of new project proposals. Origination starts before an issue is 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. Initially this service was provided by specialized division of commercial banks. At present, financial institutions and private firms also perform this service.
- **Underwriting:** Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed, then there is no liability for the underwriter. If a part of shares issues remains unsold, the underwriter will buy the shares. Thus, underwriting is a guarantee for the marketability of shares.
- **Distribution:** Distribution is the function of sale of securities to ultimate investors. This service is performing by brokers and agents who maintain a regular and direct contact with the ultimate investors.

3.8 METHODS OF FLOATATION IN PRIMARY MARKET

There are various methods of floating new issues in the primary market:

3.8.1 Offer through Prospectus

Offer through prospectus is the most popular method of raising funds by public companies in the primary market. After a prospectus is issued, the public subscribes to shares, debentures, etc. This involves inviting subscription from the public through the issue of the prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines. As per the response, shares are prearranged to the public. If the subscriptions are very high, the allocation will be done on lottery or pro-rata basis.

It provides such information as the reason for which the fund is being raised, the company's background and upcoming projection, it's a precedent financial performance, etc.

3.8.2 Offer for Sale

Institutional investors like business enterprise funds, private equity funds, etc., invest in an unlisted company when it is very small or at an early stage. Under this method, securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers.

Consequently, when the company becomes big, these investors sell their shares to the public, through the issue of the offer document and the company's shares are listed in the stock exchange. This is called an offer for sale. The advantage of this technique is that the company need not be bothered about the printing and advertisement of the prospectus, allocation of shares, etc.

3.8.3 Private Placement

A private placement is the allotment of securities by a company to institutional investors and some selected individuals. Public offers are an exclusive concern. The subsidiary cost of IPO's lean to be very high. This is why some companies favor not to go down this route. It helps to raise capital more quickly than a public issue. They offer investment opportunities to a select few individuals. The private placement is the contradictory of a public issue, in which securities are made accessible for sale on the open market.

So the company will sell its shares to economic institutes, banks, insurance companies, and some select individuals. This will help them raise the funds competently, rapidly and efficiently. Such companies do not sell or offer their securities to the public at large. Financial institutions, mutual funds, investment bank, etc. subscribe to placement orders.

3.8.4 Rights Issue

Usually, when a company is looking to expand or are in need of supplementary funds, they first turn to their present investors. This is a privilege given to existing shareholders to subscribe to a new issue of shares according to the terms and conditions of the company. So the present shareholders are given a pros-

pect to further invest in the company. They are given the “right” to buy new shares before the public is offered the chance.

Such shares are marketable in the market by the owners. Successful companies assume this technique for fundraising. The rights issue is advantageous to the company as the cost of issue is minimum.

3.8.5 e-IPOs

It stands for Electronic Initial Public Offer. A company proposing to issue capital to the public through the online system of the stock exchange has to enter into an agreement with the stock exchange. When a company wants to offer its shares to the public it can now also do so online. This is called an Initial Public Offer (IPO). An agreement is signed between the company and the related stock exchange known as the e-IPO. Issuing company also require to assign registrar to have electronic connectivity with the exchange.

3.9 ABUSES IN NEW ISSUES MARKET

The term ‘market abuse’ is used to refer to a certain circumstance in which an unlawful behaviour is seen in the business industry such as insider dealing or market manipulation in which mostly the financial investors of the markets are unreasonably disadvantaged. Market abuse includes insider dealing, market manipulation or attempted market manipulation and unlawful disclosure. Insider dealing and unlawful disclosure both involve misuse of insider information, whilst market manipulation involves dishonestly or artificially manipulating the market, for instance, by making misleading statements about the value of a security. Market abuse is any behaviour should be prohibited.

The market abuse is used to refer to those kinds of circumstances in which the laws are violated hence causing losses to the financial market investors. Here the market abuse may be caused by someone who may have used the data that was not initially available to the public. There can also be a situation in which the price setting mechanism may have been distorted of the financial instruments; these cases are referred to as the market abuse. There can be one more case in which some false or misleading information or data may have been disseminated in the market. All of these lead to market abuse.

Market abuse is a civil offence, and the penalties can include an injunction, an unlimited fine, and/or being banned from carrying out any regulated activities in the future. Two types of market abuse, insider dealing and market manipulation, also carry criminal penalties such as an unlimited fine and a prison sentence of up to seven years. The Reserve Bank of India (RBI) in March, 2019 came out with guidelines to prevent misuse of price-sensitive information by participants in markets for financial instruments. No market participant would carry out a transaction or initiate any action with the sole or dominant intention of influencing a benchmark rate or a reference rate. Market participants indulging in any such activity are liable to be denied access to markets in one or more instruments for a period that may not exceed one month at a time.

3.10 PROBLEMS OF NEW ISSUES MARKET

- **Drawback for The New Company:** In primary markets, the funds can be raised in huge quantity by the companies. If the track record of a company is sound and the company has a good reputation in the market, it can further raise the funds by way of follow on public offer or rights issue. But a company which is totally new, which is newly registered and not much popular, finds it difficult to raise the funds. In this case, company formed recently, may have good prospects, but still investors prefer the established company. This fact underlines the reality that even though primary market is for new issues of capital, still the new companies have lot of problems while raising the funds from the market.
- **Timing of New Issues:** Due to the advantages of primary market, the companies are interested to raise the capital through primary market. But if number of companies queue up for raising the capital at a time, then the market gets crowded. When the secondary market performs well, primary market gets flooded with new issues by the companies. It also has been experienced in the last decade that sometimes, in one week there are 8 to 10 new issues in the market at a time. This is

hazardous to the companies as well as the investors. Since a number of companies come up with the issue at a time, the investors get divided and the company may not get entire subscription. From investor's point of view also it is difficult for them to opt for a particular company. If at a time there are a number of issues ongoing, research, analysis and risk assessment becomes difficult. Investors may get confused.

- **Price Rigging:** This drawback is normally observed when companies come up with capital issue in the primary market. The prices of shares are artificially pulled up before issue of securities by companies. This artificial increase in price is done by some buyers and sellers among themselves or among group which engages itself in such type of activities. This push-up results into bull movement in the market.
- **Lack of Professionalism:** With the quantitative increase in the number of stock exchanges, number of brokers, it was expected that some kind of professionalism would automatically get built into the system. Especially, highly competent and professional brokers were expected to emerge during this phase. But, many brokers lacked professional standards.
- **Speculative Influence:** Though the capital markets world over faced the evil of speculative motives in India speculative influence started along with other developments taking place. With increasing number of companies listed and increase in capital formation, some speculative motives started hitting the market.
- **Cost of Public Issues:** This problem continued to have impact on development of capital market in general and primary market in particular. Brokerage, underwriting commission, prospectus printing and distribution were some of the elements of cost involved during the public issue. Similarly, there was a time gap between announcement of the issue and actual generation of capital.
- **Isolated Stock Exchanges:** The stock exchanges in India have a presence only at particular locations. At the respective locations, normally trade takes place which is also characterized by regional features. But

it must also be noted that stock brokers of one stock exchange were not allowed to operate on their own in any other stock exchanges.

- **Unethical Mergers of Companies:** The primary market is advantageous to the economy as it provides capital to the enterprises. But there are some unethical practices being developed in the primary market also. For example, a large unlisted company gets merged with small listed company through public offer. Here large company which is not listed, purchases shares of a small listed company in a big way and such mergers are dangerous as the identity of the company may get changed.
- **Underdeveloped Debt Markets:** The shares issued in the primary market are later on traded in the secondary markets i.e. stock exchanges. But a part of primary market also involves debenture financing. The debentures are issued in the primary market. But in stock exchanges there is no room for trading in debentures. The secondary market in industrial debentures remained underdeveloped over the years. Even though equity market has developed rapidly throughout the last two decades, the debentures market has remained underdeveloped. This results into less enthusiasm of long term investors in the market.
- **Other Problems:** There are other problems prevailing in the Indian markets like inflating project costs and fixing unreasonable premium in the primary market, preferential and reserved allotment of substantial part of capital, benami traders, rackets and tampering with public issue application forms, badla finance etc. Some of these problems have been sorted out, but in general, this results into loss of confidence among small and retail investors. If the secondary markets are healthy, primary markets are attractive. Hence, primary markets, most of the times do not go along the fundamentals of company, industry in particular and economy in general. Lack of protection to the small and genuine investors is also one of the drawbacks of the Indian markets.

3.11 INITIAL PUBLIC OFFERING (IPOs)

An initial public offering (IPO) refers to the process of offering shares of a private corporation to the public in a new stock issuance. Public share issuance allows a company to raise capital from public investors. The transition from a private to a public company can be an important time for private investors to fully realize gains from their investment as it typically includes share premiums for current private investors. Meanwhile, it also allows public investors to participate in the offering. A company planning an IPO will typically select an underwriter or underwriters. They will also choose an exchange in which the shares will be issued and subsequently traded publicly.

An IPO is a big step for a company. It provides the company with access to raising a lot of money. This gives the company a greater ability to grow and expand. The increased transparency and share listing credibility can also be a factor in helping it obtain better terms when seeking borrowed funds as well.

Prior to an IPO, a company is considered private. As a private company, the business has grown with a relatively small number of shareholders including early investors like the founders, family, and friends along with professional investors such as venture capitalists or angel investors.

When a company reaches a stage in its growth process where it believes it is mature enough for the rigors of SEC regulations along with the benefits and responsibilities to public shareholders, it will begin to advertise its interest in going public. Typically, this stage of growth will occur when a company has reached a private valuation of approximately $1 billion, also known as unicorn status. However, private companies at various valuations with strong fundamentals and proven profitability potential can also qualify for an IPO, depending on the market competition and their ability to meet listing requirements.

3.12 ON-LINE IPOs

Initial Public Offer is the process by which a company sells its shares to the public and thereby raises money for growth and expansion. It allows investors to buy the shares in primary market. Once the stock gets listed on

the exchange, shares can be bought through secondary market. This can be done online. Although investors can apply for IPOs online, they should remember that an IPO order cannot be placed directly through their broker. They need to place the order through their bank that provides them with ASBA facility. For online transaction investors should have Internet enabled accounts with a bank with transaction rights and have a Demat account with any Depository Participants (DPs). They need to be a resident Indian individual.

The other requirements for applying IPO online:

The investor can-

- be from any of the approved categories eligible to apply for IPO, as per SEBI Guidelines
- have a Demat account with any Depository Participants (DPs) along with a valid Permanent Account Number (PAN)
- maintain a Savings Bank or Current account with bank (excluding overdraft or loan account)
- have sufficient clear credit balance in his/her Savings Bank or Current account (without Overdraft Limit/ Loan) to block funds to the extent of application money. i.e. the application amount is blocked only against/ in the funded deposit account and that clear demarcated funds are available for '**Application Supported by Blocked Amount'** (ASBA) applications. The total bid amount for the IPO application will remain locked until the allotment is done. The investor cannot utilize the amount during the locked period.
- apply only at cut off price which is the higher of the bid price

3.13 INVESTOR PROTECTION IN PRIMARY MARKET

Investors are the pillar of the financial and securities market. They determine the level of activity in the market as their put the money in funds, stocks, etc. to help grow the market and thus, the economy. Hence, it is very important to protect the interests of the investors. Strong investor protection is essential for the healthy growth of financial markets. It encourages accurate security prices, efficient investments, and better access to external finance. Investor protection involves various measures established to protect the interests of

investors from malpractices. Securities and Exchange Board of India (SEBI) is responsible for regulations of the Mutual Funds and safeguard the interests of the investors. SEBI has given out various methods and measures to ensure the investor protection from time to time. It has published various directives, driven many investor awareness programmes, set up Investor Protection Fund (IPF) to compensate the investors.

a) Investor Protection Measures by SEBI

SEBI is a statutory regulatory body of capital market established on the 12th of April, 1992. It monitors and regulates the Indian capital and securities market while ensuring to protect the interests of the investors formulating regulations and guidelines to be adhered to. Investor protection measures by SEBI are in place to safeguard the investors from the malpractices in shares, the stock market, Mutual Fund, etc. Investor protection legislation is implemented under the Section 11(2) of the SEBI Act. The measures are as follows:

- Stock Exchange and other securities market business regulation.
- Registering and regulating the intermediaries of the business like brokers, transfer agents, bankers, trustees, registrars, portfolio managers, investment consultants, merchant bankers, etc.
- Recording and monitoring the work of custodians, depositors, participants, foreign investors, credit rating agencies, etc.
- Registering investment schemes like Mutual fund & venture capital funds, and regulating their functioning.
- Promotion and controlling of self-regulatory companies.
- Keeping a check on frauds and unfair trading methods related to the securities market.
- Observing and regulating major transactions and take-over of the companies.
- Carry out investor awareness and education programme.
- Train the intermediaries of the business.
- Inspecting and auditing the security exchanges (SEs) and intermediaries.
- Assessment of fees and other charges.

b) SEBI Guidelines for protecting interest of investors:

The main object of SEBI is not only to regulate stock markets but also to protect the interest of investors. For this purpose, SEBI has given following guidelines:

- SEBI has been encouraging investor-education. For this purpose, certain investors' associations have been registered.
- Companies raising public deposits as well as huge capital must undergo credit rating. Credit rating by an authorized authority gives a fair view about the financial strength of the organization. For this purpose, there are four credit rating agencies. They are:
  - CRISIL
  - ICRA
  - CARE and
  - Duff and Phelps Credit Rating India Pvt. Ltd.
- SEBI has taken the responsibility of disclosing fair and adequate information for investors for the purpose of investment decisions.
- For the benefit of the investors, company has to disclose its capacity utilization, adverse events and material changes of key personnel.
- Disclosure on market prices for listed company.
- Arrangement for disclosing investors grievances and redressal system.
- Compulsory disclosure in the prospectus.
- Contribution by promoters whose name figure in the prospectus.
- In case of over subscription of any company issue, SEBI representatives will be present there to look into the allotment process.
- Setting up of investors' grievances cell for handling complaints of investors.
- SEBI has right to cancel registration of any underwriter who fails to furnish business details to SEBI.
- SEBI has made it mandatory for Merchant bankers to attach diligence certificate with the prospectus for extending their accountability to the investors. The diligence certificate gives a detailed position of

the issue of shares. Only by such a certificate, the investor can file a case of incorrect statement in the prospectus on erring companies.

- There is an advertisement code by SEBI which has to be followed by companies or investors.
- To avoid any malpractice in allotment process, SEBI has appointed its representatives to look into allotment process which boosts the confidence of individual investors.
- Underwriters, registrar to issue and share transfer agent and portfolio managers have been brought under SEBI for the first time.
- Even the mutual funds have been brought under SEBI and they have to disclose NPV (Net present value) of units every day which benefits investors.
- For the benefit of the individual investors, a new scheme called stock invest account has been introduced in banks. From this stock invest account, the new issue of shares will be applied. In that, the investor will intimate the stock invest account to the company issuing the shares.
- In case of allotment, the company will inform the banker as per SEBI guidelines, and funds will be released from the stock invest account to the bank.

3.14 RECENT TRENDS IN PRIMARY MARKET

The new issues market in India has passed through both the phases of boom and depression. The new issue market in India is not fully developed as compared to other advanced countries like U.S.A., U.K. and Germany. But there has been tremendous growth in the sphere of new issue activity in India. Further the relaxation of norms relating to foreign investments and incentives provided by the government helped to sustain the impetus of growth in the market.

In the recent years, a number of new instruments such as PCDs, FCDs, PSBs and CCPs, etc. have been introduced in the securities market resulting into and upsurge in the new issue market. But the new economic policy of the Narasimha Rao government and the setting up of Se-

curities and Exchange Board of India to promote orderly and healthy growth of securities market providing investor protection has to be regarded as one of the most important developments on the securities market of India in recent years. As a result of these developments, the institutional investors and the mutual funds have gained importance, both in the primary as well as the secondary market. Another recent development that took place in the market is the setting up of the Over-the Counter Exchange of Indian (OTCEI) which began its operations in 1992 permitting smaller companies to raise capital.

During current decade there have been remarkable reforms in the India Economic scenario. Consequently, NIM has made enormous progress in recent years, moving away from fixed- price offering to price discovery through a screen-based auction for IPOs. This has reflected a quest to discover the price through an open fair, competitive auction, which is done in a fully transparent way, where all investors participate in an equal setting, and the investment bankers' or other influences do not vitiate the allocation of shares. The increase in fund mobilization from NIM in India has been exceptionally well. The recent development of New Issue Market are as follows:

3.15 BOOK-BUILDING MECHANISM

Companies all over the world use either fixed pricing or book building as a mechanism to price their shares. Over the period of time, the fixed price mechanism has become obsolete and book building has become the de-facto mechanism used in pricing shares while conducting an initial public offer (IPO).

Book building is a price discovery mechanism that is used in the stock markets while pricing securities for the first time. When shares are being offered for sale in an IPO, it can either be done at a fixed price. However, if the company is not sure about the exact price at which to market its shares, it can decide a price range instead of an exact figure. This process of discovering the price by providing the investors with a price range and then asking them to bid on it is called the book building process. It is considered to be one of the

most efficient mechanisms of pricing securities in the primary market. This is the preferred method which is recommended by all major stock exchanges and as a result is followed in all major developed countries in the world.

The detailed process of book building is as follows:

1. **Appointment of Investment Banker:** The first step starts with appointing the lead investment banker. The lead investment banker conducts due diligence. They propose the size of the capital issue that must be conducted by the company. Then they also propose a price band for the shares to be sold. If the management agrees with the propositions of the investment banker, the prospectus is issued with the price range as suggested by the investment banker. The lower end of the price range is known as the floor price whereas the higher end is known as the ceiling price. The final price at which securities are indeed offered for sale after the entire book building process is called the cut-off price.

2. **Collecting Bids:** Investors in the market are requested to bid to buy the shares. They are requested to bid the number of shares that they are willing to buy at varying price levels. These bids along with the application money are supposed to be submitted to the investment bankers. It must be noted that it is not a single investment banker who is engaged in the collection of bids. Rather, the lead investment banker can appoint sub-agents to tap into their network especially for receiving the bids from a larger group of individuals.

3. **Price Discovery:** Once all the bids have been aggregated by the lead investment banker, they begin the process of price discovery. The final price chosen in simply the weighted average of all the bids that have been received by the investment banker. This price is declared as the cut-off price. For any issue which has received substantial publicity and which is being anticipated by the public, the ceiling price is usually the cut-off price.

4. **Publicizing:** In the interest of transparency, stock exchanges all over the world require that companies make public the details of the bids that were received by them. It is the lead investment banker's duty to run advertisements containing the details of the bids received for the purchase of shares for a given period of time. The regulators in many markets are also entitled to physically verify the bid applications if they wish to.

5. **Settlement:** Lastly, the application amount received from the various bidders has to be adjusted and shares have to be allotted. For instance, if a bidder has bid a lower price than the cut-off price then a call letter has to be sent asking for the balance money to be paid. On the other hand, if a bidder has bid a higher price than the cut-off, a refund cheque needs to be processed for them. The settlement process ensures that only the cut-off amount is collected from the investors in lieu of the shares sold to them.

3.16 SEBI MEASURES FOR PRIMARY MARKET

The primary market in India, like that in other countries, is the market where investors and companies trade stocks, options and other public financial instruments. All issues on the primary market are subject to strict regulation. Companies must file statements with the Securities and Exchange Commission (SEC) and other securities agencies and must wait until their filings are approved before they can go public. SEBI has regulated the primary market through

- The regulation of issuers' access to market
- Regulation of information production at the time of issue
- Regulation of processes and procedures relating to issuance of securities

In 2000 the Securities and Exchange Board of India, or SEBI, issued a set of guidelines for the primary market that covers 17 consumer and investor protection areas, including how new companies become active on the primary market and how they issue and price securities.

- **Initial Public Offerings:** Indian companies that want to open their operations to public funding must work through a broker who is licensed with SEBI to offer and accept applications for funding through India's e-IPO system, which is an online system for bringing private companies to the primary market. The broker must work with a registrar from the company to negotiate all offers between the company and potential investors. In conjunction with the company's leadership, the broker must make all investment information available in Hindi as well as English, and must include a time frame for each offer and accepted modes of payment. The broker must keep all funds pertaining to the IPO in an escrow account and must report daily to the company's registrar. SEBI licenses brokers in order to keep unscrupulous people from taking advantage of unsuspecting companies and investors.

- **Issuing and Pricing Securities:** A company must file a draft prospectus with SEBI at least three weeks before filing its final documentation with the Registrar of Companies on the primary market. The draft prospectus contains contact information for the company, an analysis of market risks and how the company will respond to them, as well as information about the company's leadership. After the company is registered and approved, it can freely determine the price at which it wants to list its shares on the primary market. If a bank is involved in listing a company, the pricing of its shares must be approved by SEBI. The company must make public the face value of all publicly traded shares.

- **Issuing Debt Instruments:** Companies and banks that include debt instruments as part of an investment offering must disclose credit ratings to SEBI before entering into any agreements with investors. Debt instruments are statements in which the issuer raises capital by selling debt to an investor. The issuer pays back the investor with interest according to the terms of a contract. SEBI requires that all companies issuing debt instruments keep their investors informed by providing

cash flow and liquidity information. SEBI allows companies to choose to repay their debts by issuing stock or other financial instruments to those invested in the company's debt.

- **Banks Issuing Capital to a Company:** SEBI does not limit the amount of capital a financial institution can issue to a publicly traded company, though it does not permit institutions with a conflict of interest to issue capital to a company. Designated financial institutions, those that are approved by SEBI, reserve a percentage of the company in which they want to invest and are entitled to hold that percentage for three years. SEBI also allows institutional investors to evaluate their holdings in a company as they see fit, providing the institution has shown a profit over the past three years.

3.17 REGULATORY MEASURES OF SEBI

SEBI has introduced various guidelines as regulatory measures for capital issues. They are as below:

- **Disclosure of All Material Facts is made Compulsory**: SEBI has made it compulsory for companies do disclose all the facts and risk factors regarding the projects undertaken by the company. The basis on which the premium amount is calculated should also be disclosed by the company as per SEBI norms. SEBI also advises the code of ethics for advertising in media regarding the public issue.
- **Encouragement to Initial Public 0ffers**: In order to encourage Initial Public Offers (IPO) in the primary market, SEBI has permitted companies to determine the par value of shares issued by them. SEBI has allowed issues of IPOs to go for "Book Building" – i.e. reserve and allot shares to individual investors. But the issuer will have to disclose the price, the issue size and the number of securities to be offered to the public.
- **Increase of Popularity to Private Placement Market**: In recent years, private placement market has become popular with issuers because

of stringent entry and disclosure norms for public issues. Besides low cost of issuance, ease of structuring investments and saving of time lag in issuance are the other causes responsible for the rapid growth of private placement market.

- **Underwriting has made Optional**: To reduce the cost of issue in primary market, SEBI has made underwriting of issue optional. However, the condition that if an issue was not underwritten and was not able to collect 90% of the amount offered to the public, the entire amount collected would be refunded to the investor is still in force.

- **Issue of Due Diligence Certificate**: The lead managers have to issue due diligence certificate, which has now been made part of the offer document.

- **Conditions regarding Application Size etc.**: SEBI has raised the minimum application size and also the proportion of each issue allowed for firm allotment to institutions such as mutual funds.

- **Regulation of Merchant Banking**: SEBI has brought Merchant banking under its regulatory framework. The merchant bankers are now to be authorized by SEBI. Merchant bankers now have a greater degree of accountability in the offer document and issue process.

- **Imposition of Compulsory Deposit on Companies making Public Issues**: In order to induce companies to exercise greater care and diligence for timely action in matters relating to the public issues of capital, SEBI has advised stock exchanges to collect from companies making public issues, a deposit of one per cent of the issue amount which could be forfeited in case of non-compliance of the provisions of the listing agreement and, non-dispatch of refund orders and share certificates by registered post within the prescribed time.

- **Reforms as to Mutual Funds**: The Government has now permitted the setting up of private mutual funds and a few have already been set

up. UTI has now been brought under the regulatory jurisdiction of SEBI. All mutual funds are allowed to apply for firm allotments in public issues. To improve the scope of investments by mutual funds, the latter are permitted to underwrite public issues. Further, SEBI has relaxed the guidelines for investment in money market instruments. Finally, SEBI has issued fresh guidelines for advertising by mutual funds.

- **Vetting of Offer Document**: SEBI vets offer documents to make sure that the company listing the shares has made all disclosures in it. All the guidelines and regulatory measures of capital issues are meant to promote healthy and efficient functioning of the issue market (or the primary market).

  Despite all these steps, there are flagrant breaches of issue procedures through collusion between unscrupulous promoters and corrupt officials in the lead banks and even of the top officials of SEBI.



CHECK YOUR PROGRESS

1. Answer as directed:

a) RBI is the regulator of Indian capital market. (Write True or False)

b) ————— market is a market for new issues.

c) Gold is a financial asset. (Write True or False)



3.18 LET US SUMUP

We have discuss the following points in this unit:-

- The capital market refers to the institutional arrangements which facilitate the lending and borrowing of long-term and medium-term funds.
- Capital market is divided into two parts: a) The new securities market called New Issue Market which deals with the sale of new securities and shares and b) the secondary market or stock exchange which specialises in buying and selling of old securities, shares, stocks, bonds, debentures, etc.

- Capital market plays an important role in mobilising resources and diverting them in productive channels. It facilitates and promotes the process of economic growth in the country.
- There are sub-divisions of capital market namely debt market, equity market and derivative market.
- The primary market also known as the New Issue Market (NIM) is a market where new securities are issued to the public regularly.
- The main function of new issue market is to facilitate transfer of resources from savers to the users.
- Unlawful behaviour is seen in the business industry such as insider dealing or market manipulation is called market abuse.
- India is facing so many problems in new issue market.
- SEBI is the regulatory body of Indian capital market.



3.19 FURTHER READING

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services –By M. P. Tripathy
- Indian Financial System -By M Y Khan



3.20 ANSWERS TO CHECK YOUR PROGRESS

1. (a) False (b) Primary (c) False



3.21 POSSIBLE QUESTIONS

1. Write short notes on the following:

a) Functions of New Issue Market
a) Capital Market
b) Venture capital funds in India
c) Debt market
d) Equity market
e) Derivatives market
f) Hedgers
g) Speculators
d) Arbitrageurs

1. What do you mean by capital market? Explain the players of Indian Capital market.
2. Bring out the salient features of Indian capital market.
3. What is secondary market? Distinguish between primary and secondary market.
4. What do you mean by New Issue Market (NIM)? Discuss the functions of NIM.
5. Critically examine the recent trends in secondary market in India.

UNIT 4 : CAPITAL MARKET IN INDIA-II

UNIT STRUCTURE

4.1 Learning Objectives

4.2 Introduction

4.3 Meaning and Nature of Secondary Market

4.4 Functions of Secondary Market/Stock Exchange

4.5 Stock Exchange

4.6 Characteristics of a Stock Exchange

4.7 Advantages/Benefits of Stock Exchanges

4.8 Organisation and Working of Stock Exchange

4.9 Stock Exchanges in India

4.10 List of Indian Stock Exchanges

4.11 Major Weaknesses of Stock Exchange

4.12 Measures Suggested For Reform of Stock Exchange

4.13 Regulations of Stock Exchanges In India

4.14 Role of SEBI in Regulating Stock Exchanges

4.15 Internet Trading

4.16 Let Us Sum Up

4.17 Further Readings

4.18 Answers to Check Your Progress

4.19 Possible Questions

4.1 LEARNING OBJECTIVES

After going through this unit you will able to:

- state the meaning and characteristics of stock exchange
- describe the functions of stock exchange

- interpret advantages and disadvantages of stock exchange
- enumerate the evolution of stock exchanges in India
- discuss about its regulation with special relation to SEBI

4.2 INTRODUCTION

The existing companies accumulate their funds by selling of different types of securities such as shares, debentures and bonds. There should be common place where those securities can be bought and sold on a regular basis. This unit discusses about that common platform called secondary market or stock exchange. It discusses the meaning, nature, constituents and functions of secondary market.

4.3 MEANING AND NATURE OF SECONDARY MARKET

The secondary market is the stock market where existing stocks are bought and sold by the retail investors through the brokers. It is the secondary market that controls the price of the stocks. Generally when we speak about investing or trading at the stock market we mean trading at the secondary stock market. It is the secondary market where we can invest and trade in the stocks to get the profit from our stock market investment. In secondary market, the securities issued in the primary market are bought and sold. Here, you can buy a share directly from a seller and the stock exchange or broker acts as an intermediary between two parties. The secondary market is actually formed by another layer of investors who deal with primary market investor to buy and sell financial securities such as bonds and stocks. These dealings happen in the recognizable stock exchange.

The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds by providing the necessary liquidity to holdings in shares and debentures. It provides a place where these securities can be encashed without any difficulty and delay. It is an organised market where shares and debentures are traded regularly with high degree of transparency and security. In fact, an active secondary market facilitates the growth of primary market as the investors in the primary market are assured of a continuous market for liquidity of their holdings. The major play-

ers in the secondary market are the stockbrokers like merchant bankers, mutual funds, financial institutions, and the individual investors who are members of the stock exchange who facilitate the trading.

4.4 FUNCTIONS OF SECONDARY MARKET/STOCK EXCHANGE

The functions of secondary market or stock exchange can be enumerated as follows:

1. Provides Ready and Continuous Market: By providing a place where listed securities can be bought and sold regularly and conveniently, a stock exchange ensures a ready and continuous market for various shares, debentures, bonds and government securities. This lends a high degree of liquidity to holdings in these securities as the investor can encash their holdings as and when they want.

2. Provides Information about Prices and Sales: A stock exchange maintains complete record of all transactions taking place in different securities every day and supplies regular information on their prices and sales volumes to press and other media. In fact, now-a-days, we can get information about minute to minute movement in prices of selected shares on TV channels like CNBC, Zee News, NDTV and Headlines Today. This enables the investors in taking quick decisions on purchase and sale of securities in which they are interested. Not only that, such information helps them in ascertaining the trend in prices and the worth of their holdings. This enables them to seek bank loans, if required.

3. Provides safety to dealings and investment: Transactions on the stock exchange are conducted only amongst its members with adequate transparency and in strict conformity to its rules and regulations which include the procedure and timings of delivery and payment to be followed. This provides a high degree of safety to dealings at the stock exchange. There is little risk of loss on account of non-payment or non delivery. Securities and Exchange Board of India (SEBI) regulates the business in stock exchanges in India and the working of the stock brokers. Not only that, a stock exchange

allows trading only in securities that have been listed with it; and for listing any security, it satisfies itself about the genuineness and soundness of the company and provides for disclosure of certain information on regular basis. Though this may not guarantee the soundness and profitability of the company, it does provide some assurance on their genuineness and enables them to keep track of their progress.

4. Helps in Mobilisation of Savings and Capital Formation: Efficient functioning of stock market creates conducive climate for an active and growing primary market. Good performance and outlook for shares in the stock exchanges imparts buoyancy to the new issue market, which helps in mobilising savings for investment in industrial and commercial establishments. Not only that the stock exchanges provide liquidity and profitability to dealings and investments in shares and debentures. It also educates people on where and how to invest their savings to get a fair return. This encourages the habit of saving, investment and risk-taking among the common people. Thus it helps mobilising surplus savings for investment in corporate and government securities and contributes to capital formation.

5. Barometer of Economic and Business Conditions: Stock exchanges reflect the changing conditions of economic health of a country, as the shares prices are highly sensitive to changing economic, social and political conditions. It is observed that during the periods of economic prosperity, the share prices tend to rise. Conversely, prices tend to fall when there is economic stagnation and the business activities slow down as a result of depressions. Thus, the intensity of trading at stock exchanges and the corresponding rise on fall in the prices of securities reflects the investors' assessment of the economic and business conditions in a country, and acts as the barometer which indicates the general conditions of the atmosphere of business.

6. Better Allocation of Funds: As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises and they avail of the greater potential for growth. Financial resources of the economy are thus better allocated.

7. Contributes to Economic Growth: In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

8. Spreading of Equity Cult: Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

9. Providing Scope for Speculation: To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

10. Liquidity: The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.

11. Promotes the Habits of Savings and Investment: The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

4.5 STOCK EXCHANGE

Stock exchange is the term commonly used for a secondary market, which provide a place where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a regular basis. A stock exchange is generally organised as an association, a society or a company with a limited number of members. It is open only to these members who act as brokers for the buyers and sellers. The Securities Contract (Regulation) Act has defined stock exchange as an “association,

organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in securities".

It may be noted that all securities are not permitted to be traded on a recognised stock exchange. It is allowed only in those securities (called listed securities) that have been duly approved for the purpose by the stock exchange authorities. The method of trading now-a-days, however, is quite simple on account of the availability of on-line trading facility with the help of computers. It is also quite fast as it takes just a few minutes to strike a deal through the brokers who may be available close by. Similarly, on account of the system of scrip-less trading and rolling settlement, the delivery of securities and the payment of amount involved also take very little time, say, two days.

4.6 CHARACTERISTICS OF A STOCK EXCHANGE

The main characteristics of a stock exchange are:

- It is an organised market
- It provides a place where existing and approved securities can be bought and sold easily
- In a stock exchange, transactions take place between its members or their authorized agents
- All transactions are regulated by rules and by laws of the concerned stock exchange
- It makes complete information available to public in regard to prices and volume of transactions taking place every day

4.7 ADVANTAGES/BENEFITS OF STOCK EXCHANGES

Having discussed the functions of stock exchanges, let us look at the advantages which can be outlined from the point of view of (a) Companies, (b) Investors, and (c) the Society as a whole.

a) Towards the Companies

i) The companies whose securities have been listed on a stock exchange enjoy a better goodwill and credit-standing than other companies because they are supposed to be financially sound.

ii) The market for their securities is enlarged as the investors all over the world become aware of such securities and have an opportunity to invest.

iii) As a result of enhanced goodwill and higher demand, the value of their securities increases and their bargaining power in collective ventures, mergers, etc. is enhanced.

iv) The companies have the convenience to decide upon the size, price and timing of the issue.

b) Towards the Investors

i) The investors enjoy the ready availability of facility and convenience of buying and selling the securities at will and at an opportune time.

ii) Because of the assured safety in dealings at the stock exchange the investors are free from any anxiety about the delivery and payment problems.

iii) Availability of regular information on prices of securities traded at the stock exchanges helps them in deciding on the timing of their purchase and sale.

iv) It becomes easier for them to raise loans from banks against their holdings in securities traded at the stock exchange because banks prefer them as collateral on account of their liquidity and convenient valuation.

c) Towards the Society

i) The availability of lucrative avenues of investment and the liquidity thereof induces people to save and invest in long-term securities. This leads to increased capital formation in the country.

ii) The facility for convenient purchase and sale of securities at the stock exchange provides support to new issue market. This helps in promotion and expansion of industrial activity, which in turn contributes, to increase in the rate of industrial growth.

iii) The Stock exchanges facilitate realisation of financial resources to more profitable and growing industrial units where investors can easily increase their investment substantially.

iv) The volume of activity at the stock exchanges and the movement of share prices reflect the changing economic health.

v) Since government securities are also traded at the stock exchanges, the government borrowing is highly facilitated. The bonds issued by governments, electricity boards, municipal corporations and public sector undertakings (PSUs) are found to be on offer quite frequently and are generally successful.

4.8 ORGANISATION AND WORKING OF STOCK EXCHANGE

Practically, the organisation and working of a stock exchange differs from exchange to exchange in technical details although the general pattern of all exchanges is almost the same. The general pattern of a stock exchange is as follows:

(a) Constitution: It is an association of members which may be a voluntary and non--profit association or company limited by shares or guarantee.

(b) Membership: Membership is a 'must' for transacting business since non-members are not allowed to enter the stock-exchange. Membership is strictly limited, i.e., no one is allowed to be a member unless there is a vacancy. Membership is acquired outright by the payment of membership fees prescribed by the stock exchange.

(c) Management: The general administration of a stock exchange is administered by a committee of management and is called by different names in different exchanges. The selected Executive Committee of different stock exchanges carries on management of their day-to-day activities through sub-committees such as Listing Committee, Defaulters' Committee, Arbitration Committee, etc.

(d) Nature of Transactions: Two types of transactions — cash or forward — are made in a stock Transactions exchange. Cash transaction is one which reveals the delivery of securities within a short time which is settled by the payment of price. This type of transaction is also known as investment transaction since it is based on bona fide intention of purchase and sale of securities. On the contrary, a forward transaction is one which reveals forward delivery contracts and fixed settlement days. It is a speculative transaction and the settlement is made by the payment of price differences.

4.9 STOCK EXCHANGES IN INDIA

The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went up to 7 by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as 'kerb' market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It is also based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage.

Another stock exchange that needs special mention is Over the Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992 specially to cater to small and medium sized companies with equity capital of more than ₹ 30 lakh and less than 25 crore. It helps entrepreneurs in raising finances for their new projects in a cost effective manner. It provides for nationwide online ringless trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalise it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

4.10 LIST OF INDIAN STOCK EXCHANGES

A stock exchange is a place or platform which hosts a market where buyers and sellers come together to trade stocks during specific hours of business days.

Here is the list of major stock exchanges in India:

4.10.1 Bombay Stock Exchange (BSE)

Bombay stock Exchange (BSE) was established in 1875 and it is located at Dalal Streat,Mumbai. It operates with a vision of to "*Emerge as the premier Indian stock exchange with best-in-class global practice in technology, products innovation, and customer service."*

It is one of the two principal large stock exchanges of India and was founded by Mr. Premchand Roychand, famously known as the Cotton King, the Bullion King or the Big Bull. He was one of the most influential Indian businessmen of the 19th century and made a fortune in the stock-broking business.

Established in 1875, BSE is the oldest and first stock exchange of Asia and was formerly known by the name of –The Native Share & Stock Brokers Association. But the story of BSE starts back in the 1850s when 22 stockbrokers would gather under banyan trees in front of Mumbai's Town Hall. Location of these meetings changed multiple times to accommodate an increasing number of brokers. The group eventually moved to Dalal Street in the year 1874.

In the year 1986, Sensex was introduced, as the first equity index to provide a base for identifying the top 30 trading companies of the exchange, in more than 10 sectors. Apart from Sensex, other important indices of BSE are BSE 100, BSE 200, BSE 500, BSE MIDCAP, BSE SMLCAP, BSE PSU, BSE Auto, BSE Pharma, BSE FMCG, BSE Metal, etc.

As of April 2018, BSE has an overall market capitalization of over $4.9 trillion, which makes it the 10th largest stock exchange marketplace in the world. It also offers varied services such as market data services, risk man-

agement, CDSL (Central Depository Services Limited) depository services, etc. (Unit 7 of this Block discuesses broadly about BSE)

4.10.2 National Stock Exchange (NSE)

National stock exchange (NSE) is the youngest stock exchange of India which came into picture in the year 1992. It operates with a vision, "*To continue to be a leader, establish a global presence, and facilitate the financial well-being of people.***"**

In 1992, for the very first time in India, NSE introduced the advanced electronic trading system which removed the paper-based settlement system from trading and offered an easy trading facility. One year later, in the year 1993, NSE was set up as a tax paying company, which later on registered itself as a Stock Exchange under the Securities Contract Regulation Act. In the year 1995, National Securities Depository Limited (NSDL) was formed to provide depository services to the investors.

NSDL allows investors and traders to securely hold and transfer their stocks electronically along with this, it also allows investors to hold and trade in as few as one share or one bond. Nifty 50 the popular benchmark index in the Indian stock market, was introduced by NSE in the same year. Nifty lists out top 50 companies which traded on the NSE stock exchange market. (Unit 7 of this Block discuesses broadly about NSE)

4.10.3 Calcutta Stock Exchange (CSE)

CSE is a regional stock exchange (RSE) located at the Lyons Range, Kolkata and is the second oldest stock exchange in South East Asia. Incorporated in 1908, CSE is the second largest Stock Exchange in India. In the year 1980, it was granted permanent recognition by the Government of India under the relevant provisions of the Securities Contracts (Regulation) Act, 1956. While nearly 20 regional stock exchanges have voluntarily exited in the face of SEBI's stringent regulations against RSEs, CSE continues to fight a lone battle.

4.10.4 Metropolitan Stock Exchange (MSE)

MSE was recognized by SEBI on 16 September 2008 and is valid till 15 September 2019.

MSE offers a hi-tech platform to trade in the capital market, futures & options, currency derivatives, and debt market segments of the Indian market. It was recognized by SEBI on 16th September 2008 and is valid till 15th September 2019. Shareholders of MSE include Indian public sector banks, private sector banks, investors and domestic financial institutions which are subjected to CAG Audit. It has come out with a “Manifesto of Change”, which is a roadmap of what the stock exchange intends to achieve in terms of driving market development and inclusive growth over the next 10 years.

4.10.5. India International Exchange (India INX)

Opened in January 2017, India INX is India’s first international stock exchange. It is a wholly owned subsidiary of the Bombay Stock Exchange (BSE) and is located at the International Financial Services Centre (IFSC), GIFT City in Gujarat. It is claimed to be the world’s most advanced technological platform with a turn-around time of 4 microseconds which operates 22 hours a day and six days a week. Because of these timings, international investors and Non-Resident Indians (NRIs) can trade from anywhere across the globe at their preferred timings. Also, India INX launched Global Securities Market, India’s first international primary market platform that connects global investors with Indian and foreign issuers.

4.10.6 NSE IFSC Ltd.

NSE IFSC Limited (NSE International Exchange) incorporated on 29th November 2016, is a wholly owned subsidiary of the National Stock Exchange (NSE) and is located at the International Financial Services Centre (IFSC), GIFT City in Gujarat. NSE IFSC Limited has been launched to grow the financial market as well as expected to bring capital into India. It is permitted to offer

trading in securities in any currency other than the Indian rupee. NSE IFSC Limited conducts 16 hours of daily trading, which it intends to gradually expand in line with market feedback. Currently, there are two trading sessions, the first between 8 am and 5 pm and the second between 5.30 pm and 11.30 pm.

Former Stock Exchanges in India

There are 23 stock exchanges in India. Among them, two are national level stock exchanges namely BSE and NSE. The rest 21 are Regional Stock Exchanges (RSEs). Due to stringent norms introduced by SEBI, 20 RSEs in the country opted to exit the business. The list of stock exchanges which already closed their business are as follows:

S. No.	Former Stock Exchanges	Closed in
1	Ahmedabad Stock Exchange	2018
2	Delhi Stock Exchange	2017
3	Guwahati/Gauhati Stock Exchange	2015
4	Jaipur Stock Exchange	2015
5	Madhya Pradesh Stock Exchange	2015
6	Madras Stock Exchange	2015
7	OTC Exchange of India	2015
8	Pune Stock Exchange	2015
9	UP Stock Exchange	2015
10	Vadodara Stock Exchange	2015
11	Bangalore Stock Exchange	2014
12	Cochin Stock Exchange	2014
13	Inter-connected Stock Exchange of India	2014
14	Ludhiana Stock Exchange	2014
15	Trivandrum Stock Exchange	2010
16	Coimbatore Stock Exchange	2009
17	Hyderabad Stock Exchange	2007
18	Magadh Stock Exchange	2007
19	Bhubaneshwar Stock Exchange	2005
20	Mangalore Stock Exchange	2004



CHECK YOUR PROGRESS

1. Answer as directed:

a) A person appointed by a stock broker to assist to him in the business of securities trading at trading floor of stock exchanges is _____. (Fill in the gap)

b) An order for the purchase of securities at a fixed price is known as _____. (Fill in the gap)

c) In a stock exchange where the ownership, management and trading are concentrated in a single group, it is called _____. (Fill in the gap)

d) Stock Exchange provides a ready market for sale and purchase of gold and silver. (Write True or False)

e) In the stock exchange, transactions take place between companies and their shareholders directly. (Write True or False)

4.11 MAJOR WEAKNESSES OF STOCK EXCHANGE

The major weaknesses of stock exchange in India are:

1. **Lack of Professionalism:** The majority of stock brokers lack professionalism. They lack proper education, business skills, infra-structural facilities etc. which inhibits them to provide proper service to clients. They are not able to guide and counsel their clients in the manner expected of them.

2. **Domination of Financial Institutions:**Indian stock markets are dominated by a few financial institutions. The U.T.I., LIC, GIC are the main players in Indian stock markets. The buying and selling by these institutions sets the tone in the market. The market goes bullish if financial institutions start buying shares; on the other hand, it becomes bearish on their selling spree. Under SEBI guidelines, a member of mutual funds have been registered but they are concentrating more on new issues (primary market) Financial institutions in development economics to enter stock markets but their number is large and few institutions cannot influence the whole market as is done in India by three main insti-

tutions. Moreover, Indian financial institutions indulge more in buying and less in selling. With the entry of more and more Indian and foreign institutions, their influence in stock markets will gradually decline.

3. Poor Liquidity: The Indian stock exchanges suffer from poor liquidity. A small number of scrips are regularly traded on stock exchanges. A recent survey into frequency of trading showed that shares of 207 companies were traded every day, shares of 538 Companies were traded once a week, shares of 396 Companies were traded once of fortnight, shares of 954 Companies were traded once a month and shares of 959 companies were traded once a year. These statistics show the poor liquidity of most of the shares. A seller has to wait for disposing off his holdings for a longtime. When an investor is not sure of selling his shares whenever he needs money then he will be discouraged to invest in shares. There is huge backlog of pending deliveries also. This is due to the practice of short selling. The scrips are not delivered for longer periods which again creates liquidity problem. SEBI is trying to frame rules where this malpractice will be curtailed.

4. Domination by Big Operators: Some big operators influence the sentiment of stock exchanges in India. In Bombay Stock Exchange 3-4 operators used to call the shots. The case of Harshad Mehta is well known in India. He created bullish conditions in Indian stock exchanges in the first quarter of 1992 and BSE sensex nearly doubled in a very short period. This artificial increase in prices of shares adversely affected the investing public and people suffered huge losses. It is the weakness of stock exchange's working that some operators can create the sentiment as per their liking.

5. Less Floating Stocks: There is a scarcity of floating stock in Indian stock exchanges. The shares and debentures offered for sale are a small portion of total stocks. The financial institutions and joint stock companies which control over 75 percent of the scrips do not offer them for sale. The U.T.I, G.I.C., L.I.C., etc. indulge more in purchasing than in selling. It creates scarcity of stocks for trading. The markets tend to be violative and amenable to manipulations in the absence of adequate floating stocks for trading.

6. Speculative Trading: The trading in stock exchanges is mainly speculative in nature. The operators try to derive benefit out of short-term price fluctuations. Hence, one of the common evils associated with stock exchange operations is the excessive speculation. Speculation implies buying or selling securities to take advantage of price differential at different times. The speculators generally do not take or give delivery and pay or receive full payment. They settle their transactions just by paying the difference in prices. Normally, speculation is considered a healthy practice and is necessary for successful operation of stock exchange activity. But, when it becomes excessive, it leads to wide fluctuations in prices and various malpractices by the vested interests. In the process, genuine investors suffer and are driven out of the market.

7. Fluctuation of Prices: Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as on account of rumours spread by interested parties. This makes it difficult to assess the movement of prices in future and build appropriate strategies for investment in securities. However, these days good amount of vigilance is exercised by stock exchange authorities and SEBI to control activities at the stock exchange and ensure their healthy functioning.

4.12 MEASURES SUGGESTED FOR REFORM OF STOCK EXCHANGE

Following are some of the important measures suggested by Dr. L.C. Gupta for making necessary changes in the current trade practices in Indian stock exchanges in his “Export study of Trading in shares in stock Exchanges”:

(i) Uniform System of One-Week Settlement: In order to unify all stock exchanges in India on a national basis, all the SE should introduce a uniform system of one-week settlement. This uniform system will reduce the risk missing out of price movements in shares and also check the strong tendency towards over speculation and over-concentration of trading activity in a few shares. The uniform system will remove the complaint of long delay on the part of investors and also reduce the cost and delay. This system will also pave the way for easier inter-market transactions.

(ii) Market Making: The system market makers should be introduced in stock exchanges in India at par with the all leading stock exchanges of London and New York. In this system the market makers usually take the responsibility of market making for specific shares, i.e., for buying and selling a specific share at definite prices. Being an integral part of trading mechanism and all other arrangements, he protects the investors from its exploitation by the stock brokers and ensures the transactions of shares at best possible market rates and also ensure prompt execution of transactions and liquidity. This system will provide protection to investors and also liquidity to all shares.

(iii) Margin Trading and Marking to the Market System: As the margin trading system adopted by Indian SEs is defective and has failed to prevent the problem of default and over-speculation, Dr. Gupta suggested two alternatives against this system. The first one suggests adopting the margin trading system of USA in which commercial banks provide financial support to the extent of 50 per cent to the buyer in the stock market trading after necessary pledging of shares with a bank. But this system may not be acceptable to the Government at present as the country has experienced a huge problem of securities scam in the recent past.

The second alternative i.e., the marking to the market system on a daily basis is a complete system to check bankruptcy and will provide guarantee towards financial integrity of the market at all times. In this system, if there is any change in price of stocks at the close of trading, one side will get a debit for a loss and the other side will get a credit for a gain. If there is a continuous debit to a member's account regularly then it will reflect a negative balance in its account at a point of time. Once such negative balance, is reflected, then and there the member is stopped from making any further business. In the existing system, even a bankrupt member may continue to trade in securities. But to introduce this marking to the market system, it requires total computerisation of trade data.

(iv) Abolishing the System of Carry Forward: The present practice of the system of carry forward adopted by the Indian SEs has led to over-

speculation in the stock market. With the abolition of this system, the stock exchanges will be free from many problems.

(v) Formation of Governing Body (GB) and Management of Stock Exchange: The formation of GB should be done in a rational way. The Executive Director of a Stock Exchange must either be appointed by the Government or by SEBI as per the advice from the panel of independent experts, so that he can have indepen-dent control over stock brokers. The composition of GB of stock exchanges should also be changed between the broker-directors and non-broker directors in ratio of 50: 50 to make it more objective, direct and strong.

(vi) Introducing Management Information System: The stock exchanges in the country should introduce a well designed management information system (MIS) so as to feed the SEs with sufficient information relating to trading volume and prices, trading concentration in certain securities, trading concentration by some SE members, speculation etc. Such information will also help the authorities to restrict and regulate the stock markets properly.

4.13 REGULATIONS OF STOCK EXCHANGES IN INDIA

Indian Capital Markets are regulated and monitored by the Ministry of Finance, The Securities and Exchange Board of India and The Reserve Bank of India. The Ministry of Finance regulates through the Department of Economic Affairs - Capital Markets Division. The division is responsible for formulating the policies related to the orderly growth and development of the securities markets (i.e. share, debt and derivatives) as well as protecting the interest of the investors. In particular, it is responsible for-

- institutional reforms in the securities markets,
- building regulatory and market institutions,
- strengthening investor protection mechanism, and
- providing efficient legislative framework for securities markets

The Division administers legislations and rules made under:

- Depositories Act, 1996,

- Securities Contracts (Regulation) Act, 1956 and
- Securities and Exchange Board of India Act, 1992.

Regulators of Stock Exchanges in India:

- **Securities & Exchange Board of India (SEBI):** The Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992 and is the principal regulator for Stock Exchanges in India. SEBI's primary functions include protecting investor interests, promoting and regulating the Indian securities markets. All financial intermediaries permitted by their respective regulators to participate in the Indian securities markets are governed by SEBI regulations, whether domestic or foreign. Foreign Portfolio Investors are required to register with DDPs in order to participate in the Indian securities markets.
- **Reserve Bank of India (RBI):** The Reserve Bank of India (RBI) is governed by the Reserve Bank of India Act, 1934. The RBI is responsible for implementing monetary and credit policies, issuing currency notes, being banker to the government, regulator of the banking system, manager of foreign exchange, and regulator of payment & settlement systems while continuously working towards the development of Indian financial markets. The RBI regulates financial markets and systems through different legislations. It regulates the foreign exchange markets through the Foreign Exchange Management Act, 1999.

The stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, as early as 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the central Government. It has also the provision of framing of proper bylaws by every stock exchange for regulation and control of their functioning subject to the approval by the Government. All stock exchanges are required submit information relating to its affairs as required by the Government from time to time. The Government was given wide powers relating to listing of securities, make or amend bylaws, withdraw recognition to, or supersede the governing bodies of stock exchange

in extraordinary/abnormal situations. Under the Act, the Government promulgated the Securities Regulations (Rules) 1957, which provided *inter alia* for the procedures to be followed for recognition of the stock exchanges, submission of periodical returns and annual returns by recognised stock exchanges, inquiry into the affairs of recognised stock exchanges and their members, and requirements for listing of securities.

4.14 ROLE OF SEBI IN REGULATING STOCK EXCHANGES

As for measures in the secondary market, it should be noted that all statutory powers to regulate stock exchanges under the Securities Contracts (Regulation) Act have been vested with SEBI through the passage of securities law (Amendment) Act in 1995. SEBI has duly notified rules and a code of conduct to regulate the activities of intermediaries in the securities market and then registration in the securities market and then registration with SEBI is made compulsory. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives. Corporate membership has also been introduced at the stock exchanges. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions. SEBI has constantly reviewed the traditional trading systems of Indian stock exchanges and tried to simplify the procedure, achieve transparency in transactions and reduce their costs. To prevent excessive speculations and volatility in the market, it has done away with badla system, and introduced rolling settlement and trading in derivatives. All stock exchanges have been advised to setup clearing corporation/settlement guarantee fund to ensure timely settlements. SEBI organises training programmes for intermediaries in the securities market and conferences for investor education all over the country from time to time.

As part of economic reforms programme started in June 1991, the Government of India initiated several capital market reforms, which included the abolition of the office of the Controller of Capital Issues (CCI) and granting statutory recognition to Securities Exchange Board of India (SEBI) in 1992 for:

- protecting the interest of investors in securities;
- promoting the development of securities market;
- regulating the securities market; and
- matters connected there with or incidental thereto.

SEBI has been vested with necessary powers concerning various aspects of capital market such as:

- regulating the business in stock exchanges and any other securities market;
- registering and regulating the working of various intermediaries and mutual funds;
- promoting and regulating self regulatory organisations;
- promoting investors education and training of intermediaries;
- prohibiting insider trading and unfair trade practices;
- regulating substantial acquisition of shares and takeover of companies;
- calling for information, undertaking inspection, conducting inquiries and audit of stock exchanges, and intermediaries and self regulation organisations in the stock market; and
- performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government.

As part of its efforts to protect investors' interests, SEBI has initiated many primary market reforms, which include improved disclosure standards in public issue documents, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and risk factors associated with their projects while making public issue. All issue documents are to be vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. Merchant bankers and all mutual funds including UTI have been brought under the regulatory framework of SEBI. A code of conduct has been issued specifying a high degree of responsibility towards investors in respect of pric-

ing and premium fixation of issues. To reduce cost of issue, underwriting of issues has been made optional subject to the condition that the issue is not under-subscribed. All primary issues have now to be made through depository mode. The initial public offers (IPOs) can go for book building for which the price band and issue size have to be disclosed. Companies with dematerialised shares can alter the par value as and when they so desire.

4.15 INTERNET TRADING

The Securities & Exchange Board of India (SEBI) approved the report on Internet Trading brought out by the SEBI Committee on Internet Based Trading and Services In January 2000. Internet trading can take place through order routing systems, which will route client orders to exchange trading systems for execution. Thus a client sitting in any part of the country would be able to trade using the Internet as a medium through brokers' Internet trading systems.

SEBI-registered brokers can introduce Internet based trading after obtaining permission from respective Stock Exchanges. SEBI has stipulated the minimum conditions to be fulfilled by trading members to start Internet based trading and services, vide their circular no.SMDRP/POLICY/CIR-06/2000 dated January 31, 2000.

NSE became the first exchange to grant approval to its members for providing Internet based trading services. In line with SEBI directives, NSE has issued circulars detailing the operational guidelines and procedures to be complied with by members desirous of providing Internet based trading and services in circular no. NSE/MSD/41332 dated June 17, 2019.

Members can procure the Internet trading software from software vendors who are empanelled with NSE or they may develop the software through their own in-house development team or may procure the software from other non-empanelled vendors.

Members can also avail of services provided by Application Service Providers (which may inter-alia include providing / maintaining software / hard-

ware / other infrastructure etc.) for providing Internet based trading services subject to the Application Service Provider (ASP) being empanelled with the Exchange for providing such services. The Exchange has issued circular no. NSE/CMO/0028/2000 dated December 18, 2000 detailing the formalities / requirements for ASPs desirous of being empanelled with the Exchange for providing such services to trading members of NSE and circular no. NSE/MSD/41332 dated June 17, 2019 detailing the operational guidelines and procedures for members desirous of using ASPs for providing Internet based trading services.

Advantages of Online Tradingd

Following are the advantages of online trading :

- **It is simple:** It enables a trader to have a hassle free trading experience. Anyone can use these platforms as specific skill is not required to carry out trading online.
- **It is less expensive:** It is less expensive as compared to traditional mode of trading. Brokers also promote online trading as it reduces maintenance and other costs incurred by the broker.
- **Quick and less time consuming:** Trading can be done in a seamless manner and in less time. Before the advent of online technologies, trading was a cumbersome process as you had to visit the broker or call your broker for placing or cancelling trade orders. Now, you can carry out trading even through a smartphone in the simplest way.
- **Complete control:** It allows you to have complete control over your portfolio. You can place trade orders from anywhere anytime. That is the kind of flexibility you get due to online trading.
- **Chances of error are less:** In case of traditional offline trading, there were more chances of errors due to miscommunication between the traders and brokers. But in online trading, you can place trade orders

or cancel without broker's interference and hence can manage trade transactions by yourself.

- **Monitor investment at all times:** You can monitor investments anytime. There are mobile trading apps that can be downloaded in your smartphone which help you stay in touch with the markets and also monitor your investment anytime and take proper strategic moves accordingly. Loss making stocks can be removed and profit making stocks can be added to your portfolio by observing the way the market moves.
- **Access to research reports:** You can get access to top research recommendations, reports, analysis on stock price based on various charts. There are various brokerage websites through which you can have discussions with research experts as well. You can take the best move with the help of financial advisors too.

Safety measures that have to be taken in case of online trading:

- Trade orders should not be placed from shared PCs or cyber cafes.
- Always log out after carrying out trade in order to avoid any misuse of your account.
- Personal computers have to be protected against viruses by installing anti-virus solution.
- Do not click on "remember me" option when you sign in to your trading account from a different location.

Investment in financial assets is offered by several brokers. You can choose that which suits your needs and demands after comparison of brokers on the basis of services, brokerage charges, etc. Online trading helps you trade or invest in the most secured way. Its simple, easy and fast to trade online.



CHECK YOUR PROGRESS

2. Answer as directed:

a) The full form of OTCEI is _____. (Fill in the gap)

b) SENSEX is the index of _____. (Fill in the gaps)

c) NIFTY is the index of _____. (Fill in the gaps)

d) The first Indian equity index is _____. (Fill in the gaps)

e) Full form of STRIPS is _____. (Fill in the gaps)

f) Gilt Edged Securities are _____. (Fill in the gaps)

g) Zero interest bonds are sold at discount. (Write True or False)



4.16 Let Us Sum Up

We have discuses the following points in the unit :-

- The secondary market is the stock market where existing stocks are bought and sold by the retail investors through the brokers.
- The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds. Stock exchanges provide a place where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a regular basis.
- The major players in the secondary market are the stockbrokers like merchant bankers, mutual funds, financial institutions, and the individual investors who are members of the stock exchange who facilitate the trading.
- Indian stock exchanges have various weaknesses.
- The Securities and Exchange Board of India (SEBI) is the regulatory authority of Stock Exchanges in India.



4.17 FURTHER READINGS

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services –By M. P. Tripathy
- Indian Financial System -By M Y Khan



4.18 ANSWERS TO CHECK YOUR PROGRESS

1. (a) Authorised clerk (b) Limit order (c) Mutual exchange (d) False (e) False

2. (a) Over the Counter Exchange of India (b) BSE (c) NSE (d) SENSEX (e) Separate Trading of Registered Interest and Principal of Securities (f) Govt. Securities (g) True



4.19 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Advantages of stock exchanges
   b) Limitations of stock exchanges
   c) Over the Counter Exchange of India
2. What is Stock Exchange? Explain its significance in the development of Indian capital market.
3. Enumerate the main characteristics of a stock exchange and also state its limitations.
4. Critically examine the role and functions of stock exchanges in the financial system of country.
5. What do mean by listing of securities? Describe the listing and point out its merits and demerits.
6. Explain the role played by SEBI in protecting investors' interests and controlling the business at stock exchange.
7. Give explanatory notes on (a) stock exchange in India; and (b) Regulations of stock exchanges.

UNIT-5 : LISTING OF SECURITIES

UNIT STRUCTURE

5.1 Learning Objectives
5.2 Introduction
5.3 Meaning of Listing
5.4 Types of Listing of Securities
5.5 Listing Requirements
5.6 Formalities for Listing
5.7 Listing Procedure at the Stock Exchange
5.8 Conditions for Listing
5.9 Criteria for Listing of Securities
5.10 Advantages of Listing
5.11 Disadvantages of Listing
5.12 Listing Fee
5.13 Listing of Right Issue
5.14 Listing of Bonus Issue
5.15 Differences between Right Issue and Bonus Issue
5.16 Listing of Further Issues
5.17 Delisting Of Securities
5.18 Listing Conditions in BSE
5.19 Listing Requirements for NSE
5.20 Let Us Sum Up
5.21 Further Readings
5.22 Answers to Check Your Progress
5.23 Possible Questions

5.1 LEARNING OBJECTIVES

After reading this unit you will able to know–

- meaning of Listing of Securities
- formalities for Listing
- advantages and disadvantages of Listing on Stock Exchange
- rules for Listing of Securities

5.2 INTRODUCTION

For trading in the stock market, a company has to list its securities in the stock exchange. It means that the name of the company is registered in the stock exchange. The company has to fulfill certain conditions according to Companies Act. In this unit we will discuss about the meaning and advantages of listing of securities.

5.3 MEANING OF LISTING

Listing forms the very basis of the operations of stock exchange. A stock exchange does not deal in the securities of all the companies. Instead, it deals only in the listed securities of certain selected companies. Listing here means an act of inclusion of securities in the official list of a stock exchange for the purpose of trading. The company issuing securities for public subscription has to apply to a recognised stock exchange to get its securities listed. If the permission is granted, then the securities are said to have been listed. Listing, therefore, is a sort of sanction of the stock exchange permitting dealings in the specific securities. In technical language, listed securities are also called 'scrip's'.

Listing means admission of securities to dealings on a recognized stock exchanges of any incorporated company, Central and State Governments, quasi governmental and other financial institutions/corporations, municipalities, electricity, housing boards etc. stock exchange means any-body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Every recognized stock exchange i.e., a stock exchange which is for the time being recognized by the Central Government under section 4 of the Securities Contracts (Regulation) Act, 1956, has the power to make byelaws for the listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities and the suspension or prohibition of trading in any specified securi-

ties. This power to make byelaws is subject to the previous approval of the Central Government.

Further, the Central Government has the power to make or amend bye-laws of recognized stock exchanges either on a request by the governing body of a stock exchange or on its own motion. Securities are bought and sold in recognized stock exchanges through members who are known as 'brokers'. The prices at which the securities are bought and sold on a recognized stock exchange are known as 'official quotation'.

5.4 TYPES OF LISTING OF SECURITIES

1. Initial listing: Here, the shares of the company are listed for the first time on a stock exchange.

2. Listing for public Issue: When a company which has listed its shares on a stock exchange comes out with a public issue.

3. Listing for Rights Issue: When the company which has already listed its shares in the stock exchange issues securities to the existing shareholders on rights basis.

4. Listing of Bonus shares: When a listed company in a stock exchange is capitalizing its profit by issuing bonus shares to the existing shareholders.

5. *Listing for merger or amalgamation: When the amalgamated company issues new shares to the shareholders of amalgamated company, such shares are listed.*

5.5 LISTING REQUIREMENTS

The company has to offer its shares or debentures to the public for subscription. Only then, the company will be allowed to list its security in the stock exchange. Exchanges have listing requirements to ensure that only high quality securities are traded on them and to uphold the exchange's reputation among investors. For listing shares in the stock exchange, a company must have minimum of Rs. 5 crores as its equity capital and 60% of this i.e., Rs. 3 crores is offered to the public.

5.6 FORMALITIES FOR LISTING

A company wishing to have its securities listed has to apply in the prescribed form supported by following documents and particulars:

- Copies of Memorandum and Articles of Association, Prospectus or Statement in lieu of Prospectus and agreements with underwriters
- Specimen copies of shares' and debentures' certificates, letters of allotment, etc.
- Particulars of bonuses and dividends declared during the last 10 years
- Particulars of shares or debentures for which permission is sought
- Details of shares and debentures issued for consideration other than cash
- Statement showing distribution of shares and particulars of commission, brokerage, discounts or special terms towards the issue of shares
- A brief history of the company's activities since its incorporation with reference to its assets, liabilities and capital structure
- All particulars regarding capital structure
- Copies of advertisements offering securities for sale during the last 5 years
- Copies of Balance sheet, audited accounts and auditors' report for the last 5 years
- Any agreement with financial institutions
- Particulars of shares forfeited
- Certified copy of consent from SEBI

5.7 LISTING PROCEDURE AT THE STOCK EXCHANGE

After the application is made the listing committee of the stock exchange will scrutinize the application form of the company. After a careful examination of the application, the stock exchange authorities may call upon the company to execute a listing agreement. This contains the obligations and restrictions on the part of the company. The stock exchange reserves the right to cancel or

suspend the permission granted following any breach of the obligations mentioned above. Here, the stock exchange will ensure the following:

- The financial position of the company is sound
- Solvency and liquidity positions are good
- The issue is large and broad based to generate public interest.

If the application for listing is accepted, the listed company will be called to execute listing agreement with the stock exchange.

The company must follow certain obligations which are:

- The company will treat all the applications with equal fairness
- In case of over subscription, the allotment will be decided in consultation with stock exchanges; and
- The company will notify to the stock exchange any change in its management, business, capital structure or bonus or rights issue of shares

The listed company undertakes:

- That it would offer not less than 49 per cent of its issued capital for public subscription;
- That it would be fair to all applicants for shares while making allotments;
- That it would keep the stock exchange fully informed about vital matters affecting the company
- That it would ensure equitable voting rights and dividend rights

5.8 CONDITIONS FOR LISTING

Before listing securities, a company has to fulfill the following conditions:

- Shares of the company must be offered to the public through a prospectus and 25% of each class of securities must be offered.
- The prospectus should clearly mention opening of subscription, receipt of application, etc.
- The capital structure of the company should be broad-based and there should-be public interest in securities.

- The minimum issued capital must be Rs. 3 crores of which Rs. 1.80 crores must be offered to the public.
- There must be at least five public shareholders for every Rs. 1 lakh of fresh issue of capital and 10 shareholders for every Rs. 1 lakh of offer for sale of existing capital. On the excess application money, the company will have to pay interest from 4% to 15%, if there is delay in refund and delay should not be more than 10 weeks from the date of closure of subscription list.
- A company with paid up capital of more than Rs. 5 crores should get itself listed in more than one stock exchange, it includes the compulsory listing on regional stock exchange.
- The auditor or secretary of the company applying for listing should declare that the share certificates have been stamped so that shares belonging to the promoter's quota cannot be sold or hypothecated or transferred for a period of 5 years.
- Articles of Association of the company must have the following provisions:
    - A common form of transfer shall be used
    - Fully paid shares shall be used
    - No lien on fully paid shares
    - Calls paid in advance will not carry a right to dividend and will not be forfeited before the claim becomes time-barred.
    - Option to call off shares shall be given only after sanction by the general meeting.
- Letter of allotment, Letter of regret and letter of rights shall be issued simu1taneously.
- Receipts for all the securities deposited, whether for registration or split and no charges will be made for the services.
- The company will issue consolidation and renewal certificates for split certificate, letter of allotment, letter of rights and transfer, etc. when required.

- The stock exchange should be notified by the company regarding the date of board meeting, change in the composition of board of directors, and any new issue of securities, in place of reissue of forfeited shares.
- Closing the transfer books for the purpose of declaration of dividend, rights issue or bonus issue. And for this purpose, due notice should be given to stock exchange.
- Annual return of the company to be filed soon after the annual general body meeting.
- The company will have to comply with conditions imposed by the stock exchange now and then for 1istmg of security.

5.9 CRITERIA FOR LISTING OF SECURITIES

The Stock Exchange has to direct special attention to the following particulars while scrutinizing the application:

5.9.1 Articles:

(a) Whether the Articles contain the following provisions:

- A common form of transfer shall be used.
- Fully paid shares will be free from lien.
- Calls paid in advance may carry interest, but shall not confer a right to dividend.
- Unclaimed dividends shall not be forfeited before the claim becomes time barred.
- Option to call on shares shall be given only after sanction by the general meeting.
- Whether at least 49% of each class of securities issued was offered to the public for subscription through newspapers for not less than three days.
- Whether the company is of a fair size, has a broad based capital structure and there is sufficient public interest in its securities.

5.9.2 Listing of Agreement:

After scrutiny of the application, the stock exchange authorities may, if they are satisfied, call upon the company to execute a listing agreement which contains the obligations and restrictions which listing will entail. This agreement contains 39 clauses with a number of sub-clauses.

These cover various aspects of the issue of letters of allotment, share certificates, transfer of shares, information to be given to the stock exchanges regarding closure of register of members for the purpose of payment of dividend, issue of bonus and right shares and convertible debentures, holding of meetings of the board of directors for recommendation or declaration of dividend or issue of right or bonus shares or convertible debentures, submission of copies of directors' report, annual accounts and other notices, resolutions and so on to the shareholders.

The basic purpose behind making these provisions in the listing agreement is to keep the shareholders and investors informed about the various activities which are likely to affect the share prices of such companies so that equal opportunity is provided to all concerned for buying or selling of the securities. On the basis of these details, investors are able to make investment decisions based on correct information.

The stock exchange enlisting the securities of a company for the purpose of trading insists that all applicants for shares will be treated with equal fairness in the matter of allotment. In fact, in the event of over-subscription, the stock exchange will advise the company regarding the basis for allotment of shares. It will try to ensure that applicants for large blocks of shares are not given under the preference over the other.

A company whose securities are listed with a stock exchange must keep the stock exchange fully informed about matters affecting the company, e.g.,

- To notify the stock exchange promptly of the date of the Board Meeting at which dividend will be declared;

- To forward immediately to the stock exchange copies of its annual audited accounts after they are issued;
- To notify the stock exchange of any material change in the general nature or character of the company's business;
- To notify the stock exchange of any change in the company's capital; and
- To notify the stock exchange (even before shareholders) of the issue of any new shares (right shares or otherwise) as the issue of any privileges or bonus to members.

The company must also undertake:

- Not to commit a breach of any condition on the basis of which listing has been obtained;
- To notify the exchange of any occasion which will result in the redemption, cancellation or retirement of any listed securities;
- Avoid as far as possible the establishment of a false market for the company's shares;
- To intimate the stock exchange of any other information necessary to enable the shareholders to appraise the company's position.

According to Section 73 of the Companies Act, 1976, if a company indicate in its prospectus that an application has been made or will be made to a recognized stock exchange for admitting the company's shares or debentures to dealings therein, such permission must be applied for within a stipulated period to time.

The Securities Contracts (Regulation) Act, 1956, gives the Central Government power to compel an incorporated company to get its securities with a recognized stock exchange in accordance with the rules and regulations prescribed for the purpose.

If a recognized exchange refuses to list the securities of a company, the company can file an appeal against such a decision with the government.

The Act empowers the government to set aside or change the decision after giving proper opportunity to both the parties to explain their position in this regard.

5.9.3 Guidelines for Listing Securities:

To ensure the effective working of the recognized stock exchange in the public interest, Government framed Securities Contracts (Regulation) Rules, 1957. From time-to-time, these Rules have been revised whenever it has been necessary to do so depending on the environmental requirements through guidelines issued by the government in this regard.

In November 1982, certain administrative guidelines governing the listing of securities on recognized stock exchanges, in relaxation of Rule-19 (2) (b) if these Rules were issued. These guidelines broadly cover the following:

5.9.4 Established Non-FERA Companies:

According to the Act, 'Non-FERA Companies' mean (1) those companies which are incorporated in India at least ten years prior to the date of applying for the listing regulation; or companies which have a profit earning record for a continuous period of at least five years prior to the date of the listing application; and (2) in which foreign equity does not exceed 40 per cent.

The rule provides that in relation to these non-FERA companies, public offer should ordinarily be at least 49% of the issued capital of the company. But in certain cases, where there is already a considerable public shareholding in the company, a further reduction in the public offer may also be considered if the following conditions are satisfied:

- The shares are held by persons not connected with the management, their associates and associate companies.
- The shares have remained widely distributed, without undue concentration of large holdings in the hands of the shareholders on record (or their predecessors in title) for a period of at least 3 years prior to the date of the listing application.

- The number of such shareholders is at least 20 for every Rs. 1 lakh of capital held by them.

5.9.5 Other Established or New Non-FERA Companies:

In respect of:

- Other established Non-FERA companies, that is, companies incorporated in India within ten years of the date of the listing application and in which foreign equity does not exceed 40 per cent, and
- New companies without any foreign equity participation, the provisions of Rule 19 (2) (b) of the Securities Contracts (Regulation) Rules will apply. In other words, the public offer should be at least 60 per cent of the issued capital of the company in such cases.

Subscriptions by the Central Government, State Government and their agencies and public financial institutions will be counted as a part of the public offer up to a maximum extent of 11 per cent of the issued capital of the company.

5.9.6 New Companies with Foreign Equity Participation:

In respect of new companies with approved foreign equity participation, the public offer should be the balance of the issued capital after deduction of the capital subscribed by the foreign participants and the Indian promoters.

The following conditions should, however, be fulfilled:

- The public offer should in no case be less than 33 per cent of the issued capital of the company.
- The share of the Indian promoters should not be more than 40 per cent of the issued capital of the company.

5.9.7 New Companies with Non-Resident Indian Equity Participation:

Where non-residents of Indian nationally or origin of overseas companies, partnership firms, trusts, societies and other corporate bodies, owned predominant ownership is that at least 60 per cent of the ownership of these entitles should be with non-residents of Indian nationality or origin (the criterion

for determining such predominant ownership is that at least 60 per cent of the ownership of these entities should be with non-residents of Indian nationality or origin) are themselves the promoters of the company after deduction of the capital subscribed by them.

However, public offer in such a case should not be less than 26% of the issued capital of the company.

- If the non-resident Indian equity is 74 per cent, the public offer should be 26 percent of the issued capital of the company.
- If the non-resident Indian equity is 40 per cent, the public offer should be 60 per cent of the issued capital of the company. [There is no relaxation of Rule 19(2) (b) in this case].
- If the non-resident Indian equity is 30 per cent, the public offer need not exceed 60 per cent and the balance of 10 per cent can be allotted to friends, relatives and associates of the promoters. [Here again, there is no relaxation of Rule 19(2) (b)].

5.9.8 Joint Sector Companies:

In a Joint sector company, the principal promoter will be a State Government and/or its agencies and the co- promoter will be a private party. The shareholding of the State Government and/or its agencies will not ordinarily be less than that of the co-promoter.

In such cases, the public offer should be the balance of the issued capital of the company after deduction of the capital subscribed by the promoters and the co-promoters subject to the condition that the public offer should not normally be less than 33-1/3 per cent of the issued capital of the company.

To illustrate, if the State Government and/or its agencies take up 26 per cent and the co-promoter takes up 25 per cent of the issued capital of the company, the balance of 49 per cent should be offered to the public.

5.9.9 Offer for the Sale of Existing Issued Capital:

Companies can have their shares listed on recognized Stock Exchange by arranging for an offer for sale of their existing issued capital. Such an offer

for sale can be combined with a fresh issue of capital also. The extent of public offer in these cases should be in conformity with the provisions detailed above.

In addition, the following conditions should also be fulfilled:

- The net worth (i.e., existing paid up equity capital plus free reserves, excluding reserves created out of revaluation of fixed assets) of the company should not be less than its existing paid up capital and the company should not have incurred a loss in each of the three years preceding the listing application.
- The offer should result in a wide distribution of shares among the general public without undue concentration of large holdings, and the number of public shareholders should be at least 20 for every Rs. 1 lakh of the public offer.
- If the share is offered at a price above its par value, the price should have been approved by the Central Government.
- The offer should set out all material particulars relating to the company and the shares offered to the public. It must be in a form approved by the Stock Exchange concerned and must comply with all conditions pertaining to public advertisement, opening and closing of subscription lists, payment of application money, disposal of applications, basis of allotment, etc., as are applicable to a company offering fresh shares for public subscription in accordance with the listing regulations and instructions issued by the government from time-to-time.

5.10 ADVANTAGES OF LISTING

Listing of securities on the stock exchanges is advantageous to the company as well as to the investors as will be seen hereunder:

To the Company:

- The company enjoys concessions under direct tax laws as such companies are known as companies in which public are substantially interested resulting in lower rate of income-tax payable by them.

- The company gains national and international importance by its share value quoted on the stock exchanges.
- Financial institutions and banks extend term loan facilities in the form of rupee currency and foreign currency loan.
- It helps the company to mobilize resources from the shareholders through 'Rights Issue' for programs of expansion and modernization without depending on the financial institutions in line with the Government policies.
- It ensures wide distributions of shareholding thus avoiding fears of easy takeover of the organization by others.
- Listing provides effective publicity and wide marketability of the securities.
- It enhances the reputation of the concern which brightens its image in the investment market.
- It provides price continuity for securities.
- It facilitates the correct evaluation of securities in terms of their real worth.

To the Investors:

- Since the securities are officially traded, liquidity of investment by the investors is well ensured.
- Rights entitlement in respect of further issues can be disposed of in the market.
- Listed securities are well preferred by bankers for extending loan facility.
- Official quotations of the securities on the stock exchanges corroborate the valuation taken by the investors for purposes of tax assessments under Income-tax Act, Wealth- tax Act etc.
- Since securities are quoted, there is no secrecy of the price realization of securities sold by the investors.

- The rules of the stock exchange protect the interest of the investors in respect of their holdings.
- Listed companies are obliged to furnish unaudited financial results on the quarterly basis. The said details enable the investing public to appreciate the financial results of the company in between the financial periods.
- Takeover offers concerning the listed companies are to be announced to the public. This will enable the investing public to exercise their discretion on such matters.
- It protects investors' interests through the enforcement of set rules and regulations.

5.11 DISADVANTAGES OF LISTING

- Listing encroaches upon the freedom and secrecy of the activities of concerned companies.
- Listed securities may fall victim to erratic fluctuations in values.
- Unscrupulous speculators often manipulate the values of listed securities to the disadvantage of the company.
- Gambling may thrive under the garb of genuine speculation.

5.12 LISTING FEE

All listed companies are required to pay an Annual Listing Fees to the respective stock exchange. At the time of listing the companies will be required to pay an initial listing fee and a pro-rata annual fee for the remainder of the financial year. From there on the annual fee will apply. Fees are calculated on the value of the securities that are quoted. Fees also apply if the companies raise additional capital following the IPO.

NSE Listing fee:

The listing fee applicable from April 01, 2018 is as follows:

A. Listing Fee Structure based on Paid up Capital:

Particulars	**Amount (Rs)**
Initial Listing Fees	50,000
Annual Listing Fees (on equity share, bond and/ or debenture capital)	
Upto 100 crore	2,90,000
Above 100 Crore and upto 200 Crore	3,80,000
Above 200 Crore and upto 300 Crore	4,90,000
Above 300 Crore and upto 400 Crore	5,95,000
Above 400 Crore and upto 500 Crore	7,30,000

Source: https://www1.nseindia.com/corporates/content/listing_fees.htm

Companies which have a paid up capital, bond and/or debenture and/ or debt capital, etc. of more than Rs.500 crore will pay minimum fees of Rs. 7,35,000/- and an additional listing fees of Rs.4,800/- for every increase of Rs. 5 crore or part thereof in the paid up share, bond and/debenture and/or debt capital, etc.

Companies which have a paid up share, bond and /or debenture and/ or debt capital etc. of more than Rs.1,000 crore will pay minimum fees of Rs.12,20,000/- and an additional listing fees of Rs.5,125/- for every increase of Rs.5 crore or part thereof in the paid up share, bond and/debenture and/or debt capital, etc.

And

B. Fee structure based on Market Capitalisation:

- Incremental Fee shall be levied for listed companies with market capitalization above Rs. 2500 crores as follows - Rs. 4000 per Rs.1000 Crores
- The incremental fee due to market capitalization is capped at Rs. 15 lakhs (excluding the component towards paid up capital)
- For the purpose of this computation, Market Capitalization shall be deduced as follows:
    i. Monthly average market capitalization = Average of Highest market capitalization during the month and Lowest market capitalization during the month
    ii. Average of the above for the twelve months period preceding the invoicing date i.e. from 1st April to 31st March.

BSE listing fee:

Schedule of listing fees for the year 2019-20

Annual/Further Listing Fee – Equity Segment

Particulars	**Amount (In Rs.)**	
Initial Listing Fee	Rs.20,000	
Listed Capital (In Rs. Crores)	**Annual Listing Fees (In Rs.)***	
	#Commonly Listed Companies	**Exclusively Listed Companies**
Upto 100	Rs. 250,000	Rs. 300,000
Above 100 and upto 200	Rs. 300,000	Rs. 325,000
Above 200 and upto 300	Rs. 375,000	
Above 300 and upto 400	Rs. 450,000	
Above 400 and upto 500	Rs. 600,000	
Above 500 to 1000	Rs. 605,000/- and an additional listing fees of Rs. 3,530/- for every increase of Rs.5 crores or part thereof above 500 crores in the paid-up share capital	
Above 1000 to 2000	Rs. 990,000**/-** and an additional listing fees of Rs. 3,930/- for every increase of Rs.5 crores or part thereof above 1,000 crores in the paid-up share capital.	
Above 2000 to 3000	Rs. 1,000,000**/-** and an additional listing fees of Rs. 4,270**/-** for every increase of Rs.5 crores or part thereof above 1,000 crores in the paid-up share capital.	
Above 3000	Rs. 1,020,000/- and an additional listing fees of Rs. 3910/- for every increase of Rs.5 crores or part thereof above 1,000 crores in the paid-up share capital.	

Source: https://www.bseindia.com/Static/about/listing_fees.aspx

*Plus Applicable Taxes

#Commonly Listed Companies – Companies Listed on Stock Exchange(s) having nationwide presence

Note:

- The capital to be considered for the above schedule includes equity shares, preference shares, Indian Depository Receipts, Fully convertible debentures, partly convertible debentures and any other security convertible into equity shares.

- In case of debenture capital (not convertible into equity shares) listed prior to April 1, 2017, the fees applicable will be 75% of the above fees.
- Fees are applicable for the full year.
- In case of InvITs capital (Public issue) the fees applicable will be 75% of the above fees, subject to minimum of Rs. 200,000.

Fees for Privately Placed Debt Securities

Particulars	**Amount**
Initial Listing fee	Rs. 20,000
Listing Processing Fees (*applicable only to Private Companies*)	Rs. 4,500 per ISIN
Annual Listing Fee(Chargeable Per ISIN):	
Issue size upto Rs.5 Crs.	Rs.2,500
Above Rs.5 Crs. and upto Rs.10 Crs.	Rs.3,750
Above Rs. 10 Crs. and upto Rs. 20 Crs	Rs.7,500
Above Rs. 20. Crs.	Additional fee of Rs. 200 for every increase of Rs. 1 Cr or part thereof above Rs. 20 Crs. Subject to a maximum of Rs. 30,000 per instrument.
Cap on the annual listing fee of debt instruments per issuer is Rs. 5,00,000 per annum.	

Source: https://www.bseindia.com/Static/about/listing_fees.aspx

Fees for SME Segment

The annual fees is Rs 25,000/- or 0.01% of full market capitalization, whichever is higher. The basis of calculation of Market Capitalization will be the closing price as on 31st March or the last day of trading in the financial year.

Fees for Mutual Fund Segment

Particulars	**Amount**
Initial Listing Fee	NIL
Annual Listing Fee for tenure of the scheme	Payable per 'month or part thereof'
Issue size up to Rs. 50 Crs.	Rs. 1000
Above Rs.50 Crs. and upto Rs.100 Crs.	Rs. 1300
Above Rs.100 Crs. and upto Rs.300 Crs.	Rs. 2800
Above Rs.300 Crs. and upto Rs.500 Crs	Rs. 5300
Above Rs.500 Crs. and upto Rs.1000 Crs	Rs. 9300
Above Rs.1000 Crs.	Rs 14800
Processing FeesPer Single Scheme Information Document (SID)	Rs 10000

Source: https://www.bseindia.com/Static/about/listing_fees.aspx

Note: For tenure beyond One month, fees are payable for one month or any part thereof

5.13 LISTING OF RIGHT ISSUE

A rights issue is an invitation to existing shareholders to purchase additional new shares in the company. This type of issue gives existing shareholders securities called rights. With the rights, the shareholder can purchase new shares at a discount to the market price on a stated future date. The company is giving shareholders a chance to increase their exposure to the stock at a discount price.

A rights issue is a way by which a listed company can raise additional capital. However, instead of going to the public, the company gives its existing shareholders the right to subscribe to newly issued shares in proportion to their existing holdings. For example, 1:4 rights issue means an existing investor can buy one extra share for every four shares already held by him/her. Usually the price at which the new shares are issued by way of rights issue is less than the prevailing market.

Until the date at which the new shares can be purchased, shareholders may trade the rights on the market the same way that they would trade ordinary shares. The rights issued to a shareholder have value, thus compensat-

ing current shareholders for the future dilution of their existing shares' value. Dilution occurs because a rights offering spreads a company's net profit over a larger number of shares. Thus, the company's earnings per share, or EPS, decreases as the allocated earnings result in share dilution.

The benefits of the rights issue:

- Increased control of the existing shareholders
- Enhancement in the value of shares and thus there is no loss on the existing shareholders
- It increases the goodwill of the firm and brand perception
- No cost involved with the issuance of shares

Drawbacks of rights issue:

- There tends to be a dilution in the value of shares due to an increase in its numbers
- It does offer a temporary solution to management issues but may not necessarily guide in the long run.

5.14 LISTING OF BONUS ISSUE

A bonus issue, also known as a scrip issue or a capitalization issue, is an offer of free additional shares to existing shareholders. A company may decide to distribute further shares as an alternative to increasing the dividend payout. For example, a company may give one bonus share for every five shares held.

Bonus issues are given 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.

Bonus shares are issued according to each shareholder's stake in the company. For example, a three-for-two bonus issue entitles each shareholder three shares for every two they hold before the issue. A shareholder with 1,000 shares

receives 1,500 bonus shares (1000 x 3 / 2 = 1500). Bonus shares are not taxable. But the stockholder may have to pay capital gains tax, if she sells them.

Advantages and Disadvantages of Issuing Bonus Shares

Companies low on cash may issue bonus shares rather than cash dividends as a method of providing income to shareholders. Because issuing bonus shares increases the issued share capital of the company, the company is perceived as being bigger than it really is, making it more attractive to investors. In addition, increasing the number of outstanding shares decreases the stock price, making the stock more affordable for retail investors.

However, issuing bonus shares takes more money from the cash reserve than issuing dividends does. Also, because issuing bonus shares does not generate cash for the company, it could result in a decline in the dividends per share in the future, which shareholders may not view favorably. In addition, shareholders selling bonus shares to meet liquidity needs lowers shareholders' percentage stake in the company, giving them less control over how the company is managed.

The basic idea of rights issue is to raise fresh capital. A rights issue is not a common practice that a corporate organisation resorts to. Ideally, such an issue occurs when a company needs funds for corporate expansion or a large takeover. At the same time, however, companies also use rights issue to prevent themselves from being conked out.

Since a rights issue results in higher equity base for the organisation, it also provides it with better leveraging opportunities. The company becomes more comfortable when it comes to raising debt in the future as its debt-to-equity ratio reduces.

5.15 DIFFERENCES BETWEEN RIGHT ISSUE AND BONUS ISSUE

1. The rights issue is an additional issue of shares by a company for its existing shareholders. The existing shareholders have their right to subscribe

to these shares unless some special rights reserve them for any other individuals.

On the other hand, when a firm earns the supernormal amount of profits, these are converted into Capital and divided amongst the shareholders free of cost in a proportion of their respective holdings.

2. Rights shares are offered to the existing shareholders by the company for raising additional capital from the market. Rights shares are offered at a discounted price compared to the market price.

Whereas, bonus shares are issued to the shareholders free of cost.

5.16 LISTING OF FURTHER ISSUES

A company (including Private company) having a share capital can increase its subscribed capital by issue of further shares to persons who are holders of equity shares of the company in proportion to the paid up share capital on those shares, by sending a letter of offer.

In some situations, a company would consider it economically viable to increase its subscribed capital after its incorporation. This is because such a further issue would substantially increase its financial reserve and incentivize the shareholders of the company, thereby ensuring the healthy functioning of the company. Such a company which is desirous of increasing its subscribed capital by the further issue of shares is required to comply with the procedure laid down in section 62 of the Companies Act, 2013.

Companies issue additional shares for various reasons. One of the primary reasons they issue additional shares is to raise new capital to fund existing / new business operations. Companies opt to raise funds through different routes such as by way of Qualified Institutional Placement, Preferential Issue, etc. A Company may also issue additional shares to the Employees of the Company by way of Employee Stock Option Plans/Schemes and to its shareholders by way of Bonus/Rights Issue.

Further shares shall be offered-

- to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the

paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

- the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
- unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (*i*) shall contain a statement of this right;
- after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company;

- to employees under a scheme of employees' stock option, subject to [special resolution] passed by company and subject to such conditions

5.17 DELISTING OF SECURITIES

Delisting of securities means permanent removal of securities of a listed company from the stock exchange where it was registered. As a result of this, the company would no longer be traded at that stock exchange. It may happen either when the company does not comply with the guidelines of the stock exchange, or that the company has not witnessed trading for years, or that it voluntary wants to get delisted or in case of merger or acquisition of a company with/by some other company. So, broadly it can be classified under two headings:

1. **Compulsory delisting:** Compulsory delisting refers to permanent removal securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submission/comply with various requirements set out in the listing agreement within the time frames prescribed.

A stock exchange may compulsorily delist the share of a listed company under certain circumstances like:

- Non-compliance with the listing agreement for a minimum period of six months
- Failure to maintain the minimum trading level of shares on the exchange
- Promoters' 'Directors' track record especially with regard to insider trading, manipulation share prices, unfair market practices (e.g. returning of share transfer documents under objection on frivolous grounds with a view to creating scarcity of floating stock, in the market causing unjust aberrations in the share prices, auctions, close-out, etc. depending upon the trading position of directors or the firm)
- The company has become sick and unable to meet current debt obligations or to adequately finance operations, or has not paid interests on debentures for the last 2-3 years, or has become defunct, or there are no employees, or liquidator appointed etc.

2. **Voluntary delisting:** In voluntary delisting, a listed company decides on its own to permanently remove its securities from a stock exchange. This happens mainly due to merger or amalgamation of one company with the other or due to the non-performance of the shares on the particular exchange in the market.

5.18 LISTING CONDITIONS IN BSE

Listing requirement**s** are a set of conditions which a firm must meet before listing a security on one of the organized stock exchanges. A company

intending to have its securities listed on BSE has to comply with the listing requirements prescribed by it. Some of the requirements are as under:

- Minimum Listing Requirements for New Companies
- Minimum Listing Requirements for Companies already Listed on other Stock Exchanges
- Minimum Requirements for Companies Delisted by BSE seeking relisting on BSE
- Permission to Use the Name of BSE in an Issuer Company's Prospectus
- Submission of Letter of Application
- Allotment of Securities
- Trading Permission
- Requirement of 1% Security
- Payment of Listing Fees
- Compliance with the Listing Agreement
- Cash Management Services (CMS) - Collection of Listing Fees

The listing norms for companies already listed on other stock exchanges and seeking listing at BSE, made effective from August 6, 2002, are that (i) the company shall have a minimum issued and paid up equity capital of Rs. 3 crore and (ii) the company shall have a profit making track record for the preceding last three years.

5.19 LISTING REQUIREMENTS FOR NSE

A company intending to have its securities listed on NSE has to comply with the following listing requirements:

- Company must be registered as a public company under Companies act 1956 or Companies act 2013.
- Company should be at least 3 years old and 2 years should be positive net worth.
- Post issue paid-up capital should not be more than 25 Cr.



CHECK YOUR PROGRESS

1. Write True or False

a) Securities listed in a stock exchange are marketable forever.

b) All listed companies are required to pay an Annual Listing Fees to the respective stock exchange.

c) A rights issue is an invitation to existing shareholders to purchase additional new shares in the company.

d) A bonus issue is also known as a scrip issue or a capitalization issue.

e) Bonus is offered to the existing shareholders against additional charges.



5.20 LET US SUM UP

We have discuses the following points in the unit :-

- A stock exchange deals only in the listed securities of certain selected companies.
- Listing means an act of inclusion of securities in the official list of a stock exchange for the purpose of trading.
- All listed companies are required to pay an Annual Listing Fees to the respective stock exchange.
- Every recognized stock exchange has the power to make byelaws for the listing of securities on the stock exchange.
- Central Government has the power to make or amend byelaws of recognized stock exchanges either on a request by the governing body of a stock exchange or on its own motion.
- Exchanges have listing requirements to ensure that only high quality securities are traded on them and to uphold the exchange's reputation among investors.
- The stock exchange reserves the right to cancel or suspend the permission granted following any breach of the obligations mentioned above.

- Listing of securities on the stock exchanges is advantageous to the company as well as to the investors.
- A rights issue is an invitation to existing shareholders to purchase additional new shares in the company.
- A bonus issue, also known as a scrip issue or a capitalization issue, is an offer of free additional shares to existing shareholders.



5.21 FURTHER READINGS

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services –By M. P. Tripathy
- Indian Financial System -By M Y Khan
- Website of the SEBI, NSE Ltd. and BSE Ltd.



5.22 ANSWERS TO CHECK YOUR PROGRESS

1. a) False b) True c) True d) True e) False



5.23 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Need for listing of securities
   b) Listing procedures
   c) Listing of rights issue
   d) Listing of bonus issue
   e) Listing of further issue
   f) Listing fee
   g) Delisting
2. What do you mean by listing of securities? What are the procedures to be followed by a company for listing its securities in a stock exchange?
3. Enumerate the advantages and disadvantages of listing of securities.
4. Describe the listing conditions for listing in BSE and NSE.

UNIT-6 : MERCHANT BANKING

UNIT STRUCTURE

6.1 Learning Objectives
6.2 Introduction
6.3 Nature and Characteristics of Merchant Banking
6.4 Classification of Merchant Banks
6.5 Functions/Services Offered by Merchant Bankers
6.6 Qualities Required of Merchant Bankers
6.7 Merchant Banking in India
6.8 Regulation of Merchant Banking in India
6.9 Registration/Pre-requisites for Merchant Bankers
6.10 Scope for Merchant Banking in India
6.11 Let Us Sum Up
6.12 Further Readings
6.13 Answers to Check Your Progress
6.14 Possible Questions

6.1 LEARNING OBJECTIVES

After reading this unit you will able to:

- state the meaning and characteristics of merchant bank
- classify the merchant banks in India
- explain the functions and services provided by merchant banks
- enumerate the present structure of merchant banking in India
- explain the regulation of merchant banks in India
- discuss the scope of merchant banking in India

6.2 INTRODUCTION

Merchant banking is an essential part of financial sector of a country. Originally, the merchant banking business was established in Italy and Franch in the medieval period. A merchant banker in those days was a trader-cum-entrepreneur who added banking business with trading. In U.K. merchant bankers came into existence by the end of the 18th century. In USA, a kind of mer-

chant banking activity emerged through investment bankers in the early twentieth century.

The term merchant banking is used differently in different countries and so there is no precise definition for it. In London, merchant banker refers to those who are members of British Merchant banking Securities House Association who carry on consultation, leasing, portfolio services, asset management, euro credit, loan syndication etc. In America, merchant banking is concerned with mobilizing savings of people and directing the funds to business enterprise.

In the Indian context, the notification of the Ministry of Finance defines merchant banker as “any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities as manager-consultant, advisor or rendering corporate advisory services in relation to such issue management” The Amendment Regulation specifies that issue management consist of prospectus and other information relating to issue, determining financial structure, tie-up of financiers and final allotment and refund of the subscriptions, underwriting and portfolio management services. There is thin distinction between merchant banking and investment banking. The former is purely fee-based. The later is both fees as well as fund-based.

In the words of Skully “a merchant bank could be best defined as a financial institution conducting money market activities and lending, underwriting and financial advice, and investment services whose organization is characterized by a high proportion of professional staff able to able to approach problems in an innovative manner and to make and implement decisions rapidly.”

6.3 NATURE AND CHARACTERISTICS OF MERCHANT BANKING

Merchant banking is skill based activities and involves serving every financial need of every client. It requires focused skill-base to provide for the requirements of the client. SEBI has made the quality of man-power as one of

the criteria for registration as merchant banker. These skills should not be concentrated in issue management and underwriting alone, which may have an adverse impact on business. Merchant bankers can turn to any of the activities mentioned above depending upon resources, such as capital, foreign tie-ups for overseas activities and skills. The depth and sophistication in merchant banking business are improving since the avenues for participating in capital market activities have widened from issue management and underwriting to private placement, bought out deals (BODs), buy-back of shares, mergers and takeovers.

The services of merchant bank cover project counseling, pre investment activities, feasibility studies, project reports, design of capital structure, issue management, underwriting, loan syndication, mobilization of funds from non-resident Indians, foreign currency finance, mergers, amalgamation, takeover, venture capital, buy back and public deposits.

Characteristics of Merchant Banking

- High proportion of decision makers as a percentage of total staff
- Quick decision process
- High density of information
- Intense contact with the environment
- Loose organizational structure
- Concentration of short and medium term engagements
- Emphasis on fee and commission income
- Innovative instead of repetitive operations
- Sophisticated services on a national and international level
- Low rate of profit distribution
- High liquidity ratio

6.4 CLASSIFICATION OF MERCHANT BANKS

1. Public Sector Merchant Banks

- Commercial Banks (public)
- National Financial Institutions
- State Financial Institutions

2. Private Sector Merchant Banks

- Foreign Banks
- Indian Private Banks
- Leasing Banks
- Finance and Investment Companies

6.5 FUNCTIONS/SERVICES OFFERED BY MERCHANT BANKERS

Merchant banks in India are rendering varieties of financial, consultancy and allied services. The basic function of merchant banker or investment banker is marketing of corporate and other securities. In the process, he performs a number of services concerning various aspects of marketing, viz., origination, underwriting, and distribution, of securities. Earlier in India, when new issues were priced at a significant discount to their market prices, the merchant banker's job was limited to ensuring press coverage and dispatching subscription forms to every corner of the country. Now, merchant bankers are designing innovative instruments and perform a number of other services both for the issuing companies as well as the investors. The activities or services performed by merchant bankers, in India, today include:

- Project promotion services
- Project finance
- Management and marketing of new issues
- Underwriting of new issues
- Syndication of credit
- Leasing services
- Corporate advisory services
- Providing venture capital
- Operating mutual funds and off shore funds
- Investment management or portfolio management services
- Bought out deals
- Providing assistance for technical and financial collaborations and joint ventures
- Management of and dealing in commercial paper

- Investment services for non-resident Indians
- Public deposits
- Corporate counseling
- Project counseling and feasibility studies
- Mergers and amalgamations
- Debenture trusteeship
- Acceptance house business
- Issue management
- Export financing for capital goods
- Hire-purchasing financing
- Investment trusts
- Valuation of assets
- Financial management, etc.

1. Project Appraisal

This service helps corporates in analyze the soundness of a project, which may be setting up a new unit/expansion/modernization etc. It is a process of examining the technical, commercial, financial and economic viability of a project to ensure that it generates sufficient returns on the resources invested in it. The study of viability involves detached verification of project's ability to stand the tests of technical, financial and commercial feasibilities and management's capabilities to successfully implement and run the project. A service project report will be prepared for the company, including finalization of capital structure. Project appraisal includes:

- Financial appraisal (liquidity analysis, capital structure analysis, profitability analysis etc
- Technical appraisal (factors of production, technology, civil works, site location etc)
- Economic appraisal (also known as cost-benefit analysis, social cost, impact on employment, impact of the economy)

2. Syndication of Loan

Merchant Bankers arrange short, medium and long term loans for their clients. They analyze the pattern of clients cash flows, based on which the

terms of borrowing can be defined. It then prepares a detailed loan memorandum which is circulated to various banks and financial institutions and they are invited to participate in the syndicate. The merchant banks then negotiate the terms of lending based on which the final allotment is done. It also arranges for raising foreign exchange loans and external commercial borrowings for import of capital.

3. Issue Management

This is the primary function of merchant bankers. It refers to the management of securities offering of corporates to the general public and existing shareholders on rights basis. Merchant bankers act as lead managers and assists companies in arriving at quantum and nature of issue and obtaining consent/clearance from various statutory authorities, preparing draft prospectus, obtaining approval from appropriate authorities etc. it also assists companies in tying up with underwriters for the issue, appoint other intermediaries like brokers, bankers, advertising agents, registrar to the issue and co-ordinates the activities of these agencies and institutions from the successful flotation of the issue. It also helps in listing the securities in stock exchange, finalizing basis of allotment, arranging for refund, handling investor complaints etc.

Merchant banks help companies raise funds by selling shares to the public by issuing prospectus. Shares may be issued at par, premium or discount. SEBI guidelines for pricing of public issues are as follows:

- New company set up by entrepreneurs without a track record can issue shares only at par
- New company set up by an existing company with a 5-year track record of consistent profitability is free to price its issue provided promoting company takes at least 50% of the equity and the issue price is offered to all new investors uniformly.
- An existing private/closely held company with 3-year track record of consistent profitability is allowed to freely price the issue.
- Existing listed company can freely price further issue.

Process of public issues

- Vetting of prospectus (by SEBI)
- Appointment of underwriters, bankers, registrars and brokers
- Filing and prospectus with registrar of companies
- Printing and dispatch of prospectus and application forms
- Filing of initial listing application (within 10 days of filing prospectus with ROC: initial listing application be made to concerned stock exchange)
- Promotion of issue
- Statutory announcement (opening and closing dates, announcement to be made at least 10 days before opening subscription list)
- Collection of application
- Processing of allocation (by registrar to the issue)
- Establishing liability of underwriters (if issue is undersubscribed)
- Allotment of shares (after formal approval by concerned stock exchange)
- Listing of issue (with concerned stock exchange)

4. Underwriting of Issues

In order to ensure full subscription or the stipulated minimum subscription of 90% of the issue; companies enter into an agreement with financial institutions, banks, brokers and bankers to underwrite the issue amount. Merchant bankers can underwrite issues and assist companies in tying up with other underwriters. The word 'underwriter' is said to have come from the practice of having each risk-taker write his or her name under the total amount of risk that he or she was willing to accept at a specified premium. In a way, this is still true today, as new issues are usually brought to market by an underwriting syndicate in which each firm takes the responsibility (and risk) of selling its specific allotment.

Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed, then there is no liability for the underwriter. If a part of shares issues remains unsold, the underwriter will buy the shares. Thus, underwriting is a guarantee for the marketability of shares.

Underwriting is frequently done in investment banking, insurance and commercial banking. In investment banking, underwriting is the practice by

which investment bankers represent corporate and government entities in the initial public offering of their securities. The investment bankers cover the risk of selling the securities to the public. This is a way of distributing a newly issued security, such as stocks or bonds, to investors. A syndicate of banks (the lead managers) underwrites the transaction, which means they have taken on the risk of distributing the securities. Should they not be able to find enough investors, they will have to hold some securities themselves.

In the securities industry an underwriter is a company, usually an investment bank that helps companies introduce their new securities to the market. In the insurance business, an underwriter is a company liable for insured losses in return for a fee (premium). Underwriting is the process by which investment bankers raise investment capital from investors on behalf of corporations and governments that are issuing securities (both equity and debt). It is also the process of issuing insurance policies.

5. Corporate Counseling

Corporate counseling covers the entire field of merchant banking activities viz. project counseling, capital restructuring, project management, public issue management, loan syndication, working capital, fixed deposit, lease financing, acceptance credit etc. the scope of corporate counseling is limited to giving suggestions and opinions to the client and help taking actions to solve their problems. It is provided to a corporate unit with a view to ensure better performance, maintain steady growth and create better image among investors.

6. Bankers to the Issue

Collection of subscription money/application money for an issue from the investors, acknowledgement, proper accounting of the money received, sending reports/certificates, informing collection details are the services provided in the banker to the issue role.

7. Investment Counseling

This activity involved assisting firms, companies, trusts, funds and associations in the choice of shares and stocks for investment depending upon the needs and the risk-return trade-off, as well as taxation and time considerations.

8. Portfolio Management Services

Portfolio refers to investment in different kinds of securities such as shares, debentures or bonds issued by different companies and securities issued by the government. It is not merely a collection of unrelated assets but a carefully blended asset combination within a unified framework. Hence, a portfolio is a collection of different kinds of investments. Portfolio management refers to maintaining proper combination of securities in a manner that they give maximum return within minimum risk. Merchant bankers provide portfolio management services to their clients. Today the investors are very prudent. Every investor is very interested in safety, liquidity and profitability of his investment. But investors cannot study and choose the appropriate securities. They need expert guidance. Merchant bankers have a role to play in this regard.

9. Registrar and Transfer Agent

Transfer agency work involves carrying out transfer work in respect of securities after complying with stipulated formalities/procedures. Preparation and printing of dividend warrants and dispatching them to share holders is also covered here. Other services include attending to complaints of applicants/investors, coding and verification of applications, allotment, processing and dispatching allotment letters, providing various documents and certificates etc.

10. Mergers, Amalgamations and Acquisitions

Some companies desire to restructure themselves in order to effectively meet competition. Merchant bankers provide all requisite guidance and services for restructuring, to prepare due diligence, necessary clearance from statutory bodies like SEBI, ROC etc. as per the statutory stipulations, for the process of mergers, acquisitions and amalgamations.

11. Venture Capital

Merchant bankers help the companies obtaining venture capital for financing their new and innovative strategies. Venture capital is a type of funding for a new or growing business. It usually comes from venture capital firms that specialize in building high risk financial portfolios. With venture capital, the venture capital firm gives funding to the startup company in exchange for equity in the startup.

12. Leasing Finance

Merchant bankers also help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor allows the issue of his specific asset such as equiptment by the lessee for a certain period. The lessor charges a fee called rentals.

13. Non-resident Investment

Merchant bankers provide investment advisory services to attract NRI investment in primary and secondary markets, undertake buying and selling of securities on their behalf, secure clearances from RBI under FEMA for repatriation of interest and dividends etc.

14. Joint Ventures

Merchant bankers help corporate bodies with joint ventures in India and abroad.

6.6 QUALITIES REQUIRED OF MERCHANT BANKERS

Merchant bankers play a significant role as a catalyst to transform the project ideas into industrial ventures. They help promotion of the enterprise by undertaking various activities such as market surveys, choice of suitable location and its size, preparation of documents and obtaining consent from various authorities. They help in taking important decisions such as financing mix, management of public issues, credit syndication etc. the success of the merchant bankers depends on the quality of service and soundness of advice to clients. To perform these services effectively the merchant bankers are expected to process certain qualities which are described bellow:

- Ability to analyse various aspects such as technical, financial and economic aspects concerning the formation of an industrial project.
- Knowledge about the various aspects of capital markets, trends in stock exchange, psychology of investing public, change in economic and technological environment in the country.
- Ability to build up the bank-client relationship and live up to the clients' expectations with total involvement in the project assigned to them.
- Innovative approach in developing capital market instruments to satisfy the ever changing needs of investing public.

- Integrity and maintenance of high professional standards are the essential requisites for the success of merchant bankers' present scenario.



CHECK YOUR PROGRESS

1. Answer as directed:

a)_____ is the regulatory body of merchant banking in India. (Fill in the gap)

b) Merchant banks in India started in _____. (Fill in the gap)

6.7 MERCHANT BANKING IN INDIA

The Banking Commission Report in 1972, in view of the widening industrial base of the country, stressed the need for merchant banking in India. As a matter of fact, the Grindlays Bank initiated the merchant banking activity in Indian capital market in 1967. Their business form was on the management of public issues and financial consultancy. Citibank introduced its merchant banking division in 1970. Following the recommendations of the Banking Companies (1072), the State Bank of India established its merchant banking division in 1973. The more was followed by the ICICI in starting merchant banking services in 1974. The mid-seventies onwards there was a mushroom growth of merchant banking sector as several banks including Bank of Baroda, Canara Bank, Mercantile Bank, United Bank of India, among others and well as IFCI and IDBI, besides many NBFCs started providing merchant banking services.

By 1995, there were 934 merchant banks registered with the SEBI which include 34 commercial banks with subsidiaries institutions, 21 states institutions, 10 international banks with subsidiaries, 8 financial institutions banks, 7 foreign financial investments, 4 leasing, 16 private banks, and 834 financial and investment companies. The SEBI has categorized them into four groups. Category I contained over 40 percent of merchant bankers. In 1997, however this classification was discontinued and only category I remained. The minimum net worth for this category is ₹ 5 crores and the registration fee was 2.5 lakhs for two initial years and 1 lakh in the third year.

6.8 REGULATION OF MERCHANT BANKING IN INDIA

The Securities and Exchange Board of India (SEBI) is the regulatory body of merchant banking in India. The SEBI has laid down code of conduct for the merchant bankers to follow and they are also required to submit their annual balance sheet, profit & loss account, etc. along with their working result. The SEBI is also authorized to inspect the books of accounts, records and other documents of the merchant banks. In the case of defaulters, the SEBI can suspend or cancel their registration.

In essence, merchant bankers are basically identifiable as issue houses. They undertake pre-issue and post-issue management. The SEBI's guidelines in this context are to be adhered to by the merchant bankers. The merchant bankers are required to ensure that the prospectus of the client companies must provide the necessary information as per the Companies Act, 1956 and the SEBI's guidelines. For underwriting activity they need to obtain a certified copy of registration from the SEBI.

The main objective of the merchant banking regulation is to control the raising of funds in the primary market and ensure cost-effectiveness. The SEBI is striving a fair, efficient and flexible primary market with such regulations. The merchant banking activity in India is govern by:

- Guidelines given by the Securities and Exchange Board of India (SEBI) and Ministry of Finance
- Companies Act, 1956
- Securities guidelines of Stock Exchange

Licensed merchant bankers have to register with the SEBI. The registration of merchant banking is compulsory for the activities such as:

- Debenture trusteeship
- Authorisation
- Portfolio management
- Capital issues pre and post
- Takeover by acquisition of shares

6.9 REGISTRATION/PRE-REQUISITES FOR MERCHANT BANKERS

Registration with SEBI is mandatory to carry out the business of merchant banking in India. An applicant should comply with the following norms:

- Applicant should be a body corporate.
- Applicant should have minimum net worth of 5 crore.
- Applicant must have at least 2 employees with prior experience of merchant banking.
- Applicant should have necessary infrastructure like office space, equipment, manpower etc.
- Applicant should not carry on any business other than those connected with the securities market and must have necessary experience in the same.
- Applicant should not have been involved in any securities scam, proved guilty for any offense or been accused of moral turpitude.
- Any associate co, group co, subsidiary or inter-connected co of applicant should not have been a registered merchant banker.

6.10 SCOPE FOR MERCHANT BANKING IN INDIA

1. Growth of New Issues Market: The growth of new issue market is unprecedented since 1990-1991. Merchant banking can help with the further sophistication and penetration of the new issues market.

2. Entry of Foreign Investors: Foreign institutional investors were allowed to invest in the primary and secondary market in 1992 and also, Indian companies were allowed to directly tap foreign capital through euro issues. Further, foreign direct investment by NRIs has risen considerably due to number of incentives offered to them. They need the services of merchant bankers to advise them for their investment in India. The increasing number of joint ventures abroad by Indian companies also requires expert services of merchant bankers.

3. Hanging Policy of Financial Institutions: The policy of decentralization, increase in demand for technical and financial services and encouragement of small and medium industries, requires the services of merchant bankers.

4. Development of Debt Market: The development of debt market will offer tremendous opportunity to Merchant Bankers.

5. Innovations in Financial Instruments: The Indian capital market has witnessed innovations in the introduction of financial instruments. This has further extended the role of merchant bankers as market makers for these instruments.

6. Corporate Restructuring: Due to liberalization and globalization, competition in the corporate sector is becoming intense. To survive and thrive, companies need new strategies, structures and methods of functioning. This has led to corporate restructuring including mergers, acquisitions, etc. These developments offer a good opportunity to merchant bankers to extend their area of operations.

7. Disinvestment: The government of India has raised ₹ 2000 crores through disinvestment of equity shares of selected public sector undertakings in 93-94. Merchant Bankers can help in the disinvestment process.



CHECK YOUR PROGRESS

2. Answer as directed:

a) Merchant banks concept in India introduced by _____. (Fill in the gap)

b) Credit card is a prepaid card. (Write True or False)



6.11 LET US SUMUP

In this unit we have discuss the following:

- The services of merchant bank cover project counseling, pre investment activities, feasibility studies, project reports, design of capital structure, issue management, underwriting, loan syndication, mobilization of funds from non-resident Indians, foreign currency finance, mergers, amalgamation, takeover, venture capital, buy back and public deposits.
- Merchant banking is skill based activities and involves serving every financial need of every client.

- Merchant bankers play a significant role as a catalyst to transform the project ideas into industrial ventures.
- Grindlays Bank initiated the merchant banking activity in Indian capital market in 1967.
- The Securities and Exchange Board of India (SEBI) is the regulatory body of merchant banking in India.



6.12 FURTHER READING

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services –By M. P. Tripathy
- Indian Financial System -By M Y Khan



6.13 ANSWERS TO CHECK YOUR PROGRESS

1. (a) SEBI (b) 1969
2. (a) ANZ Grindlays (b) False



6.14 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Portfolio management
   b) Project counseling
   c) Traveller's Cheques
2. Define Merchant Banking? Explain its Nature and characteristics.
3. What are Merchant Bankers? Discuss briefly the financial services provided by merchant bankers in Indian capital market?
4. Put a light on the scope for Merchant Banking in India.
5. Write an essay on Classification of Merchant Banking.

UNIT 7 : TRADING AND SETTLEMENT SYSTEM IN STOCK EXCHANGES

UNIT STRUCTURE

7.1 Learning Objectives

7.2 Introduction

7.3 Meaning of Stock Exchange

7.4 Functions of Stock Exchange

7.5 Features of Stock Exchange

7.6 Bombay Stock Exchange (BSE)

7.7 BSE-BOLT System

7.8 Bad Delivery

7.9 Short Delivery

7.10 Auction of Shares

7.11 National Stock Exchange (NSE)

7.12 Order Types and Books

7.13 Demat Settlement

7.14 Physical Settlement

7.15 Institutional Segments

7.16 Funds Settlement

7.17 Valuation Debit

7.18 Valuation Price

7.19 Let Us Sum Up

7.20 Further Readings

7.21 Answers to Check Your Progress

7.22 Possible Questions

7.1 LEARNING OBJECTIVES

After going through this unit you will able to:

- state the meaning, features and functions of stock exchange
- know about the stock exchanges in India
- understand the BSE and NSE

- to learn about the trading procedure on a Stock Exchanges
- know different types of settlements
- enumerate the meaning of pay-in and pay-out, bad delivery, short delivery, NEAT system, Demat settlement, funds settlement, valuation debit, valuation price etc.

7.2 INTRODUCTION

It is essential for the success of a recognised stock exchange that there must be written and codified rules, bye-laws and regulations to ensure smooth conduct of business in the stock exchange. Rules of trading, clearing and settlement of transactions should be very clear to avoid misunderstandings, to ensure rapid dealings and prompt settlements, to prevent artificial price fluctuations, to encourage a large volume of trade by building confidence in the investors, to educate the investors regarding the malpractice followed by companies and speculators etc. This unit deals with trading, clearing and settlement mechanism followed by various stock exchanges.

7.3 MEANING OF STOCK EXCHANGE

Stock exchange is an important institution in the capital market. It is a secure place where trading is done in a systematic way. Here, the secored how securities are bought and sold as per well-structured rules and regulations. Securities mentioned here include debenture and share issued by a public company, debenture and bonds issued by the government bodies, municipal and public bodies.

7.4 FUNCTIONS OF STOCK EXCHANGE

Some of the significant functions of the Stock Exchange are listed below:

- **Economic Barometer:** A stock exchange is a solid barometer to gauge the economic circumstance of a country. A stock exchange is also known as a pulse of the economy or economic mirror which reflects the economic conditions of a country.
- **Pricing of Securities:** The stock market helps to assess the securities on the basis of demand and supply factors. The securities of effec-

tive and growth-oriented organisations are estimated higher as there is more demand for such securities.

- **Safety of Transactions:** In the stock market only the indexed securities are traded and stock exchange authorities include the corporations named in the trade list only after verifying the soundness of the organisation. The organisations which are listed also have to function within the stringent rules and regulations. This guarantees the security of dealing through the stock exchange.
- **Contributes to Economic Growth:** In stock exchange securities of various organisations are traded. This method of disinvestment and reinvestment helps to invest in the most productive investment proposal and this leads to capital structure and economic growth.
- **Spreading of Equity Cult:** Stock exchange urges people to invest in ownership securities by managing new issues, better trading practices and by educating the people about investment.
- **Providing Scope for Speculation:** To assure liquidity and demand of supply of securities the stock exchange allows healthy consideration of securities.
- **Liquidity:** The principal purpose of the stock market is to present a ready market for sale and purchase of securities. The presence of the stock exchange market gives certainty to investors that their investment can be transformed into cash whenever they want.
- **Better Allocation of Capital:** The shares of profit-making organisations are valued at higher prices and are actively traded so such organisations can efficiently raise capital from the stock market.
- **Promotes the Habits of Savings and Investment:** The stock market gives attractive chances for investment in different securities. These attractive opportunities inspire people to save more and invest in securities of the corporate sector rather than investing in unfruitful assets such as gold, silver, etc.

7.5 FEATURES OF STOCK EXCHANGE

- **A market for securities:** It is a wholesome market where securities of government, corporate companies, semi-government companies are bought and sold.
- **Second-hand securities:** It associates with bonds, shares that have already been announced by the company once previously.
- **Regulate trade in securities:** The exchange does not sell and buy bonds and shares on its own account. The broker or exchange members do the trade on the company's behalf.
- **Dealings only in registered securities:** Only listed securities recorded in the exchange office can be traded.
- **Transaction:** Only through authorised brokers and members the transaction for securities can be made.
- **Recognition:** It requires to be recognized by the central government.
- **Measuring device:** It develops and indicates the growth and security of a business in the index of a stock exchange.
- **Operates as per rules**: All the security dealings at the stock exchange are controlled by exchange rules and regulations and SEBI guidelines.

7.6 BOMBAY STOCK EXCHANGE (BSE)

BSE is an Indian stock exchange located at Dalal Street, Mumbai and operates with a vision of to "*Emerge as the premier Indian stock exchange with best-in-class global practice in technology, products innovation, and customer service."*

It is one of the two principal large stock exchanges of India and was founded by Mr. Premchand Roychand, famously known as the Cotton King, the Bullion King or the Big Bull. He was one of the most influential Indian businessmen of the 19th century and made a fortune in the stock-broking business.

Established in 1875, BSE is the oldest and first stock exchange of Asia and was formerly known by the name of -The Native Share & Stock Brokers Association. But the story of BSE starts back in the 1850s when 22 stockbro-

kers would gather under banyan trees in front of Mumbai's Town Hall. Location of these meetings changed multiple times to accommodate an increasing number of brokers. The group eventually moved to Dalal Street in the year 1874. BSE is an integral component of the "$1 trillion" club, having the 11th largest market capitalisation value at $2.2 trillion.

In the year 1986, Sensex was introduced, as the first equity index to provide a base for identifying the top 30 trading companies of the exchange, in more than 10 sectors. Apart from Sensex, other important indices of BSE are BSE 100, BSE 200, BSE 500, BSE MIDCAP, BSE SMLCAP, BSE PSU, BSE Auto, BSE Pharma, BSE FMCG, BSE Metal, etc.

As of April 2018, BSE has an overall market capitalization of over $4.9 trillion, which makes it the 10th largest stock exchange marketplace in the world. It also offers varied services such as market data services, risk management, CDSL (Central Depository Services Limited) depository services, etc.

a) Working of Bombay Stock Exchange (BSE):

In 1995, the BSE switched from an open-floor to an electronic trading system. There are more than a dozen electronic exchanges in the U.S. alone with the New York Stock Exchange (NYSE) and Nasdaq being the most widely known. Today electronic systems dominate the financial industry overall, offering fewer errors, faster execution, and better efficiency than traditional open-outcry trading systems.

Securities that the BSE lists include stocks, stock futures, stock options, index futures, index options, and weekly options. The BSE's overall performance is measured by the Sensex, an index of 30 of the BSE's largest stocks covering 12 sectors.

Financial transactions in BSE are done online through an electronic trading system. Market orders can be directly placed in BSE online, without the requirement of external specialists through direct market access. Due to the

absence of such limit orders, focus is shifted from buyers/sellers to the total value of transactions in a day.

Trading in the BSE share market has to be done through a brokerage agency, against a stipulated charge. However, direct investment access is given to certain preferential investors making large transactions in the BSE stock market. BOLT-Bombay Online trading platform is used by this stock exchange for efficient trading.

Transactions made in BSE online are done through T+2 rolling settlement, wherein all transactions are processed within two days. Securities and Exchange Board of India (SEBI) is responsible for the regulation of this stock exchange, continuously updating rules for its smooth operation.

In order to induce more transparency and efficiency in the trading system, NSE and BSE introduced nationwide online fully automated "Screen Based Trading System". The trading platform used by BSE is called BOLT-Bombay Online Trading. The order of investors is placed on the basis of time and price basis.

Recently BSE has launched new software for trading called BEST (BSE Electronic Smart Trader). It can be downloaded directly from Android play store and an investor can enjoy zero transaction charges for 6 months on cross currency derivatives.

b) Trading/Settlement Process at BSE:

i) Step 1: Finding a Broker

A broker acts as an intermediary or a mediator between the investor and the stock exchange. The work of a broker is transfer of order electronically from the investor to the exchange. Any transaction that occurs in stock market is taken care by the stock exchange. Normally in India the stock exchange for trading is active from 9:15 AM to 3:30 PM. However from 1st October, 2018 SEBI has decided to extend the trading hours till 11:55 pm in a move to attract the investors dealing in Indian products on overseas exchanges. The brokers should be selected on the following basis:

- Watching out for fees taken for opening an online trading account
- Having a proper look at ratings and customer service.
- Brokerage charge for intraday trading
- Brokerage charge on selling a long held share
- Margin provided by the broker on intraday trading
- The broker must provide information regarding investment opportunities on a regular basis.

ii) Step 2: Opening Account with the Broker

Having selected a broker it is time to open an online trading account with the broker. A broker always opens a trading account in the name of the investor/ client only if he/she is satisfied about the credit worthiness of the client. If the broker feels satisfied with the client he/she will open the account by writing the client's name in the broker's book. The minimum requirement for opening a trading account is PAN card, and bank account failing to which the account cannot be opened.

iii) Step 3: Placing the Order

After the account is opened successfully a notification will be provided via email or message. Then the investor can begin the trading as per his/her wish. The trading or investment is done by purchasing a specified number of shares of a particular company. The order when placed is incomplete until the order status shows complete. Different online trading platforms follow different symbols to mark the order placing. Order can also be placed via a telephonic call with the broker. There are different types of orders:

c) Share Groups on BSE

Stock classification is the process of grouping stocks for ease of understanding**.** In India both BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) classifies stocks. More or less the classification of stocks is similar on both platforms.

This stock classification was done to handle the stocks based on trading characteristics of Indian shares on the exchange platform and are known as grades. Mainly there are seven grades of stocks namely, A, B, T, S, TS & Z. All other stocks which fail the characteristics of any one of these grades were kept in others. These grades are scores of stocks on the basis of their size, liquidity and exchange compliance. Moreover, you will also reason yourself for any of your's such decisions.

i) A Group stocks - highly liquid stocks

- The stocks fall in the category of A Group, are the most liquid counters among all the stocks listed on the BSE.
- The market rates A Group stocks as excellent in all aspects and they also show comparatively high traded volume during trading.
- Settlement of A Group stocks trades is done under the normal rolling settlement process.

ii) T Group stocks - the stocks in trade-to-trade

- The stocks fall under T group follows trade-to-trade settlement system of the exchange.
- Each trade in this group is seen as a separate transaction and there is no netting-out of trades as in the rolling system
- The traders, who buy shares of this category or sell the script of this group, have to pay the amount or deliver the shares by T+2 days.
- For example, you bought 100 shares of T Group and sold another 100 shares on the same day. Then, the shares you have bought, you will have to pay the price of those shares in two days. And for the shares you have sold, you will have to make the delivery of shares by T+2 days, so that Exchange can make the settlement on time.
- Stocks of T group are regularly moved in and out of trade-to-trade settlement depending on the speculative interest that governs them.

iii) S Group stocks - small and medium stocks

- The stocks of 'S Group' fall under the BSE's Indonext segment.
- The BSE Indonext comprises small and medium companies that have a listing in the regional Stock Exchange.

- Generally, the turnover of S grade companies is rupees 5 crore and tangible assets of rupees 3 crore.
- Apart from the small size of the company, the other risk that comes with investing in them is low liquidity.

iv) TS Group stocks - it is a mix of T & S groups

- TS group is the combination of T & S group of shares.
- It consists of stocks in the "BSE-Indonext" segments also.
- These category stocks settle on a trade-to-trade basis as a surveillance measure.

v) Z Group stocks – caution to retail investors

- The companies of Z grade stocks have not complied with the exchange's listing requirements that have failed to redress investor's complaints.
- This grade also includes stocks of companies that have dematerialization arrangement with only one of the two depositories – CDSL and NSDL.
- The stocks of Z category are the riskiest scripts. Not much information is available to such companies in the public domain.
- These companies have low media coverage that keeps them relatively hidden from public scrutiny that makes such scripts more vulnerable to insider trading.
- Z Group companies already have a poor score in redressing investor complaints.

vi) B Group stocks - stocks that are left behind

- B Group comprises stocks that don't fall in any of the other groups.
- These counters see normal volumes and settle under the rolling system.

vii) Other classification

- Tradable financial instruments which are other than companies' stocks, form "Others". Group G & F falls under "others".
- The exchange also facilitates trading in fixed income securities, like company deposits. These instruments form F Group.
- Retail investors trade in government securities like long-dated GOI bonds on the exchange. Instruments of government securities come in Group G.

7.7 BSE-BOLT SYSTEM

Online trading in India has changed the meaning of trading in the country. With no requirement for a broker, trading has become easier, faster and far more convenient than earlier days. There is no need for any paperwork through online investing and the need for a middleman is eliminated. All the stock accounts are stored in Demat account where they can be viewed. The Bombay Stock exchange (BSE) provides an efficient and transparent market for trading in debt instruments, equity and derivatives. BSE online trading was established in 1995 and is the first exchange to be set up in Asia. This is performed through a system known as BOLT (BSE's Online Trading System).

In the stock exchange, a key index is used to keep track of the important or the most traded stocks in the exchange. Bolt is an automated system launched by BSE for traders from around the globe to place trades in Bombay Stock Exchange. This system allows making bulk trades as it can process a good amount of trades around the price you want to take position.

The BOLT system (Bombay On-line Trading) has been introduced in the Bombay stock exchange. Now all scrips on BSE are being traded through BOLT. The brokers and their agents conduct trading under the BOLT system from their Trading Work Stations (TWS). At every TWS, the BOLT system displays 'touchline' which will share the best bid and offer prices presently available in the market. The BOLT system also displays at every TWS 'market view' which will provide detailed market information on each listed stock.

7.8 BAD DELIVERY

A stock that cannot be transferred, especially because of improperly filed paperwork or another fairly innocuous reason, is called bad delivery. In other words, the delivery of such a stock is only stopped by legal and/or regulatory rules. One of the biggest problems faced by the investors in the secondary market is that of bad delivery which arises out of rejection of physical shares sent it to the companies by the buyers for getting them transferred in their names.

In order to help the buyers BSE has set up a Bad Delivery Cell (BDC) based upon the Uniform Norms for Good/Bad Deliveries formulated by SEBI. BDC follows a weekly cycle for acceptance of objections and rectifications. The cycle commences every Tuesday, on which the objections are accepted in the clearing house. The members have a facility of directly uploading the bad delivery claims in the BDC backend software and can download the various reports issued by the BDC, by using the BDC upload-download software. The physical/objection documents are accepted in the clearing house only if the data has been successfully loaded in the BDC backend software.

The objections, which have been forwarded to the clearing house by the buying clearing members on the first day of the cycle, need to be rectified by the seller clearing members and submitted to the clearing house on the 21st day of that particular cycle. BDC issues notices on every Monday, Tuesday and Thursday, giving the details of the claims against sellers, bad delivery schedule and auction for the un-rectified securities.

7.9 SHORT DELIVERY

In the equity segment whenever a share is bought or sold, and not squared off on the same day (i.e. non-intraday trades), such transactions result into delivery transactions. This means that if the shares are bought, the client needs to pay the full amount and take the delivery of shares in his Demat account. Similarly, if the shares are sold for delivery, the client has to give the shares to the exchanges to be transferred to the corresponding buyer. If the seller fails to deliver the shares (whether partially or fully), it is known as 'Short Delivery of Shares'.

Stock markets in India operate on T+2 rolling settlement cycles. Simply put, shares bought on Monday (T day) are settled on Wednesday (T + 2 day). Shares sold on Monday (T day) are to be settled/delivered on Wednesday (T + 2 day).

7.10 AUCTION OF SHARES

In the equity segment, shares can be sold for delivery only if the shares are available in the Demat account of the client. The client needs to transfer

the shares to the exchanges on T+2 days. If the client fails to transfer the shares within the stipulated time, such transaction results into default of pay-in obligation and short delivery of shares.

The buyer of the shares is the rightful acquirer of the shares and the shares needs to be transferred to his account. Since the seller has defaulted in delivery of the shares, the exchange would put the undelivered shares for 'Auction'. This Auction will happen on the T+2 day itself. In the auction session, people who already have shares in the Demat account can offer their shares. The auction window time is between 2.00 p.m. to 2.45 p.m. Clients of the broker where the default has happened cannot participate for the auction in the same script. The auction price is taken at the lowest price offered in the auction. The highest price would be not more than 20% and not less than 20% of the closing price of the T+1 day i.e. the previous day prior to settlement day. If the shares are offered, the shares are given to the buyer of the shares on T+3 day. The seller has to pay the price for the shares offered in the auction, which is generally higher than the market price prevailing on the day.

7.11 NATIONAL STOCK EXCHANGE (NSE)

NSE is the youngest stock exchange of India which came into picture in the year 1992 and operates with a vision, "*To continue to be a leader, establish a global presence, and facilitate the financial well-being of people.***"**

In 1992, for the very first time in India, NSE introduced the advanced electronic trading system which removed the paper-based settlement system from trading and offered an easy trading facility. One year later, in the year 1993, NSE was set up as a tax paying company, which later on registered itself as a Stock Exchange under the Securities Contract Regulation Act. In the year 1995, National Securities Depository Limited (NSDL) was formed to provide depository services to the investors.

NSDL allows investors and traders to securely hold and transfer their stocks electronically along with this, it also allows investors to hold and trade

in as few as one share or one bond. Nifty 50 the popular benchmark index in the Indian stock market, was introduced by NSE in the same year. Nifty lists out top 50 companies which traded on the NSE stock exchange market.

a) Market Segments in NSE:

The NSE operates the following sub-segments in the equities segment:

- **Rolling Settlement:** In a rolling settlement, each trading day is considered as a trading period and trades executed during the day are settled based on the net obligations for the day. At NSE, trades in rolling settlement are settled on a T+2 basis i.e. on the 2nd working day. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. Typically trades taking place on Monday are settled on Wednesday, Tuesday's trades settled on Thursday and so on.
- **Limited Physical Market:** Pursuant to the directive of SEBI to provide an exit route for small investors holding physical shares in securities mandated for compulsory dematerialised settlement, the Exchange has provided a facility for such trading in physical shares not exceeding 500 shares. This market segment is referred to as 'Limited Physical Market' (small window). The Limited Physical Market was introduced on June 7, 1999.
- **Institutional Segment:** The Reserve Bank of India had vide a press release on October 21, 1999, clarified that inter-foreign-institutional-investor (inter-FII) transactions do not require prior approval or post-facto confirmation of RBI, since such transactions do not affect the percentage of overall FII holdings in Indian companies. To facilitate execution of such Inter-Institutional deals in companies where the cut-off limit of FII investment has been reached, the Exchange introduced a new market segment on December 27, 1999.
- **Qualified Foreign Investor (QFI) Segment:** SEBI vide circulars CIR/ IMD/FII&C/3/2012 dated January 13, 2012, CIR/ IMD/ FII&C/ 4/ 2012 dated January 25, 2012 provide guideline for Investment by Qualified Foreign Investors (QFI) in Indian Equity Shares. As per the SEBI circu-

lar, when the aggregate shareholding of all the QFIs in a company reaches 8% of the equity paid up capital, the company's name along with ISIN shall be published in caution list by the depositories and no fresh purchases shall be allowed without prior approval of the depositories. To facilitate QFIs to trade in companies where the caution limit of QFI investment has been reached and QFI wish to buy without the prior approval of the depositories exchange has introduced new market segment w.e.f. March 20, 2012.

- **Trade for Trade Segment:** The scrips in Trade for Trade segment are made available for trading under BE series. The settlement of scrips available in this segment is done on a trade for trade basis and no netting off is allowed. The criteria for shifting scrips to/from Trade for Trade segment are decided jointly by the Stock Exchanges in consultation with SEBI and reviewed periodically.
- **Block trading Session:** The SEBI vide letter MRD/DoP/SE/Cir - 19/05 dated September 02, 2005 and CIR/MRD/DP/118/2017 dated October 26, 2017 guidelines outlining a facility of allowing Stock Exchanges to provide separate trading window to facilitate execution of large trades. The Exchange has introduced new block window mechanism for the block trades from January 01, 2018.
- **Post Close Session:** In accordance with SEBI letter SMD/Policy/9916/2003 dated May 20, 2003 notifying scheme / guidelines outlining a facility of providing Trading Session after normal market hours in Capital Market Segment, 'Closing Session' has been introduced by the Exchange from June 16, 2003.

b) NEAT System Operation in NSE:

NSE operates on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. NEAT is a screen-based trading system. NSE also offers 'NEAT Plus' package that provides members trading in multiple markets on the exchange with a unified trading interface. NSE consciously opted in favour of an order driven system as opposed to a quote driven system. This has helped reduce jobbing spreads not only on NSE but in other

exchanges as well, thus reducing transaction costs. The NEAT system has four types of market. They are:

- **Normal Market:** All orders which are of regular lot size or multiples thereof are traded in the Normal Market. For shares that are traded in the compulsory dematerialised mode the market lot of these shares is one. Normal market consists of various book types wherein orders are segregated as Regular lot orders, Special Term orders, Negotiated Trade Orders and Stop Loss orders depending on their order attributes.
- **Odd Lot Market:** All orders whose order size is less than the regular lot size are traded in the odd-lot market. An order is called an odd lot order if the order size is less than regular lot size. These orders do not have any special terms attributes attached to them. In an odd-lot market, both the price and quantity of both the orders (buy and sell) should exactly match for the trade to take place. Currently the odd lot market facility is used for the Limited Physical Market as per the SEBI directives.
- **Auction Market:** In the Auction Market, auctions are initiated by the Exchange on behalf of trading members for settlement related reasons. There are 3 participants in this market.
    i) Initiator -the party who initiates the auction process is called an initiator
    ii) Competitor -the party who enters orders on the same side as of the initiator
    iii) Solicitor -the party who enters orders on the opposite side as of the initiator

7.12 ORDER TYPES AND BOOKS

The NSE trading system provides complete flexibility to members in the kinds of orders that can be placed by them. Orders are first numbered and time-stamped on receipt and then immediately processed for potential match. Every order has a distinctive order number and a unique time stamp on it. If a match is not found, then the orders are stored in different 'books'. Orders are stored in price-time priority in various books. Price priority means that if two

orders are entered into the system, the order having the best price gets the higher priority. Time priority means if two orders having the same price are entered, the order that is entered first gets the higher priority.

The Equities segment has following types of books:

- **Regular Lot Book:** The Regular Lot Book contains all regular lot orders that have none of the following attributes attached to them.
    - All or None (AON)
    - Minimum Fill (MF)
    - Stop Loss (SL)
- **Special Terms Book:** The Special Terms book contains all orders that have either of the following terms attached:
    - All or None (AON)
    - Minimum Fill (MF)
- **Stop-Loss Book:** Stop Loss orders are stored in this book till the trigger price specified in the order is reached or surpassed. When the trigger price is reached or surpassed, the order is released in the Regular lot book. The stop loss condition is met under the following circumstances:
    - Sell order: A sell order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or falls below the trigger price of the order.
    - Buy order: A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.
- **Odd Lot Book:** The Odd lot book contains all odd lot orders (orders with quantity less than marketable lot) in the system. The system attempts to match an active odd lot order against passive orders in the book. Currently, pursuant to a SEBI directive, the Odd Lot Market is being used for orders that have quantity less than or equal to 500 viz. the Limited Physical Market.

- **Auction Book:** This book contains orders that are entered for all auctions. The matching process for auction orders in this book is initiated only at the end of the solicitor period.

7.13 DEMAT SETTLEMENT

Settlement of securities is a business process whereby securities or interests in securities are delivered. Settlement involves the delivery of securities from one party to another. Delivery usually takes place against payment known as delivery versus payment. It is mandatory to have a Demat account in order to purchase shares since trading equity involves delivery of shares.

Investing in equity shares in physical form entails a lengthy procedure, lot of paperwork and risk of getting fake shares. In order to keep the entire experience easy and streamlined, a Demat account is required. While trading online, Demat account is used to hold shares and securities in dematerialised/ electronic format. Under dematerialisation, your share certificates are converted from physical form to electronic form so as to increase their accessibility.

You need a Demat Account number to settle trades electronically. Having a Demat Account allows you to buy shares and store them safely. It is similar to a bank account in which you hold deposits with the bank and the record of debit/credit balances are maintained in a bank passbook. In the same way, when you purchase or sell shares, it will be credited or debited to/from your Demat Account respectively. You can open a Demat Account without possessing any shares and can maintain a zero balance in your account.

Through dematerialization, so-called Demat accounts allow for electronic transactions when shares of stock are bought and sold. Within a Demat account, the certificates for stocks and other securities of the user are held as a means for seamless trades to be made. The Depository System has facilitated paperless trading and settlement of dematerialised securities. Now the time taken to complete transaction has shrunk drastically in favour of investors.

7.14 PHYSICAL SETTLEMENT

The Securities and Exchange Board of India had approved a framework to strengthen the derivatives market. As part of its efforts, it will move all stocks that are cash-settled to physical settlement in a phased manner. It also tightened the selection criteria for introduction of stocks into the derivatives segment.

Settlement by physical delivery is carried out by clearing brokers or their agents. Immediately, after the last day of trading, the regulated exchange's clearing organization shall report a sale and a purchase of the underlying asset at the prior day's settlement price (normally the closing price). Traders who hold a short position in the physical settlement of futures contract to expiration are required to deliver the underlying asset. Traders not owning them are obligated to buy them at the current price and those who already own the assets have to hand it over to the requisite clearing organization.

As stated by SEBI, starting from July 2018 expiry, Future and Option (F&O) positions are being moved from cash settlement mode to compulsory physical delivery settlement in a phased manner. Starting from October 2019 expiry, all stock F&O contracts will be compulsorily physically settled. If you hold a position in any Stock F&O contract, at expiry, you will be required to give/take delivery of stocks.

7.15 INSTITUTIONAL SEGMENTS

The Reserve Bank of India had vide a press release on October 21, 1999, clarified that inter-foreign-institutional-investor (inter-FII) transactions do not require prior approval or post-facto confirmation of the Reserve Bank of India, since such transactions do not affect the percentage of overall FII holdings in Indian companies. (Inter FII transactions are however not permitted in securities where the FII holdings have already crossed the overall limit due to any reason). To facilitate execution of such Inter-Institutional deals in companies where the cut-off limit of FII investment has been reached, the Exchange introduced a new market segment on December 27, 1999.

The securities where FII investors and FII holding has reached the cut-off limit as specified by RBI (2% lower than the ceiling specified by RBI) from time to time would be available for trading in this market type for exclusive selling by FII clients. The list of securities eligible / become ineligible for trading in this market type would be notified to members from time to time.

Salient Features of the Institutional segment

- Trading in this market segment is available for institutional investors only. In order to ensure that the overall FII ceiling limits are not violated, trading members shall be allowed to enter sell orders in this market segment only for their FII clients. However, members can enter buy orders on behalf of FII/FI clients.
- Trading takes place under series type 'IL' under market type 'N'
- The minimum tradable quantity in this market is 1.
- Trading shall be done on T+2 rolling settlement basis only. Settlement of transactions shall be on dematerialised mode only
- The base price and the price bands applicable for this segment are the same as those applicable for the corresponding normal market on that day.
- In case of buy/sell orders, members shall be required to enter the custodial participant code at the time of order entry. Members shall not be allowed the facility of trade warehousing for the IL Market segment.

7.16 FUNDS SETTLEMENT

Funds settlement refers to the transfer of funds from buyer to seller and the transfer of an asset's title from seller to buyer. When an investor sends an order to his or her broker, that trade information is sent to a clearing house (for example, the National Securities Clearing Corporation). The clearinghouse processes and records the trade, and then issues a report to the broker/dealers involved that includes their net securities positions and the money to be settled among the parties.

The NSCC forwards settlement instructions to the Depository Trust & Clearing Corporation (DTCC), asking it to electronically transfer the ownership of the securities from the selling broker's account to the buying broker's account. The DTCC also transfers funds from the buying broker's bank account to the selling broker's bank account. The brokerages then adjust their clients' ac-

counts accordingly. The process is similar for institutional investors. For most stock trades, this takes three business days to occur. For option trades, fund settlement usually takes one business day. Funds settlement also occurs for dividend payments. Foreign markets may have different settlement procedures or times to completion.

7.17 VALUATION DEBIT

On the settlement day NSE Clearing accepts pay-in of securities made by members through depositories and identifies the shortages. The members are debited by an amount equivalent to the securities not delivered and valued at a valuation price. This is known as valuation debit. For all such short deliveries NSE Clearing conducts a buying-in auction on the T+2 day, after completion of the pay-out, through the NSE trading system. If the buy-in auction price is more than the valuation price, the Cash market (CM) is required to make good the difference. All shortages not bought-in are deemed closed out.

7.18 VALUATION PRICE

Valuation Price means the value of each restricted stock unit or performance stock unit based on the average of the closing prices on the stock exchange for shares for the 10 trading days preceding the valuation date. A trading day is any day that the shares are traded on the stock exchange. Valuation price is the price per unit as determined by dividing the agreed value by the aggregate number of units issued and outstanding as of the end of the fiscal period utilized in calculating the agreed value.

Valuation Price means, with respect to any units that are the subject of a valuation for purposes of this agreement, the fair market value of such units, determined jointly by the company and the transferor; provided that if they are unable to reach agreement on such value within ten business days following the relevant date of determination of such fair market value, such value shall be determined by an independent qualified appraiser selected by the transferor and the company within ten business days thereafter; the determination of fair market value by such appraiser shall be final and binding on the company and the transferor, and the fees and expenses of such appraiser shall be paid by the company.



CHECK YOUR PROGRESS

Write the full form of the following:

a) CDSL

b) BOLT

c) BEST

d) TWS

e) BDC

f) QF

lg) NEAT

h) F&O

i) DTCC

j) NSDL



7.19 LET US SUM UP

In this unit we have discuss the following:

- Stock exchange is an important factor in the capital market where the securities are bought and sold as per well-structured rules and regulations.
- The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE).
- At present we have 23 stock exchanges in the country.
- Established in 1875, BSE is the oldest and first stock exchange of Asia and was formerly known by the name of -The Native Share & Stock Brokers Association.

- In the year 1986, Sensex was introduced, as the first equity index to provide a base for identifying the top 30 trading companies of the exchange, in more than 10 sectors.
- BSE is performed through a system known as BOLT (BSE's Online Trading System).
- A stock that cannot be transferred, especially because of improperly filed paperwork or another fairly innocuous reason, is called bad delivery.
- If the seller fails to deliver the shares (whether partially or fully), it is known as 'Short Delivery of Shares'.
- NSE is the youngest stock exchange of India which came into picture in the year 1992 and operates with a vision*, 'To continue to be a leader, establish a global presence, and facilitate the financial well-being of people.'*
- NSE operates on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. NEAT is a screen-based trading system.
- While trading online, Demat account is used to hold shares and securities in dematerialised/electronic format.
- Funds settlement refers to the transfer of funds from buyer to seller and the transfer of an asset's title from seller to buyer.



7.20 FURTHER READINGS

- Financial Markets and Services –By E. Gordon & Dr. K Natarajan
- Indian Financial System –By Gobinda Deka
- Financial Services – By M. P. Tripathywebsites of BSE and NSE



7.21 ANSWERS TO CHECK YOUR PROGRESS

a) Central Depository Services Limited
b) Bombay On-line Trading
c) BSE Electronic Smart Trader
d) Trading Work Stations
e) Bad Delivery Cell
f) Qualified Foreign Investors
g) National Exchange for Automated Trading
h) Future and Option
i) Depository Trust & Clearing Corporation
j) National Securities Depository Limited



7.22 POSSIBLE QUESTIONS

1. Write short notes on the following:
   a) Bombay On-line Trading (BOLT)
   b) National Exchange for Automated Trading (NEAT) System
   c) Pay-in and pay-out
   d) Bad delivery
   e) Short delivery
   f) Demat settlement
   g) Physical settlement
2. Write an overview on Indian Stock Exchange.
3. Enumerate the features and functions of stock exchange.
4. Discuss about the settlement procedures in BSE.
5. Write a note on NSE. Explain the market segments of NSE.
6. What do you mean by institutional segment? Mention the salient features of Institutional segment.

****