PERIYAR UNIVERSITY

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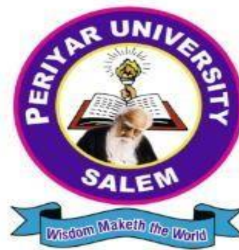
CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

MASTER OF COMMERCE
SEMESTER – I



CAPITAL MARKET
(Elective I B)

(Candidates admitted from 2024 onwards)

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SYLLABUS

CAPITAL MARKETS

UNIT I : Introduction to Financial Markets

Financial markets - Definition - Role - functions - Constituents -Financial Instruments - Indian Financial Market - Global Financial Market - Capital Market -Evolution and growth - Constituents - Capital Market Instruments - Types - Preference shares- Equity Shares - Non - voting equity shares - Company fixed deposits - Warrants -Debentures and Bonds

UNIT II: Regulation of Indian Capital Market

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UNIT IV: Stock Exchange

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UNIT- I
FINANCIAL MARKETS

1.1 Financial Market - An Introduction

The financial market is a broad term encompassing a variety of marketplaces where traders buy and sell assets such as stocks, bonds, currencies, and derivatives. It plays a crucial role in the global economy by facilitating the allocation of resources, promoting economic growth, and providing a platform for investors to diversify their portfolios.

1.1.1 Meaning and Definition of Financial Markets

The Financial Market is the cornerstone of the nation's economic framework. By channel funds from investors to borrowers, it facilitates investment and hence plays a crucial role in the country's economic development.

A financial market is a marketplace where buyers and sellers trade financial instruments, such as stocks, bonds, currencies, and derivatives. Investors, companies, and governments raise capital, manage risks, and transfer assets over here. These markets can be further classified into primary market and secondary market. In the primary market, trades between financial institutions and traders take place. Financial Markets are typically characterized by having transparent pricing, basic regulations on trading, costs & fees, and market forces determining the prices of securities that trade.

1.1.2 Role of Financial Market

Financial markets play a crucial role in an economy. Some of their roles and functions can be seen as follows:

i. **Mobilization of Capital**: They efficiently channel savings and investments towards businesses that need funding to grow and create jobs.

ii. **Maintaining Liquidity**: Markets provide liquidity by enabling buyers and sellers to quickly transact without causing significant price changes. This liquidity is

crucial for economic stability and growth, as it allows investors to convert assets into cash swiftly.

iii. **Risk Management**: Some financial instruments like derivatives allow businesses and investors to hedge against risks, like sudden currency fluctuations.

iv. **Price Discovery**: Financial markets provide a platform where the prices of securities are determined by the forces of supply and demand. This pricing mechanism helps in allocating resources and coordinating economic activity efficiently.

v. **Information Aggregation and Coordination**: Markets reflect information in the prices of securities, helping to coordinate economic activity. The prices at which trades occur can reflect the collective sentiment about the present and future economic conditions.

The Financial Market plays a critical role in the modern economy. They facilitate the flow of funds and financial instruments globally, helping to fuel economic growth and development. As the global and the Indian economy evolve, the roles and functions of these markets will continue to remain crucial.

1.1.3 Types of Financial Market

Financial markets are diverse, encompassing various types each serving distinct purposes in the economic ecosystem.

Stock markets are platforms where shares of publicly held companies are issued and traded. Examples include the New York Stock Exchange (NYSE) and NASDAQ. They enable companies to raise capital from investors in exchange for equity, and provide a venue for investors to buy and sell shares, thus facilitating liquidity and investment opportunities.

Bond markets are where participants can issue new debt or buy and sell existing debt securities, such as government or corporate bonds. These markets are crucial for entities needing to borrow money and for investors seeking fixed-income investments. They play a significant role in determining interest rates and funding public and private expenditures.

Commodity markets deal with raw materials and primary products such as oil, gold, and agricultural products. These markets allow producers and consumers to hedge against price volatility and invest in commodities as assets. Major exchanges include the Chicago Mercantile Exchange (CME) and the London Metal Exchange (LME).

Foreign exchange markets (Forex) are the largest and most liquid financial markets, where currencies are traded. This market is essential for global trade and investment as it facilitates currency conversion and helps manage foreign exchange risk. The Forex market operates 24/7, reflecting its global nature.

Derivatives markets involve financial instruments like futures, options, and swaps that derive their value from underlying assets. These markets are vital for risk management, as they allow participants to hedge against potential losses in other investments. They also provide leverage opportunities, where investors can amplify potential returns (and risks).

Money markets deal with short-term debt instruments with maturities of one year or less, such as Treasury bills and commercial paper. These markets are critical for managing liquidity and funding short-term needs for both governments and corporations. They help maintain the stability of the financial system by providing safe and liquid investment options.

Capital markets include both stock and bond markets, focusing on raising long-term capital for companies and governments. They play a pivotal role in the economic development by channeling savings into productive investments, thus fostering growth and innovation.

Let's Sum Up

Dear Learners, in the first section, we have seen financial markets are integral to the functioning of the economy, facilitating capital raising, providing liquidity, enabling price discovery, and offering mechanisms for risk management. They encompass various types, each serving specific roles that collectively support economic stability and growth.

Check Your Progress – QUIZ 1

1. **What is the primary function of financial markets?**

   A) To provide entertainment

   B) To facilitate the exchange of goods and services

   C) To facilitate the exchange of financial instruments

   D) To enforce government regulations

2. **Which of the following is NOT a role of financial markets?**

   A) Providing liquidity

   B) Facilitating price discovery

   C) Enforcing legal contracts

   D) Raising capital

3. **How do financial markets contribute to economic growth?**

   A) By collecting taxes for the government

   B) By facilitating efficient allocation of resources

   C) By producing goods and services

   D) By regulating all financial transactions

4. **Which market is the largest and most liquid financial market in the world?**

   A) Stock Market

   B) Bond Market

   C) Foreign Exchange Market

   D) Commodity Market

5. **Money markets deal with financial instruments that have maturities of:**

    A) Less than one year

    B) One to five years

    C) Five to ten years

    D) More than ten years

6. **Which type of market involves trading raw materials and primary products?**

    A) Stock Market

    B) Bond Market

    C) Commodity Market

    D) Derivatives Market

Function And Classification of Financial Markets

1.2 Financial Markets

Financial markets perform critical functions that support economic growth and stability, such as capital formation, price discovery, liquidity provision, and risk management. They are classified into various types, each serving specific purposes and catering to different financial needs and instruments.

1.2.1 Functions of Financial Markets

Financial markets play a vital role in the economy by performing several key functions that facilitate economic growth, stability, and efficiency. Here are the primary functions of financial markets:

1. Capital Formation

Financial markets enable businesses and governments to raise capital by issuing stocks, bonds, and other financial instruments. This process allows companies to fund

expansion, innovation, and operations, while governments can finance public projects and services. By mobilizing savings and directing them to productive investments, financial markets contribute to economic development.

2. Price Discovery

Through the interaction of buyers and sellers, financial markets help determine the prices of financial instruments. This price discovery mechanism reflects the collective information, expectations, and sentiments of market participants, ensuring that asset prices are set efficiently based on supply and demand. Accurate price signals help investors make informed decisions.

3. Liquidity Provision

Financial markets provide liquidity, allowing investors to quickly buy or sell securities with minimal impact on their prices. This liquidity is essential for the smooth functioning of the economy, as it ensures that assets can be easily converted to cash when needed. High liquidity reduces transaction costs and risks associated with holding financial assets.

4. Risk Management

Markets offer various financial instruments, such as derivatives (futures, options, swaps), that allow participants to hedge against potential risks. These instruments enable businesses and investors to protect themselves from adverse price movements, interest rate fluctuations, and other financial uncertainties, thereby managing financial risk effectively.

5. Efficient Allocation of Resources

By channelling funds from savers to borrowers, financial markets ensure that resources are allocated to their most productive uses. This efficient allocation promotes economic growth and development by supporting investments in innovation, infrastructure, and other productive activities. It helps in the optimal distribution of capital across different sectors of the economy.

6. Facilitation of Trade and Investment

Financial markets facilitate domestic and international trade by providing mechanisms for currency exchange and cross-border transactions. This support for global economic integration allows businesses to operate on an international scale, enhancing trade, investment, and economic cooperation between countries.

7. Provision of Information

Financial markets disseminate vital information about the financial health of companies, industries, and economies. This information helps investors, policymakers, and other stakeholders make informed decisions. Market data on prices, volumes, and trends serve as important indicators of economic performance and investor sentiment.

8. Improvement of Corporate Governance

By exposing companies to market scrutiny, financial markets encourage better corporate governance practices. Companies that are publicly traded need to adhere to stringent regulatory and disclosure requirements, which promotes transparency, accountability, and efficient management. This oversight helps protect investors' interests and enhances trust in the financial system.

In summary, financial markets perform critical functions such as capital formation, price discovery, liquidity provision, risk management, efficient resource allocation, facilitation of trade and investment, provision of information, and improvement of corporate governance. These functions collectively contribute to the stability, growth, and efficiency of the global economy.

1.2.2 Classification of Financial Market

The financial market can be classified into three different forms.

1. **By Nature of Claim**

Debt Market — It is a market where fixed bonds and debentures or bonds are

exchanged between investors.

Equity Market – It is a place for investors to deal with equity.

2. **By Maturity of Claim**

Money Market — It deals with monetary assets and short-term funds such as a certificate of deposits, treasury bills, and commercial paper, etc. which mature within twelve months.

Capital Market – It trades medium and long term financial assets.

3. **By Timing of Delivery**

Cash Market – It is a marketplace where trade is completed in real-time.
Futures Market — Here, the delivery or compensation of products are taken in the future specified date.

4. **By Organizational Structure**

Exchange-Traded Market — It has a centralised system with a patterned procedure.

Over-the-Counter Market — It has a decentralised organisation with customised procedures.

1.2.3 Participants in Financial Markets

1. **Individual Investors**:

Retail investors who buy and sell securities for personal accounts.

2. **Institutional Investors**:

Entities such as pension funds, mutual funds, insurance companies, and hedge funds that manage large pools of capital.

3. **Corporations**:

Companies that issue stocks or bonds to raise capital and invest in various financial instruments for strategic purposes.

4. **Government and Regulatory Bodies**:

Ensure the stability and integrity of financial markets through regulation and oversight, such as the Securities and Exchange Commission (SEC) in the United States.

5. **Financial Intermediaries**:

Include banks, brokerage firms, and investment advisors that facilitate transactions between buyers and sellers.

Let's Sum Up

Financial markets are essential for economic stability and growth, performing critical functions like capital formation, price discovery, liquidity provision, and risk management. They are classified into various types based on the instruments traded and serve a wide range of participants, from individual investors to large institutions and governments.

Check Your Progress – QUIZ 2

1. **Which of the following is a primary function of financial markets?**

   A) Conducting market research

   B) Providing liquidity

   C) Managing customer relations

   D) Producing goods and services

2. **What role do financial markets play in economic growth?**

   A) Collecting taxes for the government

   B) Facilitating efficient allocation of resources

   C) Regulating industrial production

   D) Providing educational services

3. **Which of the following markets deals with short-term debt instruments?**

    A) Stock market

    B) Money market

    C) Commodity market

    D) Foreign exchange market

4. **The primary purpose of the bond market is to:**

    A) Trade commodities like oil and gold

    B) Facilitate currency exchanges

    C) Raise long-term funds through debt securities

    D) Provide short-term loans

5. **Who are the primary participants in the financial markets that provide capital for long-term investments?**

    A) Individual investors

    B) Institutional investors

    C) Government bodies

    D) Market makers

6. **Which of the following participants in financial markets is responsible for regulatory oversight?**

    A) Individual investors

    B) Financial intermediaries

    C) Regulatory bodies

    D) Corporations

FINANCIAL INSTRUMENTS

1.3 Financial Instruments

Financial instruments are contracts for assets that have a monetary value. These contracts can be concluded with different providers, for example with banks or with a broker - depending on the assets in question.

For example, if a company were to pay cash for a bond, another party is obligated to deliver a financial instrument for the transaction to be fully completed. One company is obligated to provide cash, while the other is obligated to provide the bond.

Basic examples of financial instruments are cheques, bonds, securities.

There are typically three types of financial instruments: cash instruments, derivative instruments, and foreign exchange instruments.

1.3.1 Cash Instruments

Cash instruments are financial instruments with values directly influenced by the condition of the markets. Within cash instruments, there are two types; securities and deposits, and loans.

Securities: A security is a financial instrument that has monetary value and is traded on the stock market. When purchased or traded, a security represents ownership of a part of a publicly-traded company on the stock exchange.

Deposits and Loans: Both deposits and loans are considered cash instruments because they represent monetary assets that have some sort of contractual agreement between parties.

1.3.2 Derivative Instruments

Derivative instruments are financial instruments that have values determined from underlying assets, such as resources, currency, bonds, stocks, and stock indexes. The five most common examples of derivatives instruments are synthetic agreements, forwards, futures, options, and swaps. This is discussed in more detail below.

Synthetic Agreement for Foreign Exchange (SAFE): A SAFE occurs in the over-the-

counter (OTC) market and is an agreement that guarantees a specified exchange rate during an agreed period of time.

Forward: A forward is a contract between two parties that involves customizable derivatives in which the exchange occurs at the end of the contract at a specific price.

Future: A future is a derivative transaction that provides the exchange of derivatives on a determined future date at a predetermined exchange rate.

Options: An option is an agreement between two parties in which the seller grants the buyer the right to purchase or sell a certain number of derivatives at a predetermined price for a specific period of time.

Interest Rate Swap: An interest rate swap is a derivative agreement between two parties that involves the swapping of interest rates where each party agrees to pay other interest rates on their loans in different currencies.

1.3.3 Foreign Exchange Instruments

Foreign exchange instruments are financial instruments that are represented on the foreign market and primarily consist of currency agreements and derivatives.

In terms of currency agreements, they can be broken into three categories.

Spot: A currency agreement in which the actual exchange of currency is no later than the second working day after the original date of the agreement. It is termed “spot” because the currency exchange is done “on the spot” (limited timeframe).

Outright Forwards: A currency agreement in which the actual exchange of currency is done “forwardly” and before the actual date of the agreed requirement. It is beneficial in cases of fluctuating exchange rates that change often.

Currency Swap: A currency swap refers to the act of simultaneously buying and selling currencies with different specified value dates.

Asset Classes of Financial Instruments

Beyond the types of financial instruments listed above, financial instruments can also be categorized into two asset classes.

The two asset classes of financial instruments are debt-based financial instruments and equity-based financial instruments.

1. Debt-Based Financial Instruments

Debt-based financial instruments are categorized as mechanisms that an entity can use to increase the amount of capital in a business. Examples include bonds, debentures, mortgages, U.S. treasuries, credit cards, and line of credits (LOC).

They are a critical part of the business environment because they enable corporations to increase profitability through growth in capital.

2. Equity-Based Financial Instruments

Equity-based financial instruments are categorized as mechanisms that serve as legal ownership of an entity. Examples include common stock, convertible debentures, preferred stock, and transferable subscription rights. They help businesses grow capital over a longer period of time compared to debt- based but benefit in the fact that the owner is not responsible for paying back any sort of debt.

A business that owns an equity-based financial instrument can choose to either invest further in the instrument or sell it whenever they deem necessary.

Lets Sum Up

Financial instruments are essential components of the financial markets, serving multiple functions such as capital raising, risk management, liquidity provision, price discovery, and the transfer of funds. They come in various forms, including equity, debt, derivatives, hybrid, and money market instruments, each catering to different needs and preferences of market participants. These instruments collectively ensure the smooth operation and stability of financial systems globally.

Check Your Progress – QUIZ 3

1. **Which of the following is an example of an equity instrument?**

    A) Treasury Bill

    B) Corporate Bond

    C) Preferred Stock

    D) Certificate of Deposit

2. **What is the primary feature of a convertible bond?**

A) It can be converted into a specific number of equity shares

B) It pays a variable interest rate

C) It has a fixed maturity date

D) It is only issued by governments

3. **Which financial instrument is typically used for short-term borrowing?**
A) Commercial Paper

B) Corporate Bond

C) Common Stock

D) Preferred Stock
4. **Which type of derivative contract gives the holder the right, but not the obligation, to buy or sell an asset at a predetermined price?**

A) Futures

B) Options

C) Swaps

D) Bonds

5. **What is the main purpose of a futures contract?**

A) To provide dividends to shareholders

B) To hedge against price fluctuations in an underlying asset

C) To raise capital through equity

D) To facilitate short-term lending

6. **Which of the following is NOT a characteristic of a bond?**

A) Pays periodic interest

B) Represents ownership in a company

C) Has a fixed maturity date

D) Can be issued by governments and corporations

7 **Which financial instrument is a short-term, unsecured promissory note issued by a corporation?**

A) Treasury Bill

B) Commercial Paper

C) Municipal Bond

D) Preferred Stock

1.4 FINANCIAL MARKETS

The Indian financial market is a broad and dynamic sector consisting of various sub-markets and institutions that facilitate the mobilization and allocation of capital. These markets are integral to India's economic development, providing avenues for investment, liquidity, and risk management.

Global financial markets are interconnected systems where financial instruments are traded across various countries. These markets facilitate international trade, investment, and economic cooperation, influencing global economic stability and growth.

1.4.1 Financial Market in India

Just like any other market, the financial market also involves trading, that is, buying and selling of nothing but financial products and services. Subsequently, the financial markets basically deal with the sale and purchase of several types of investments, financial services, loans, etc. The demand and supply of financial instruments is dynamic as the financial instruments determine their prices.

Financial markets bridge the gap between borrowers and lenders. They bring together individuals that have surplus funds and those who are in need of funds so that there can be easy transfer of funds between them. The transfer of funds takes place through various kinds of financial instruments operating in the financial markets.

Structure of Financial Market in India

The financial market in India can be broadly divided into two main components, that

is, the money market and the capital market. Wherein, the capital market is further divided into primary and secondary markets. Let’s understand more about the structure of the financial market in India.

Money Market

The money market acts as a marketplace for short-term borrowing and lending. At the wholesale level, it involves large-volume transactions between traders and institutions. At the retail level, the money market involves mutual funds bought by individual investors and accounts opened by bank customers.

The assets traded in the money market are risk-free and highly liquid. As the maturity period is less, the risk of volatility is low and the returns are low as well.

Common examples of instruments traded in the money market are treasury bills, commercial papers, certificates of deposits, bankers’ acceptance, etc.

Following are some of the important money market instruments or securities.

i. **Call Money**: Call money is mainly used by the banks to meet their temporary requirement of cash. They borrow and lend money from each other normally on a daily basis. It is repayable on demand and its maturity period varies in between one day to a fortnight. The rate of interest paid on call money loan is known as call rate.

ii. **Treasury Bill**: A treasury bill is a promissory note issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments, that means, at any time the holder of treasury bills can transfer of or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference between the issue price and the face value of the treasury bill represents the interest on the investment. These bills are secured instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play major role in the Treasury bill market.

iii. **Commercial Paper**: Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. The CP is an unsecured instrument issued in the form of promissory note. This instrument was

introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market.

iv. **Certificate of Deposit**: Certificate of Deposit (CDs) are short-term instruments issued by Commercial Banks and Special Financial Institutions (SFIs), which are freely transferable from one party to another. The maturity period of CDs ranges from 91 days to one year. These can be issued to individuals, co-operatives and companies.

v. **Trade Bill**: Normally the traders buy goods from the wholesalers or manufactures on credit. The sellers get payment after the end of the credit period. But if any seller does not want to wait or in immediate need of money he/she can draw a bill of exchange in favour of the buyer. When buyer accepts the bill it becomes a negotiable instrument and is termed as bill of exchange or trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawee i.e., the buyer of goods. When trade bills are accepted by Commercial Banks it is known as Commercial Bills. So trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

Capital Market

Capital Market may be defined as a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc. It consists of two different segments namely primary and secondary market.

Components of Capital Markets

Primary Market:

The primary market is where new securities are issued and sold for the first time.

Companies, governments, and other entities use this market to raise capital by issuing stocks and bonds. The funds raised are used for various purposes such as expanding operations, funding new projects, or refinancing existing debts. Key activities in the primary market include Initial Public Offerings (IPOs) and bond issuances .

Secondary Market:

The secondary market is where existing securities are traded among investors. This market provides liquidity and enables investors to buy and sell securities without impacting the issuing entity. Stock exchanges like the New York Stock Exchange (NYSE) and NASDAQ are prominent examples of secondary markets. The secondary market helps in price discovery and provides a platform for continuous trading of securities .

1.4.2 International Financial Markets

Meaning

An asset is anything of durable value, ; that is, anything that acts as a means to store value over time. Real assets are assets in physical form (e.g., land, equipment, houses, etc.), including "human capital" assets embodied in people (natural abilities, learned skills, knowledge). Financial assets are claims against real assets, either directly (e.g., stock share equity claims) or indirectly (e.g., money holdings, or claims to future income streams that originate ultimately from real assets). Securities are financial assets exchanged in auction and over-the-counter markets whose distribution is subject to legal requirements and restrictions (e.g., information disclosure requirements).

Lenders are people who have available funds in excess of their desired expenditures that they are attempting to loan out, and borrowers are people who have a shortage of funds relative to their desired expenditures who are seeking to

obtain loans. Borrowers attempt to obtain funds from lenders by selling to lenders newly issued claims against the borrowers' real assets, i.e., by selling the lenders newly issued financial assets.

A financial market is a market in which financial assets are traded. In addition to enabling exchange of previously issued financial assets, financial markets facilitate

borrowing and lending, by facilitating the sale by newly issued financial assets. A financial institution is an institution whose primary source of profits is through financial asset transactions. Examples of such financial institutions include discount brokers, banks, insurance companies, and complex multi-function financial institutions.

Lets Sum Up

Both Indian and global financial markets play pivotal roles in economic development, investment, and capital allocation. While Indian financial markets cater to the domestic economy and its unique regulatory framework, global financial markets facilitate international trade and investment, influencing global economic dynamics. Understanding the structure, participants, and regulatory environment of these markets is essential for stakeholders ranging from individual investors to multinational corporations.

Check Your Progress – QUIZ 4

1. **Which of the following is the oldest stock exchange in India?**

    A) National Stock Exchange (NSE)

    B) Bombay Stock Exchange (BSE)

    C) Calcutta Stock Exchange (CSE)

    D) Multi Commodity Exchange (MCX)

2. **The Reserve Bank of India primarily regulates which of the following markets?**

    A) Stock Market

    B) Commodity Market

    C) Money Market
    D) Derivatives Market

3. **Which regulatory body oversees the securities market in India?**

    A) Reserve Bank of India (RBI)

    B) Ministry of Finance

C) Securities and Exchange Board of India (SEBI)

D) Insurance Regulatory and Development Authority of India (IRDAI)

4. **Which of the following is the largest stock exchange in the world by market capitalization?**

A) Tokyo Stock Exchange (TSE)

B) London Stock Exchange (LSE)

C) New York Stock Exchange (NYSE)

D) Shanghai Stock Exchange (SSE)

5. **The National Stock Exchange (NSE) of India is known for which major feature?**

A) Being the oldest stock exchange

B) Its electronic trading system

C) Trading exclusively in commodities

D) Being government-owned

6. **Which financial instrument is NOT typically traded in the money market?**

A) Treasury Bills

B) Commercial Paper

C) Corporate Bonds

D) Certificates of Deposit

1.5 Capital Market

Capital Market may be defined as a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc. It consists of two different segments namely primary and secondary market. The primary market deals with new or fresh issue of securities and is, therefore, also known as new issue market; whereas the secondary market provides a place for purchase and sale existing securities and is often termed as stock market or stock exchange.

i. **Primary Market** : The Primary Market consists of arrangements, which facilitate the procurement of long term funds by companies by making fresh issue of shares and debentures. You 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. You must have learnt about 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.

ii. **Secondary Market** : 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 players in the primary market are merchant bankers, mutual funds, financial institutions, and the individual investors; and in the secondary market you have all these and the stockbrokers who are members of the stock exchange who facilitate the trading.

As opposed to the money market, capital markets deal in long-term securities. The securities that have a maturity period of more than a year are traded in the capital market. Subsequently, the market trades in both debt as well as equity-oriented securities.

Participants of the capital market include Foreign Institutional Investors (FIIs), financial institutions, NRIs, individuals, and so on. The capital market is further divided into Primary Market and Secondary Market.

1.5.1 Evolution and Growth of Capital Market

The period between 1947 and 1973 marked the development of infrastructure for capital market. During this period, a network of development financial institutions such as IFCI, ICICI, IDBI and UTI, SFCs and SIDCs were established. These financial institutions strengthened the capital market.

During the period between 1980 and 1992, debenture emerged as a powerful instrument of resource mobilization in the primary market. The public sector bonds were introduced. A number of stock exchanges came into existence. There was a momentous growth in the secondary market.

SEBI emerged as an effective regulatory body for the primary and secondary markets and afford a measure of protection to small investors. New financial services such as credit rating was introduced.

A number of committees were constituted in order to suggest measures to revamp and restructure the working of the secondary market and cause buoyancy in the primary market. Some of these committees were: Committee on Organization and Management of Stock Exchange, Working group on the Development of the Capital Market, A Study Group for Guidelines Relating to Valuation and New Instruments, A High Powered Study Group on Establishment of New Stock Exchange, A Committee on Trading in Public Sector Bonds and Units of Mutual Funds.

1.5.2 Constituents

The constituents of the capital market comprise of development banks, specialised financial institutions, investment institutions, state level development banks, mutual funds; lease companies, financial service companies, commercial banks and other specialised institutions were set up by development banks for the growth of the capital market, notably, SEBI, SHCI, CRISIL, IICRA, the I-Sec, AMC, OTCEI and the National Stock Exchange.

(i) There has been an accelerated growth of the long-term capital market in India in the recent years. But the absolute size in relation to the economy is still small and the institutional structure inadequate.

(ii) In this purpose, we must reach out and activate the potential investors in parts of the country other than the western region and in rural and semi-urban areas. This could be done, if a few large reliable national level private sector investing or promoting companies are established, which would have the capability of establishing branches in several centres and in training and appointing its own agents in the smaller towns.

(iii) The desirability of introducing the new instruments. In this, the non-voting shares and the equity warrant may be considered. With the introduction of non-voting shares in a company, the controlling groups could be persuaded by the regulatory authorities to reduce their holdings correspondingly.

(iv) Supply of venture capital is high risk business, but the reward would also be high. Government must allow private investing agencies to be set up which could supply this capital to new ventures.

(v) In relation to demand, the flow of institutional funds into the housing sector has been quite meagre. The housing finance system that we build up must facilitate an adequate flow of institutional finance to the housing sector as one of the priority sectors.

(vi) "Commercial Paper" having maturity period ranging from 30 days to a year may be introduced, as it would relieve pressure in the long-term or medium-term funds.

Let's Sum Up

capital market is integral to economic development, providing a platform for raising capital, enabling liquidity, ensuring efficient allocation of resources, and facilitating risk management. By connecting savers and borrowers, capital markets help in the growth of businesses and economies globally. Understanding the structure, functions, and participants of capital markets is essential for anyone involved in finance and investment.

Check Your Progress – QUIZ 5

1. **What is the primary function of the primary market?**

   A) Trading existing securities

   B) Issuing new securities

   C) Providing loans to investors

   D) Regulating the stock market

2. **Which of the following is a key characteristic of preferred stocks?**

   A) Voting rights

   B) Variable dividends

   C) Fixed dividends

   D) Higher risk than common stocks

3. **What type of instrument is commonly traded in the bond market?**

   A) Common stocks

   B) Corporate bonds

   C) Options

   D) Real estate

4. **Which of the following is NOT a function of the capital market?**

   A) Providing liquidity

B) Risk management

C) Fund raising

D) Printing money

5. **Which regulatory body oversees the securities market in India?**

A) Reserve Bank of India (RBI)

B) Ministry of Finance

C) Securities and Exchange Board of India (SEBI)

D) Insurance Regulatory and Development Authority of India (IRDAI)

6. **What is the role of the secondary market?**

A) To issue new securities

B) To trade existing securities

C) To provide short-term loans

D) To regulate interest rates

7. **Which of the following best describes the term "liquidity" in the context of capital markets?**

A) The ability to meet long-term financial obligations

B) The ease with which an asset can be converted into cash

C) The volatility of stock prices

D) The interest rates on government bonds

1.6 Capital Market Instruments

Capital market instruments encompass a broad range of financial tools, including equities, bonds, derivatives, ETFs, and foreign exchange instruments. They play a crucial role in fundraising for entities and offering diverse investment opportunities, crucial for economic growth, risk management, and wealth generation

Equities

As capital market instruments, equities enable companies to raise capital by selling ownership stakes. They are traded on stock markets, allowing investors to buy and sell shares, with their value influenced by the company's performance and market dynamics. This trading not only provides liquidity but also helps in price discovery, making equities vital for both corporate financing and investment opportunities. Equities, includes both equity and preference shares, serve as key capital market instruments.

- **Equity Share**

  An equity share represents a portion of ownership in a company. When you buy equity shares, you become a part-owner of that company. As a shareholder, you may get voting rights in major company decisions and a share of the profits, known as dividends. These shares can increase in value if the company does well, offering profit potential.

- **Preference Share**

  Preference shares are a type of stock in a company that give shareholders certain advantages over common stockholders. Typically, preference shareholders receive dividends before common shareholders and these dividends are often fixed. While they usually don't have voting rights in company decisions, they have a higher claim on company assets if the company goes bankrupt. Preference shares are a blend of stocks and bonds characteristics.

Debt Instruments

Debt instruments, like bonds and debentures, are essentially loans that investors give to companies or governments. When you invest in these, you're lending money

and in return, you receive interest payments over a specified period. At the end of the term, the principal amount is repaid.

They are a key part of capital markets, providing a way for entities to raise funds for various projects. Unlike equities, which represent ownership, debt instruments are a form of borrowing and offer a fixed return, making them a different kind of investment with generally lower risk compared to stocks

- **Bonds**
  Bonds are like loans given by investors to companies or governments. When you buy a bond, you're lending money to the bond issuer. In return, they promise to pay you back the principal amount on a future date and make regular interest payments along the way, known as coupon payments. Bonds are a way to invest while earning steady income and are generally considered lower-risk compared to stocks.
- **Debentures**
  Debt instruments, like bonds and debentures, are essentially loans that investors give to companies or governments. When you invest in these, you're lending money and in return, you receive interest payments over a specified period. At the end of the term, the principal amount is repaid. They are a key part of capital markets, providing a way for entities to raise funds for various projects. Unlike equities, which represent ownership, debt instruments are a form of borrowing and offer a fixed return, making them a different kind of investment with generally lower risk compared to stocks.

Derivative Instruments

Derivative instruments are financial contracts whose value is derived from an underlying asset, like stocks, commodities, or interest rates. They are used for hedging risks or for speculation. Examples include:

- **Forward**: A customized contract between two parties to buy or sell an asset at a predetermined future date and price.
- **Future**: Similar to forwards but standardized and traded on exchanges. They

oblige the buyer to purchase, or the seller to sell, an asset at a set future date and price.

- **Options**: These give the buyer the right, but not the obligation, to buy (call option) or sell (put option) an asset at a specified price before a certain date.
- **Interest Rate Swap**: A contract in which two parties exchange cash flows based on different interest rates applied to a principal amount, often used to hedge interest rate risks.

Exchange-Traded Funds

Exchange-traded funds (ETFs) are capital market instruments that track indexes, commodities, bonds, or a basket of assets like an index fund but trade like stocks on an exchange. Each ETF share represents a portion of the fund's portfolio, giving investors access to a diversified set of assets or a specific market segment.

They offer flexibility, as they can be bought and sold throughout the trading day at market prices, and typically have lower fees than traditional mutual funds. ETFs are popular among investors for portfolio diversification, ease of trading, and their ability to reflect real-time market prices, making them an effective tool for both passive and active investment strategies.

Foreign Exchange Instruments

Foreign Exchange Instruments in the capital market are tools used for trading currencies between countries. These include currency pairs like the US Dollar against the Euro. Investors and companies use them to exchange one currency for another, which is essential for international trade, travel, or investment.

They can also be used for speculation, and betting on currency movements to make profits. These instruments help manage risks associated with currency fluctuations and play a vital role in global financial markets, facilitating cross-border transactions and investments.

1.6.1 Preference Shares

Meaning

Preference shares, also known as preferred stock, is an exclusive share option which enables shareholders to receive dividends announced by the company before the equity shareholders.

Preference shares provide the shareholders with the special right to claim dividends during the company lifetime, and also with the option to claim repayment of capital, in case of the wind up of the company. It is considered as a hybrid security option as it represents the characteristics of both debt and equity investments.

The capital raised by issuing preference shares is known as preference share capital and preference shareholders can be regarded as owners of the company. They however do not enjoy any kind of voting rights, unlike equity shareholders.

Features of Preference Shares

The following are the features of preference shares:

i. Preferential dividend option for shareholders.
ii. Preference shareholders do not have the right to vote.
iii. Shareholders have a right to claim the assets in case of a wind up of the company.
iv. Fixed dividend payout for shareholders, irrespective of profit earned.
v. Acts as a source of hybrid financing.

Types of Preference Shares

The various types of preference share are discussed below:

i. **Cumulative preference share**: Cumulative preference shares are a special type of shares that entitles the shareholders to enjoy cumulative dividend payout at times when a company is not making profits. These dividends will be counted as arrears in years when the company is not earning profit and will be paid on a cumulative basis, the next year when the business generates

profits.

ii. **Non-cumulative preference shares**: These types of shares do not accumulate dividends in the form of arrears. In the case of non-cumulative preference shares, the dividend payout takes place from the profits made by the company in the current year. If there is a year in which the company doesn't make any profit, then the shareholders are not paid any dividends for that year and they cannot claim for dividends in any future profit year.

iii. **Participating preference shares**: These types of shares allow the shareholders to demand a part in the surplus profit of the company at the event of liquidation of the company after the dividends have been paid to the other shareholders. In other words, these shareholders enjoy fixed dividends and also share a part of the surplus profit of the company along with equity shareholders.

iv. **Non-participating preference shares**: These shares do not yield the shareholders the additional option of earning dividends from the surplus profits earned by the company. In this case, the shareholders receive only the fixed dividend.

v. **Redeemable Preference Shares**: Redeemable preference shares are shares that can be repurchased or redeemed by the issuing company at a fixed rate and date. These types of shares help the company by providing a cushion during times of inflation.

vi. **Non-redeemable Preference** Shares: Non-redeemable preference shares are those shares that cannot be redeemed during the entire lifetime of the company. In other words, these shares can only be redeemed at the time of winding up of the company.

vii. **Convertible Preference Shares**: Convertible preference shares are a type of shares that enables the shareholders to convert their preference shares into equity shares at a fixed rate, after the expiry of a specified period as mentioned in the memorandum.

viii. **Non-convertible Preference** Shares: These type of preference shares cannot be converted into equity shares. These shares will only get fixed

dividend payout and also enjoy preferential dividend payout during the

dissolution of a company.

1.6.2 Equity Share

Meaning

An equity share, normally known as ordinary share is a part ownership where each member is a fractional owner and initiates the maximum entrepreneurial liability related to a trading concern. These types of shareholders in any organization possess the right to vote.

Features of Equity Shares Capital

Equity share capital remains with the company. It is given back only when the company is closed. Equity Shareholders possess voting rights and select the company's management.

The dividend rate on the equity capital relies upon the obtainability of the surfeit capital. However, there is no fixed rate of dividend on the equity capital.

Types of Equity Share

i. **Authorized Share Capital-** This amount is the highest amount an organization can issue. This amount can be changed time as per the company's recommendation and with the help of few formalities.
ii. **Issued Share Capital-** This is the approved capital which an organization gives to the investors.
iii. **Subscribed Share Capital-** This is a portion of the issued capital which an investor accepts and agrees upon.
iv. **Paid Up Capital-** This is a section of the subscribed capital, that the investors give. Paid-up capital is the money that an organization really invests in the company's operation.
v. **Right Share-** These are those type of share that an organization issue to their existing stockholders. This type of share is issued by the company to preserve the proprietary rights of old investors.
vi. **Bonus Share-** When a business split the stock to its stockholders in the dividend form, we call it a bonus share.

vii. **Sweat Equity Share-** This type of share is allocated only to the outstanding workers or executives of an organization for their excellent work on providing intellectual property rights to an organization.

Merits of Equity Shares Capital

i. ES (equity shares) does not create a sense of obligation and accountability to pay a rate of dividend that is fixed.
ii. ES can be circulated even without establishing any extra charges over the assets of an enterprise.
iii. It is a perpetual source of funding, and the enterprise has to pay back; exceptional case — under liquidation.
iv. Equity shareholders are the authentic owners of the enterprise who possess the voting rights.

Demerits of Equity Shares Capital

i. The enterprise cannot take either the credit or an advantage if trading on equity when only equity shares are issued.
ii. There is a risk, or a liability overcapitalization as equity capital cannot be reclaimed.
iii. The management can face hindrances by the equity shareholders by guidance and systematizing themselves.
iv. When the firm earns more profits, then, higher dividends have to be paid which leads to raising in the value of the shares in the marketplace and its edges to speculation as well.

1.6.3 Non-voting shares

Non-voting shares **do not give the holder any voting rights in the company**. This means that the holder is entitled to a portion of the company's capital, but is not able to take part in its general meetings.

Non-voting shares are mostly issued to employees or to family members of the main shareholders. This class of shares allows the main shareholders to retain control of the company whilst multiplying the number of shareholders.

1.6.4 Company Fixed Deposits

A company FD, also known as a company term deposit, is a kind of fixed deposit provided by corporations such as finance companies, home finance firms, or other types of NBFCs.

For many businesses, company FDs are an excellent means to raise capital from the general public. A number of rating agencies, including ICRA, CARE, and CRISIL, evaluate the credibility of these term deposits.

Characteristics of the Company Fixed Deposits

i. Corporate FD comes with a credit rating from reputable rating agencies like ICRA, CRISIL, and CARE. The rating will indicate a higher chance of default in the interest and principal payments and so helps the depositor in determining the financial institution's creditworthiness.

ii. Depositors could also ask for a premature withdrawal from the companies. Most of the HFCs and NBFCs charge a penalty rate on public deposits. However - particular public deposits have a three-month lock-in or fixed term where the deposits can't be withdrawn.

iii. The loans against corporate Fixed deposits are also open to depositors in both - cumulative and non-cumulative Fixed Deposits schemes. However - some financial institutions levy a premium over the entire fixed deposit interest rate.

iv. The interest income earned on corporate FDs is taxed based on the depositor's tax bracket.

v. Depositors can also pick from the options of interest pay-out alternatives given by NBFCs or HFCs on their requirements. There are monthly, quarterly, half-yearly, and annual pay-out options that are open.

vi. Depositors could also choose the cumulative Fixed Deposit option where the interest component is reinvested, enhancing the power of compounding. As a result - the cumulative option would help the depositor in earning better returns than non-cumulative options.

vii. Corporate FDs are much riskier than bank FDs since they are not insured by the deposit insurance program offered by DICGC. In the case of Fixed Deposits opened with scheduled banks, a depositor's deposits of up to Rs. 5 lakh that is

held with each scheduled bank are protected from adverse events such as bank failures under the depositor insurance program.

1.6.5 Warrants

Warrants are a contract that gives the right, but not the duty, to buy or sell a security—most usually, equity—before expiry at a certain amount. The price at which the underlying security may be bought or sold is called the exercise price or the strike price.

The Indian and American warrants may be executed at any time on or before the expiry date, while European warrants can be exercised only on the expiry date.

Warrants giving the right to buy a security are referred to as call warrants; those giving the right to sell a security are known as put warrants.

Warrants are similar to options in many respects, but they are differentiated by a few key factors. Companies usually provide warrants themselves, not by a third party, and are traded more often over-the-counter than on an exchange.

Investors cannot write warrants as they want.

Warrants are dilutive, in contrast to options. When an investor exercises his warrant, they receive newly issued stock rather than the stock that is already outstanding. Warrants appear to have much longer periods than alternatives between problem and expiry, typically years rather than months.

Warrants do not pay dividends or come with the right to vote. Investors are drawn to warrants as a way to leverage their positions in a company, to hedge against downside (for example, by combining a put warrant with a long position in the underlying stock) or to maximize arbitrage opportunity.

Bonds

Bonds refer to high-security debt instruments that enable an entity to raise funds and fulfil capital requirements. It is a category of debt that borrowers avail from individual investors for a specified tenure. Organisations, including companies, governments, municipalities and other entities, issue bonds for investors in primary markets. The

corpus thus collected is used to fund business operations and infrastructural development by companies and governments alike. Investors purchase bonds at face value or principal, which is returned at the end of a fixed tenure. Issuers extend a percentage of the principal amount as periodical interest at fixed or adjustable rates. Individual investors acquiring bonds have legal and financial claims to an organisation's debt fund. Borrowers are, therefore, liable to pay the entire face value of bonds to these individuals after the term expires. As a result, bondholders receive debt recovery payments before stakeholders in case a company faces bankruptcy.

Characteristics of Bonds

Bonds have several features that investors should take into account. The popularity of this debt instrument can be attributed to some intrinsic factors, as mentioned below.

- **Face Value**

Face value implies the price of a single unit of a bond issued by an enterprise. Principal, nominal, or par value is used alternatively to refer to the price of bonds. Issuers are under a legal obligation to return this value to the investor after a stipulated period.

Bond example - An investor chooses to purchase a corporate bond at face value of Rs. 6,500. The company issuing the bond is thus obliged to return Rs. 6,500 plus interest to the investor after the maturity of the tenor. Note that the face value of a bond is different from its market value as market operations influence the latter.

- **Interest or Coupon Rate**

Bonds accrue fixed or floating rates of interest across their tenure, payable periodically to creditors. Bond interest rates are also called coupon rates as per the tradition of claiming interests on paper bonds in the form of coupons.
Interest earned on a bond depends on various aspects such as tenure, the issuer's repute in the public debt market.

- **Tenure of Bonds**

Tenure or term refers to the period after which bonds mature. These are financial debt contracts between issuers and investors. Financial and legal obligations of an issuer to the investor or creditor are valid only until the tenure's end.They can thus be segregated as per the tenure applicable for them. Bonds with maturity periods below 5 years are called short-term bonds, whereas a tenure of 5- 12 years is attributed to intermediate-term bonds. Long-term bonds refer to the ones with terms higher than 12 years. Also, longer tenures suggest the participation of issuing companies in prevailing businesses in the trade market in the long-term.

- **Credit Quality**

The credit quality of a bond refers to the creditors' consensus on the performance of a company's assets in the long-term. It is determined by the degree of confidence that investors have in an organisation's bonds. Credit rating agencies classify bonds based on the risk of a company defaulting on debt repayment.

These agencies assign risk grading to private players in the market and categorise bonds into investment grade and non-investment grade debt instruments. Investment grade securities are susceptible to lower yields due to a steady market risk factor, whereas non-investment grade securities offer high returns at considerable risks.

- **Tradable Bonds**

Bonds are tradable in the secondary market. The ownership can thus shift among various investors within a given tenure. These creditors often sell their bonds to other entities when market prices exceed the nominal values as they have an option to secure bonds with high yield and appropriate credit ratings.

Types of Bonds

The various types of bonds include:

- **Fixed-rate bonds**

  Fixed-rate bonds pay consistent interest amounts until maturity. The bondholders earn predictable and guaranteed returns regardless of the prevailing market conditions.

  For example, An investor purchased a ten-year fixed-rate government bond of Rs. 1000, issued on 20th April 2013 which offers a coupon rate of 7.5%. The investor will get a fixed interest of Rs. 75, annually every April, till 20th April 2023.

- **Floating-rate bonds**

  Floating-rate bonds do not pay fixed returns each period. Instead, the interest rates vary, depending on the set benchmark, during the tenure.
  For example, an investor purchased an 8-year floating rate bond issued in 2015. The bond pays interest of 40 points higher than the prevailing National Savings Certificate interest rate. This means the NSC interest rate is the benchmark and any fluctuation in it directly affects the coupon payment of this bond.

- **Zero-coupon bonds**

  As the name implies, these bonds do not pay periodic coupons during their tenure. Though, these bonds are issued at a discount and repayable at the par value. The difference is the yield for investors.
  For example, an investor buys a 20-year zero-coupon bond, with a face value of Rs. 1000, at Rs. 700. At the end of 20 years, the issuer will pay Rs. 1000 to the bondholder.

- **Perpetual bonds**

  Perpetual bonds are those debt securities which do not have a maturity. In this type of bond, the issuer does not repay the principal amount to the bondholders. Though, they keep paying steady coupon payments to the bondholders till perpetuity.

- **Inflation-linked bonds**

  These types of bonds aim at minimizing the impact of inflation on the face value and coupon payments. The principal is adjusted according to the inflation and coupon payments are made based on the adjusted principal.
  For example, an investor purchases an Inflation-linked bond with a face value of Rs. 100. After a year, the inflation-adjusted principal amounts to Rs. 107. Therefore, the coupon will be paid considering Rs. 107 for that period.

- **Convertible Bonds**

  The investors holding convertible bonds get the right to convert the bond to a predefined number of equity shares in the issuing company at a particular time from the tenure. Though, the investor can also opt to receive the principal repayment at the maturity, if they don't want to exchange it with shares.

- **Callable Bonds**

  Callable bonds are high coupon paying securities that give the issuer the right to call back the bonds at a pre-agreed price and date.

- **Puttable Bonds**

  Puttable bonds give the bondholder the right to return the bond and ask for repayment of principal at a pre-agreed date before maturity. Since the benefit offered is for investors, these bonds pay lower returns.

Debenture:

The word 'debenture' itself is a derivation of the Latin word 'debere' which means to borrow or loan. Debentures are written instruments of debt that companies issue under their common seal. They are similar to a loan certificate.

Debentures are issued to the public as a contract of repayment of money borrowed from them. These debentures are for a fixed period and a fixed interest rate that can be payable yearly or half-yearly. Debentures are also offered to the public at large, like equity shares. Debentures are actually the most common way for large companies to borrow money.

Types of Debentures

There are various types of debentures that a company can issue, based on security, tenure, convertibility etc. Let us take a look at some of these types of debentures.

- **Secured Debentures:** These are debentures that are secured against an asset/assets of the company. This means a charge is created on such an asset in case of default in repayment of such debentures. So in case, the company does not have enough funds to repay such debentures, the said asset will be sold to pay such a loan. The charge may be fixed, i.e. against a specific assets/assets or floating, i.e. against all assets of the firm.
- **Unsecured Debentures:** These are not secured by any charge against the assets of the company, neither fixed nor floating. Normally such kinds of debentures are not issued by companies in India.
- **Redeemable Debentures**: These debentures are payable at the expiry of their term. Which means at the end of a specified period they are payable, either in the lump sum or in instalments over a time period. Such debentures can be redeemable at par, premium or at a discount.
- **Irredeemable Debentures:** Such debentures are perpetual in nature.

There is no fixed date at which they become payable. They are redeemable when the company goes into the liquidation process. Or they can be redeemable after an unspecified long time interval.

- **Fully Convertible Debentures:** These shares can be converted to equity shares at the option of the debenture holder. So if he wishes then after a specified time interval all his shares will be converted to equity shares and he will become a shareholder.
- **Partly Convertible Debentures**: Here the holders of such debentures are given the option to partially convert their debentures to shares. If he opts for the conversion, he will be both a creditor and a shareholder of the company.
- **Non-Convertible Debentures**: As the name suggests such debentures do not have an option to be converted to shares or any kind of equity. These debentures will remain so till their maturity, no conversion will take place. These are the most common type of debentures.

Let's Sum up

Financial markets play a crucial role in the economy by facilitating capital formation, price discovery, liquidity, risk management, and savings and investment. They encompass a variety of instruments, including equities, debt, derivatives, and hybrids. The Indian financial market, regulated by entities like SEBI and RBI, is integral to the country's economic development. Similarly, the global financial market

provides a platform for international trade and investment. The capital market, comprising primary and secondary markets, has evolved significantly, driven by technological advancements and globalization, offering various instruments such as preference shares, equity shares, non-voting equity shares, company fixed deposits, warrants, debentures, and bonds.

Check your Progress – QUIZ 6

1. **Tax-rate is relevant and important for calculation of specific cost of capital of ________.**

   A. Equity Share

   B. Preferential Share

   C. Debentures

   D. None of the above

2. **What is a financial market?**

   A. A place where goods are bought and sold

   B. A system for raising capital by buying and selling stocks, bonds, and other securities

   C. A bank that provides loans

   D. A government agency that regulates the economy

3. **Which of the following is a primary market activity?**

   A. Trading stocks on the NYSE

   B. Issuing new corporate bonds

   C. Selling existing bonds to another investor

   D. Buying mutual funds

4. **What does an Initial Public Offering (IPO) involve?**

   A. A company issuing bonds for the first time

B. A company selling its shares to the public for the first time

C. A company merging with another company

D. A company buying back its shares

5. **What is market risk?**

A. The risk of an investor not being able to sell their investment

B. The risk of losing money due to overall market movements

C. The risk of a bond issuer defaulting

D. The risk of changes in interest rate

1.7 Unit Summary

Financial markets are platforms that facilitate the buying and selling of financial instruments like stocks, bonds, and commodities, playing a crucial role in mobilizing savings, providing liquidity, and reducing transaction costs. Their key constituents include primary and secondary markets, money markets, capital markets, forex markets, and derivatives markets, dealing with instruments such as equities, bonds, and derivatives. The Indian financial market features organized sectors like NSE and BSE, while the global financial market encompasses international capital, forex, and commodity markets. Capital markets, evolving from local exchanges to global electronic platforms, consist of primary markets for new issues and secondary markets for existing securities. Key instruments in capital markets include preference shares, equity shares, non-voting equity shares, company fixed deposits, warrants, and debentures and bonds, each offering various risk and return profiles for investors.

1.7.1 Glossary

Price Determination	Setting the prices of financial instruments based on supply and demand.
Liquidity	Ensuring assets can be quickly bought or sold.
Risk Sharing	Distributing risk among market participants.
Efficiency	Reducing transaction costs and providing a platform for buyers and sellers to meet.
Equity Instruments	Financial instruments representing ownership, such as stocks.
Debt Instruments	Financial instruments representing loans, such as bonds and debentures.
Derivatives	Financial contracts like futures and options.
Hybrid Instruments	Financial instruments combining features of equity and debt, like convertible debentures.

1.7.2 Self-Assessment Question

Short Answers Questions:

SI.No	Questions	Level
1	What are financial markets?	K1
2	What role do financial markets play in the economy?	K1
3	Name three key constituents of financial markets.	K3
4	What are some common financial instruments traded in financial markets?	K4
5	What distinguishes the Indian financial market?	K4
6	How does the global financial market operate?	K4
7	What is the capital market?	K2
8	Name two capital market instruments.	K3
9	What are preference shares?	K2
10	What is a warrant in financial markets?	K2

Long Answer Questions

Sl.No	Questions	Level
1	Explain their primary functions.	K3
2	Describe the constituents of financial markets and their roles.	K4
3	Discuss the evolution and growth of capital markets.	K4
4	Explain the main types of capital market instruments and their characteristics.	K5
5	Compare and contrast the Indian financial market with the global financial market.	K5

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Unit II: Regulation of Indian Capital Market			
Regulatory Framework - Committees on Regulatory Framework - SEBI - Objectives - Management - Powers and functions - Regulatory role - Investor Protection - Insider Trading - Rationale - Insiders – Insider information - Connected persons.			
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UNIT II

REGULATION OF INDIAN CAPITAL MARKET

Legislative framework

The Indian Securities Market is regulated by 3 main regulators, the Department of Company Affairs (‘DCA’), the Securities and Exchange Board of India (‘SEBI’) and the Reserve Bank of India (‘RBI’). The 3 key legislations which are relevant to the securities market are as under:

(a) Companies Act, 1956

(b) Securities and Exchange Board of India Act, 1992

(c) Securities Contract (Regulations Act), 1956.

Companies Act: The Companies Act is the fundamental statute which deals with the issue of shares, types of shares, debentures, transfer of shares, premium on shares, bonus issues, rights issues, etc.

SEBI Act: The SEBI Act is the main Act from which several other Rules and Regulations have originated. The Act constitutes a Board (“the SEBI”) to protect the investors’ interest in securities and to promote the development and to regulate the securities market. The SEBI replaces the erstwhile Controller of Capital Issues. The SEBI has various powers under the Act including to issue various Regulations to better regulate the securities market and for better investor protection. It governs and regulates the market intermediaries. It has wide powers of investigation, survey, search and seizure, powers to impound documents, take statements on oath, etc. Thus, the powers enshrined in the SEBI are of a very wide amplitude. It also has powers to issue “directions, e.g., cease and desist” orders, by virtue of which, it can prohibit any person or intermediary from carrying out certain operations. The Act provides for stringent penalties for different types of offences and violations.

SCRA : The Securities Contracts (Regulation) Act or the SCRA is another important piece of legislation. This Act has been in force since 1956. It is an Act which regulates the stock exchanges and contracts in securities. It gives power to regulate and govern the stock exchanges and their working. This Act is also administered by the SEBI.

If one were to point out the most important provision of this Act, then it would undoubtedly which defines the term “securities”. The Act prohibits any contracts in securities unless they are of the following types: (a) Contracts carried out through the members of a recognised stock exchange; or (b) Spot Delivery Contracts. The Act and its Rules also prescribe the conditions for listing of securities on the stock exchanges. It also provides for the amount of public holding required in every company seeking listing.

2.1 Regulatory Framework

Regulatory framework and legislation

The demand for long-term capital comes predominantly from private sector manufacturers, agriculture, trade, and government agencies. The supply side consists of individuals, corporate savings, insurance savings, banks, specialised financing agencies and the surplus of governments. Regulating this affair, therefore, becomes important to ensure transparency and investor confidence both domestically and internationally.

India’s capital markets are regulated and monitored primarily by:

- Securities & Exchange Board of India (SEBI);
- Department of Economic Affairs, Ministry of Finance, Government of India;
- Ministry of Corporate Affairs, Government of India; and
- Reserve Bank of India.

The regulators draft legislation, issue circulars, notifications, guidelines and regulations from time to time to regulate the securities market in India. They also have the power of oversight over various market participants. The stock exchanges also frame their own rules, regulations and byelaws to regulate the securities market. The key statutes and regulations governing the securities market are:

2.1.1 Companies Act

All the companies listed on a recognised stock exchange must comply with the provisions laid out by this Act, including corporate governance norms. Corporate governance norms include shareholder decision-making processes, auditing

standards, etc. These norms ensure transparency for investors in their operations.

The statute deals with issues, allotments, transfers of securities, and various other aspects relating to company management. The statute contains standard disclosures about the public offering of capital, mainly concerning projects and management of the company, information about other listed companies managed by the same management, and risk factors perceived by the management.

The Companies Act also regulates underwriting, use of premiums and discounts on issues, rights and bonus issues, payment of interests and dividends, supply of annual reports, and other information. The statute also provides for insolvency and NCLT/NCLAT provisions.

2.1.2 Securities and Exchange Board of India Act

Securities Contracts (Regulation) Act of 1956 (SCRA)

This statute virtually controls all aspects of securities trading and the running of stock exchanges, directly or indirectly. The aim of the SCRA is to prevent undesirable transactions in securities. The stock exchanges determine their own listing regulations in conformity with the minimum listing criteria set out in the Securities Contract (Regulation) Rules, 1957. The Act gives the Central Government and SEBI regulatory jurisdiction over:

- stock exchanges through a process of recognition and continued supervision,
- contracts in securities, and
- listing of securities on stock exchanges.

A stock exchange is to be recognised only if the conditions prescribed by the Central Government are fully adhered to. Organised trading activity in securities takes place on a specified recognised stock exchange.

2.1.3 Securities Contract

Securities & Exchange Board of India: 1992 (SEBI Act)

SEBI is provided with statutory powers for:

- protecting the interests of investors in the securities market.
- promoting the development of the securities market.
- regulating the securities market, such as issue and transfer of securities, insider trading, futures and options trading, etc. to protect investors' interests.
- promote awareness among investors.
- training of intermediaries about the safety of the market.

and all matters connected to the parameters above. The objectives of SEBI have been laid down in the preamble of the SEBI Act.

The Reserve Bank of India Act of 1934 (RBI Act)

The RBI Act exercises concurrent authority over contracts pertaining to the sale and purchase of securities, gold-related securities, money market securities and securities derived from the same, and ready-forward contracts in debt securities.

The RBI Act defines a security as a "bond, debenture, debenture stock, deposit receipt, certificate of deposit, security receipt, unit of a mutual fund or any other

instrument of a similar nature, issued by a body corporate or by any other person." A gold-related security is a security that is linked to the price of gold. A money market security is a security that is issued with a maturity of less than one year. A security derived from a money market security is a security that is created by combining two or more money market securities.

A ready-forward contract for a debt security is a contract to buy or sell a debt security at a future date at a predetermined price.

The RBI Act gives the RBI the power to regulate and supervise the trading of securities, gold-related securities, money market securities and securities derived from the same, and ready-forward contracts in debt securities. The RBI can impose

requirements on the participants in these markets, such as requirements for capital adequacy, margin requirements, and reporting requirements. The RBI can also take action against market participants who violate the law.

The RBI Act also gives the RBI the power to investigate and prosecute violations of the law. The RBI can impose penalties on market participants who violate the law, such as fines, imprisonment, or both.

The Depositories Act of 1996

This statute provides for the dematerialization of shares, eliminating the risks associated with physical certificates. It allows the electronic transfer of shares from one depository member to another without changing ownership rights over them. **The primary objective of the Depositories Act is:**

- making securities freely transferable, subject to certain exceptions; all securities are transferable freely in the depositories mode, restricting the company's right to use its discretion in effecting the transfer of securities;
- dematerialization of the securities in the depository mode; and
- providing for maintenance of ownership records in a book entry form.

The Banking Regulation Act of 1949

This legislation establishes control over banking infrastructure in India. The Act also aims at protecting the interests of the depositors through provisions like the opening/closing of accounts, deposits and withdrawals, among other things.The Act was enacted in 1949 in the wake of the banking crisis of the 1930s.

The crisis had led to a loss of confidence in the banking system, and the government felt the need to enact legislation to regulate the banking industry and protect the interests of depositors.

The Act establishes a regulatory framework for banks in India. It defines a bank as *"any company which transacts the business of banking."* The Act also sets out the powers and functions of the Reserve Bank of India (RBI), which is the central bank of

India. The RBI is responsible for regulating the banking system and ensuring the safety and soundness of banks.

The Act also provides for the establishment of a Deposit Insurance Corporation (DIC). The DIC is responsible for providing deposit insurance to depositors at banks. Deposit insurance protects depositors against the loss of their deposits in the event of a bank failure. The Act has been amended several times since its enactment. The most recent amendment was made in 2017. The amendment introduced a number of changes to the Act, including changes to the definition of a bank, the powers of the RBI, and the deposit insurance scheme.

The Banking Regulation Act of 1949 is a vital piece of legislation that plays a key role in regulating the banking industry in India. The Act helps to ensure the safety and soundness of banks, and it protects the interests of depositors.

Lets Sum Up

Indian capital market is essential for fostering a stable, transparent, and investor-friendly environment. Through the efforts of SEBI, RBI, and other regulatory bodies, India aims to maintain robust market infrastructure, protect investor interests, and promote sustainable growth. Understanding the regulatory framework is crucial for market participants to navigate the complexities of the capital market and contribute to its development.

Check Your Progress – QUIZ 1

1. **Which regulatory body is primarily responsible for regulating the securities market in India?**

   A) Reserve Bank of India (RBI)

   B) Ministry of Finance

   C) Securities and Exchange Board of India (SEBI)

   D) Insurance Regulatory and Development Authority of India (IRDAI)

2. **Which act provides SEBI with statutory powers to regulate the securities market?**

A) Companies Act, 1956

B) Securities Contracts (Regulation) Act, 1956

C) SEBI Act, 1992

D) Indian Contract Act, 1872

3. **What is the primary objective of the SEBI (Prohibition of Insider Trading) Regulations, 2015?**

A) Regulating mutual funds

B) Prohibiting trading based on unpublished price-sensitive information

C) Facilitating the issue of new securities

D) Regulating mergers and acquisitions

4. **Which body regulates the money market and foreign exchange market in India?**

A) Ministry of Finance

B) Reserve Bank of India (RBI)

C) SEBI

D) Bombay Stock Exchange (BSE)

5. **What is the purpose of the SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015?**

A) Regulating the issuance of mutual funds

B) Mandating the disclosure of financial and non-financial information by listed companies

C) Controlling the foreign exchange market

D) Governing the takeover of companies

6. **Which regulatory framework governs the acquisition of shares and control in companies to ensure fair treatment of all shareholders?**

A) SEBI (Prohibition of Insider Trading) Regulations

B) SEBI (Substantial Acquisition of Shares and Takeovers) Regulations

C) SEBI (Issue of Capital and Disclosure Requirements) Regulations

D) Companies Act

7. **Which organization uses the SEBI Complaints Redress System (SCORES) to facilitate the resolution of investor complaints?**

A) Reserve Bank of India (RBI)

B) Ministry of Finance

C) Securities and Exchange Board of India (SEBI)

D) National Stock Exchange (NSE)

2.2 SEBI

2.2.1 Formation of SEBI

The Securities and Exchange Board of India (SEBI) was first established as a non-statutory body in 1988 for the regulation of the securities market. It acquired the statutory powers on 30th January 1992 in accordance with the SEBI Act 1992. SEBI became an autonomous body on 12 April 1992 and was soon constituted as the regulator of capital markets under the Government of India. The headquarters of the

Security and Exchange Board of India is located in Mumbai, Maharashtra and has four regional offices in New Delhi, Kolkata, Chennai and Ahmedabad.

The Indian capital market is regulated primarily by this regulatory body. Regulatory, monitoring, and management functions are performed by it for the Indian securities market. Incorporating rules and regulations is intended to safeguard investors' interests and foster a safe investment environment. As part of its work, it also develops investment-related guidelines for improving the investment situation in India.

2.2.2 Structural Organisation of SEBI

SEBI is an autonomous organization that works under the administration of the Union Finance Ministry. The Security and Exchange Board of India (SEBI) is managed by the following members:

1. The chairman was nominated by the Union Government of India.

2. Two members, i.e., Officers from the Union Finance Ministry.
3. One member from the Reserve Bank of India.
4. The remaining five members are nominated by the Union Government of India. Three of the five members should be full-time members.

2.2.3 Objectives

The Securities and Exchange Board of India (SEBI) is the regulatory body for the securities market in India. Its primary objectives are as follows:

Regulation and Oversight: SEBI aims to regulate the securities market and ensure orderly and transparent functioning of stock exchanges and other securities markets.

Investor Protection: SEBI seeks to protect the interests of investors by ensuring fair practices and disclosures, promoting investor education, and addressing grievances promptly.

Development of Securities Market: SEBI works towards developing the securities market by introducing new products and services, promoting fair competition among market participants, and encouraging innovation.

Regulation of Intermediaries: SEBI regulates various intermediaries in the securities market, such as stockbrokers, merchant bankers, mutual funds, and portfolio managers, to ensure they operate in a fair and transparent manner.

Promotion of Market Integrity: SEBI aims to maintain market integrity by preventing fraudulent and unfair trade practices, insider trading, and market manipulation.

Policy Formulation: SEBI formulates policies and regulations related to the securities market in consultation with stakeholders, government bodies, and market participants.

Educational Initiatives: SEBI promotes investor education and awareness through various initiatives to empower investors with knowledge about investing in securities and understanding market risks.

Enforcement: SEBI enforces its regulations and takes actions against violations through measures such as penalties, suspensions, or prosecution to ensure compliance and maintain market discipline.

2.2.4 Management

The Securities and Exchange Board of India (SEBI) is managed through a structured governance framework involving several key entities and roles:

Board of SEBI: The highest decision-making body of SEBI is its Board, consisting of a Chairman (who is nominated by the Government of India), other members (including officials from the Ministry of Finance, Reserve Bank of India, and experts from various fields), and senior officers of SEBI. The Board sets the overall policy direction and oversees the functioning of SEBI.

Chairman: The Chairman of SEBI is appointed by the Government of India and plays a pivotal role in providing leadership to the organization. The Chairman presides over Board meetings, represents SEBI in various forums, and oversees the implementation of policies and regulations.

Committees: SEBI has various committees to assist in its functions and decision-making. These committees may include committees for specific tasks such as regulatory issues, market development, investor protection, etc. The committees consist of SEBI officials, experts from the industry, and other stakeholders.

Divisions and Departments: SEBI operates through several divisions and departments that are responsible for different aspects of its regulatory functions. These divisions include Legal Affairs, Market Regulation, Investment Management, Enforcement, Economic and Policy Analysis, etc. Each division is headed by a senior officer who reports to the Chairman or the Board.

Regional Offices: SEBI has regional offices across major cities in India, which are responsible for overseeing and regulating market activities within their respective jurisdictions. These offices play a crucial role in ensuring compliance with SEBI regulations and addressing local issues.

Advisors and Consultants: SEBI may engage advisors and consultants from time to time to provide expert advice on specific matters related to market regulation, policy formulation, legal issues, etc.

Collaboration and Coordination: SEBI collaborates with other regulatory bodies,

government agencies, international organizations, and stakeholders to ensure effective regulation and development of the securities market.

Overall, SEBI's management structure is designed to ensure efficient governance, transparency, and accountability in regulating the securities market in India, with a focus on investor protection, market integrity, and sustainable market development

Lets Sum Up

SEBI, the Securities and Exchange Board of India, was established in 1988 as a statutory regulatory body to oversee the securities market in India. It operates under the SEBI Act, 1992, and reports to the Ministry of Finance. SEBI's organizational structure includes a Chairman, Board of Directors, and various departments for regulatory functions. Its primary objectives include protecting investor interests, promoting fair and transparent securities markets, and regulating intermediaries. SEBI manages market operations through regulations, enforcement actions, and policy initiatives.

Overall, SEBI plays a crucial role in fostering investor confidence,

ensuring market integrity, and facilitating the growth and development of the Indian securities market.

Check Your Progress – QUIZ 2

1. **In which year was SEBI established as the statutory regulatory body for the securities market in India?**

A. 1980

B. 1988

C. 1992

D. 1998

2. **Who is the head of SEBI?**

A. Prime Minister of India

B. Finance Minister of India

C. Chairman of SEBI

D. Governor of Reserve Bank of India

3. **What are the primary objectives of SEBI?**

A. Promote industrial growth

B. Protect investor interests

C. Manage fiscal policy

D. Conduct monetary policy

4. **Under which ministry does SEBI operate?**

A. Ministry of Commerce and Industry

B. Ministry of Corporate Affairs

C. Ministry of Finance

D. Ministry of External Affairs

5. **Which act grants statutory powers to SEBI for regulating the securities market?**

A. SEBI Act, 1988

B. SEBI Act, 1992

C. SEBI Amendment Act, 2000

D. SEBI Regulation Act, 1995

2.3 FUNCTIONS OF SEBI

2.3.1 Protective Functions

- Prohibit securities markets related fraudulent and unfair trade practices
- Prohibit insider trading in securities
- Issue directions to protect the interests of investors, intermediaries, fair trade, and balance of trade.

2.3.2 Regulatory Functions

- Regulate the business in stock exchanges and any other securities markets
- Register and regulate the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and other intermediaries
- Register and regulate the working of venture capital funds, mutual funds, and other schemes
- Regulating substantial acquisition of shares and take over of companies
- Raise requests for information, inspection, conducting inquiries and audits

2.3.3 Development Functions

- Promote investors education and training of intermediaries of securities markets.
- Promoting and regulate self-regulatory organisations

2.3.4 Powers of SEBI:

- Passing judgments in cases of fraud and unethical practices in the securities market.
- Facilitating transparency, accountability, and fairness in the market.
- Examining the Book of Accounts and other vital documents to gather evidence against violations, and imposing rules, passing judgments, and taking legal actions against violators.
- Formulating rules and regulations to protect the interests of investors, covering areas like listing obligations, insider trading regulations, and disclosure

requirements.

- Eliminating malpractices in the securities market through the formulation of rules and regulations.

2.3.5 Role Of SEBI

SEBI was established to monitor and improve the Indian Capital market. In order to achieve this goal, it looks after the needs of the three most important financial participants involved in the Indian capital market. Those three parties are:

1). **Issuers of securities:** In any company that is listed on the stock exchange, the issuers are organizers that help raise funds from the financial market. The role of SEBI here is to ensure that IPO and FPO issuance is done fairly and without misrepresentation.

2). **Protect Investor's Interest**: The role of SEBI is to protect investor's interests and prevent unfair trade practices so that investor's interests don't get harmed. Protecting the interests of traders and investors is important for the survival of the capital market because they are an integral part of the capital market.

3). **Financial Intermediaries**: SEBI act as the financial market intermediaries, ensuring that stock market trades take place smoothly and securely. Their purpose is to oversee the activities of financial intermediaries such as NBFCs, brokers, sub-brokers, and so on.

Apart from this SEBI oversees and manages the complaints division dealing with complaints about the Commodity derivatives segment of the recognized stock exchanges, dealing with investor's grievances, investor education, and policy related to it.

Lets Sum Up

SEBI, the Securities and Exchange Board of India, performs protective functions by safeguarding investor interests through regulations against fraud and malpractice. Its regulatory functions include overseeing stock exchanges, intermediaries, and enforcing compliance with securities laws. SEBI also plays a pivotal role in the development of the securities market by introducing reforms, promoting transparency,

and enhancing market efficiency. It exercises extensive powers such as investigation, inspection, and imposing penalties to maintain market integrity. Overall, SEBI's role encompasses ensuring fair practices, fostering investor confidence, and fostering a conducive environment for the growth and stability of India's securities market.

Check Your Progress – QUIZ 3

1. **What is the primary objective of SEBI's protective functions?**

A. Promote industrial growth

B. Protect investor interests

C. Facilitate foreign investments

D. Monitor government securities

2. **SEBI regulates which of the following entities in the securities market?**
A. Banks only

B. Stock exchanges, intermediaries, and listed companies

C. Insurance companies

D. Retail investors

3. **SEBI promotes the development of the securities market by:**

A. Imposing strict capital controls

B. Restricting market access

C. Introducing reforms and enhancing transparency

D. Controlling inflation rates

4. **Which of the following is NOT a power exercised by SEBI?**

A. Investigation

B. Imposing penalties

C. Issuing currency

D. Conducting inspections

5. **The role of SEBI includes:**

A. Promoting political campaigns

B. Ensuring fair practices and market integrity

C. Managing foreign relations

D. Controlling agricultural prices

2.4 Regulatory Role

2.4.1 Investor Protection

Meaning

The term 'investor protection' means a process or a mechanism by which the interest of an investor is protected in the security market. Basically, it denotes the acts done with object to bring and maintain transparency in procedural aspect while dealing with investor through some regulatory bodies by means of some suitable legislation. In order to protect the interest of the investors, various investors protection mechanisms have been established in India. There are mainly three means i.e. mechanisms to protect the interest of investors in the security market regulatory bodies like SEBI, various Acts and Judiciaries.

Investor Protection According to the SEBI Act, 1992 Investor protection is 'protecting the interest of the investors in securities and promoting the development of and to regulate the securities market and for matters connected therewith or incidental thereto.' Generally, investor protection is known as legislation to protect the small investors from unscrupulous investment brokers and advisers. Thus, the term 'investor protection' means those steps and measures which are required to protect the interest

of the investors by enacting suitable legislation, establishing regulatory bodies or by passing of regulations or guidelines for protecting the interest of the investors in the capital market.

Role of SEBI in Investor Protection

The Role of SEBI in Investor Protection 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. Some of are:

1) **Issue of guidelines:** SEBI has issued guidelines to companies (bringing new issues in the market) mutual funds, portfolio managers, merchant bankers, underwriters, lead managers, etc. These guidelines are for bringing transparency in their operations and also for avoiding exploitation of investors by one way or the other. SEBI has introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. In order to reduce the cost of issue, the underwriting is made optional on certain terms. These steps are also for the protection of investors. SEBI keeps watch on all intermediaries and see that they follow the guidelines in the right spirit. It also takes panel actions when the guidelines are not followed. These steps give protection to investors.

2) **Public interest advertisements:** SEBI issues public interest advertisements to enlighten investors on the basic features of various instruments and minimum precautions they should take before choosing an investment. The SEBI desires to create awareness among investors about their rights and about remedies if problem arise. It has published some booklets for the information and guidance of investors.

3) **Dealing with complaints of investors**: The investors can make complaints to SEBI if they face problems relating to their investment in industrial securities and financial assets. SEBI receives thousands of complaints relating to non-receipt of refund orders, allotment letters, nonreceipt of dividend or interest and delays in the transfer of shares and debentures. SEBI is making efforts to solve such complaints through appropriate measures.

4) **Investor education:** SEBI is aware that investor education is important for his protection. It encourages the formation of investor associations that disseminate

information through news letters. SEBI is bringing out two monthly publications for the investors. These are: (a) SEBI- Market Review, (b) SEBI News-letter. These publications are for the education, guidance and protection of investors.

5) **Investor surveys:** SEBI has also conducted surveys in respect of investment and opportunities for the benefit of small investors. The findings of the surveys are given wide publicity so as to provide proper guidance to investors regarding their investment decisions.

6) **Introduction to stock invest:** SEBI has introduced stock invest as a new instrument useful while submitting application for shares. This new instrument introduced through the co-operation of banks gives protection to investors as they get interest on the application money till the allotment of shares.

7) **Disclosures by companies:** SEBI has introduced norms for disclosure of half yearly unaudited results of companies. It has also revised the format of prospectus to provide more information to investors. It also insists that every share application form is accompanied by an abridged prospectus. The provisions relating to disclosures are for the information and protection of small/average investors.

2.4.2 Insider Trading

Insider trading occurs when personnel with non-public, material information about a public corporation trade in its stock or other securities.

An insider is a person who is a part of the company whose stocks they are trading. They may or may not possess confidential non-public knowledge regarding the firm.

Insider trading can be either unlawful or legal, depending on when the trade is made and the laws of the country in which the trader is located.

Definitions: Insider trading is defined as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise non-public information which can be crucial for making investment decisions.

SEBI Regulate Insider Trading

SEBI perceives trading by the following groups or individuals as a form of insider trading.

Therefore, any person coming under one of these categories should avoid trading equities for the firm for which they are classified as an insider.

1. Immediate relatives of connected individuals or insiders
2. An associated company or holding firm directly linked with the other corporation
3. A high-level executive belonging to such a holding firm of the parent company
4. An official working at a clearing house or stock exchange
5. Asset management company board members or a trustee in mutual fund management companies
6. A Board member or chairman of a public financial organisation

SEBI also restricts the procurement of Unpublished Price Sensitive Information or UPSI, unless required by law or legal proceeding.

2.4.3 Rationale

Understanding the rationale in financial markets involves grasping the underlying reasons and principles that guide various financial activities and decisions. Here are some key aspects to consider:

Efficient Allocation of Capital: Financial markets exist to facilitate the efficient allocation of capital. Investors, through various financial instruments like stocks, bonds, and derivatives, allocate their savings to entities (such as corporations or governments) that need capital for growth or operations.

Price Discovery: Financial markets help in determining fair prices for financial assets. The interaction of buyers and sellers in markets establishes equilibrium prices based

on supply and demand dynamics, reflecting the perceived value of assets.

Risk Management: Participants in financial markets use various instruments to manage risks associated with uncertain future outcomes. For instance, derivatives such as options and futures allow investors to hedge against price fluctuations in assets.

Liquidity Provision: Markets provide liquidity, allowing investors to buy and sell assets easily. Liquidity ensures that investors can convert their investments into cash quickly without significantly impacting market prices.

Facilitation of Economic Growth: Well-functioning financial markets support economic growth by channeling savings into productive investments. This process enables businesses to expand, create jobs, and innovate, contributing to overall economic development.

Information Transmission: Financial markets serve as mechanisms for transmitting information about economic conditions, corporate performance, and investor sentiment. Prices reflect collective beliefs and expectations, influencing economic decisions.

Capital Formation: Financial markets facilitate the issuance of new securities (e.g., IPOs) and debt instruments (e.g., bonds), enabling companies and governments to raise capital for projects, expansion, or refinancing.

Investor Participation: Individuals and institutions participate in financial markets to earn returns on their investments. Different investors have varying risk tolerance levels and investment objectives, influencing market dynamics.

2.4.4 Insider

According to the Regulations, "Insider" means any person who is or was connected to the company or is deemed to have been connected with the company and who reasonably is expected to have access, connection to unpublished price sensitive information in relation to that company.

2.4.5 Insider information

Insider information in financial markets refers to material, non-public information about

a company that could affect its stock price once disclosed to the public. Here are key points about insider information:

Definition: Insider information typically includes confidential details about a company's financial performance, business operations, upcoming mergers or acquisitions, significant contracts, or other events that could impact its stock price.

Regulation: Most financial markets have strict regulations against trading on insider information. In many jurisdictions, insider trading is illegal because it undermines market integrity and fairness by giving certain individuals an unfair advantage over others.

Legal Framework: Laws and regulations governing insider trading vary by country, but they generally prohibit insiders—such as company executives, directors, and employees—from buying or selling securities based on non-public information that could influence market prices.

Penalties: Individuals found guilty of insider trading can face severe penalties, including fines, imprisonment, and civil lawsuits. Companies may also face legal consequences for failing to prevent insider trading among their employees.

Impact on Market Confidence: Insider trading undermines investor confidence in the fairness of financial markets. When insiders profit from privileged information, it erodes trust and can distort market prices, potentially harming ordinary investors.

Enforcement: Regulatory bodies, such as the Securities and Exchange Commission (SEC) in the United States, actively monitor and investigate suspicious trading activities to detect and prosecute insider trading violations.

Companies are required to establish internal controls and procedures to prevent insider trading among their employees. This includes educating employees about insider trading laws and implementing restrictions on trading during sensitive periods.

2.4.6 Connected Person

The Regulation defines that a "connected person" means any person who- (i) is a director, as defined in clause (13) of section 2 of the Companies Act, 1956 of a company, or is deemed to be the director of the company by virtue of sub-clause

(10) of section307 of the Act. (ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company, whether temporary or permanent and who may reasonably be expected to have an access to unpublished, price sensitive information in relation to that company.

Price Sensitive Information: means any information, which relates directly or indirectly to a company and which if published, is likely to materially affect the price of securities of the company. Following are some examples of Price Sensitive Information:

1. Financial results of the company.
2. Intended declaration of Dividends.

3. Issue of shares by way of public rights, bonus, etc.

4. Any major expansion plans or execution of new projects 5. Amalgamation, mergers and takeovers.

5. Disposal of the whole/substantial of the undertaking.

Why to Control Insider Trading?

To protect general investors. The manipulation of market by using Insider trading generally causes great losses to a company, thus leading to loss for investors or great profit only for the Insiders and no investor. It steals away the possibility of earning profit from an investor.

To protect the interest and reputation of the company. Once a company faces a problem of Insider Trading, investors tend to lose confidence in the company and stop investing in the company and also selling all the stocks of the company.

To maintain confidence in the stock exchange operations. With SEBI also regulating all the trading's, if any Insider gets a chance to get past the laws, it decreases the investors' confidence in the stock exchange operations itself.

To maintain Public confidence in the financial system as a whole. Indian Financial Market is still very low in the domestic investment rate. To have a healthy economy, a proper financial system is a must and for that, confidence in the market is of utmost importance. Rationale behind Prohibiting Insider Trading:

Securities market deals with the allocation of capital in an economy. This function enables market efficiency, where market's price reflects the risk and future returns accurately. Insider trading appears biased to investors as insiders have additional price sensitive information before them and can use it to make profits while the late reception of information makes investors suffer loss or not gain the deserved profits. If a market is integrated and free of illegal trading, it may lead to healthy growth of the market and such markets can inspire the confidence of the Investors. Insider trading leads to loss of confidence of Investors on the market which can lead to a halt in market dealings thus causing a situation similar to the Great Economic

Depression of the United States. Besides, a company's information is its property and no one but the company must profit from it.

Significant Penalties:

• SEBI may impose a penalty of not more than Rs. 25 Crores or three times the amount of profit made out of Insider Trading; whichever is higher.

• SEBI may initiate criminal prosecution; or

• SEBI may issue order declaring transactions in Securities based on unpublished price sensitive information; or

• SEBI may issue orders prohibiting an insider or refraining an insider from dealing in the securities of the company.

Let’s Sum up

The regulatory framework of the Indian financial markets, primarily governed by SEBI, aims to ensure the fair, transparent, and efficient functioning of the market. Several committees have contributed to shaping these regulations. SEBI's main objectives are to protect investors, promote the development of the market, and regulate market participants. It achieves these through its regulatory, developmental, and protective functions.

Insider trading regulations are crucial to maintaining market integrity by ensuring that all investors have equal access to material information. SEBI actively monitors and regulates insider trading to prevent unfair practices, safeguarding the interests of all market participants. The framework includes provisions for identifying insiders and

connected persons, mandating disclosures, and providing mechanisms for investor protection

Check your Progress – QUIZ 4

1. Which regulatory body is primarily responsible for regulating the securities market in India?

A. Reserve Bank of India (RBI)
B. Ministry of Finance
C. Securities and Exchange Board of India (SEBI)
D. Insurance Regulatory and Development Authority (IRDA)

2. Which act provides the legal framework for the regulation of stock exchanges and contracts in securities in India?

A. Companies Act, 2013
B. Depositories Act, 1996

C. Securities Contracts (Regulation) Act, 1956
D. SEBI Act, 1992

3. Which regulation governs the disclosure requirements for listed companies in India?

A. Insider Trading Regulations
B. Listing Obligations and Disclosure Requirements (LODR)
C. Takeover Code
D. Investor Education and Protection Fund (IEPF)

4. What is the primary objective of SEBI's market surveillance activities?

A. To monitor and ensure the integrity of the financial statements of companies
B. To prevent market manipulation, insider trading, and other fraudulent activities

C. To regulate the banking sector and ensure financial stability

D. To promote foreign investment in the Indian market

5. Which of the following is a key feature of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations?

A. Regulating the issuance of initial public offerings (IPOs)

B. Governing the acquisition of substantial shares and takeovers of companies

C. Monitoring the activities of mutual funds

D. Ensuring compliance with corporate social responsibility (CSR) norms

6. Which mechanism has SEBI established for investors to lodge complaints and seek redressal?

A. Investor Education and Protection Fund (IEPF)

B. SEBI Complaints Redress System (SCORES)

C. Market Infrastructure Institutions (MIIs)

D. Disclosure and Investor Protection (DIP) Guidelines

2.5 Unit Summary

The regulatory framework for financial markets ensures market integrity, transparency, and investor protection. Key committees, such as the Narasimham Committee, have shaped these regulations. The Securities and Exchange Board of India (SEBI) is the primary regulatory authority, with objectives to protect investor interests, promote and regulate the securities market, and ensure fair market practices. SEBI's management structure includes a board of directors, comprising a chairman, and members appointed by the government. SEBI's powers and functions include drafting regulations, conducting investigations, and imposing penalties. Its regulatory role encompasses overseeing market intermediaries, stock exchanges, and ensuring compliance with securities laws. Investor protection is a critical aspect, with measures against insider trading, which involves trading based on non-public, material information by insiders or connected persons. SEBI's efforts to curb insider trading aim to maintain market fairness and investor confidence.

2.5.1 Glossary

Regulatory Framework	The system of rules, institutions, and practices designed to oversee and manage financial markets, ensuring their integrity, transparency, and proper functioning.

Committees on Regulatory Framework	Groups established to review and recommend improvements to financial regulations. Notable committees include the Narasimham Committee, which has influenced the current framework.
Investor Protection	Measures and regulations implemented to safeguard investors from malpractices, ensuring fair treatment and transparency in the financial markets.
Insider Trading	The illegal practice of trading on the stock exchange to one's own advantage through having access to confidential information.
Rationale for Insider Trading Regulation	To maintain market integrity and fairness by preventing those with privileged information from having an unfair advantage.
Insiders	Individuals who have access to non-public, material information about a company, typically including directors, officers, and employees.

2.5.2 Self-Assessment Question

Short Answers Questions:

Sl.No	Questions	Level
1	Explain the regulatory role of SEBI in overseeing market intermediaries.	K3
2	Compare the roles and functions of SEBI with another regulatory authority in a different financial market.	K4
3	Evaluate the effectiveness of SEBI's regulatory framework in maintaining market integrity and investor confidence.	K4
4	Propose reforms to enhance SEBI's regulatory framework for better investor protection in the evolving global financial market.	K4

Long Answer Questions:

Sl.No	Questions	Level
1	Discuss the objectives of SEBI and how it ensures investor protection in the Indian securities market.	K5
2	Analyse the rationale behind regulating insider trading and the measures taken by SEBI to curb this practice.	K5
3	Assess the impact of insider trading on market fairness and investor trust, citing examples and regulatory responses by SEBI	K6
4	Create a comprehensive strategy for SEBI to combat insider trading, including preventive measures and enforcement strategies.	K6

2.5.3 Reference Book

1. Indian Financial System" by M.Y. Khan, Year of Publication: 2018, Publisher: McGraw Hill Education
2. Securities Market Operations" by VK Bhalla, Year of Publication: 2017, Publisher: S. Chand Publishing

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UNIT III

PRIMARY MARKET

3.1PRIMARY MARKET

3.1.1 Introduction of Primary Market

The primary market is also known as new issues market, which refers to the market where securities, such as stocks, primary bonds, and debentures, are created and issued for the first time by companies or governments in order to raise capital. In finance we refer to the market where new securities are bought and sold for the first time as primary market.

In the primary market, companies or governments sell their securities directly to investors, who purchase them for the first time. The primary market plays an important role in the economy as it provides companies and governments with a way to raise funds, and investors with an opportunity to invest in new securities.

2.1.1 Functions of Primary Market

The primary market performs several important functions in the economy. Let's learn about these functions of primary market in details. The following are few of the objectives of primary market:

Raising capital

The primary market is a vital source of capital for companies looking to expand their operations, invest in new projects, or pay off existing debt. By issuing new securities in the new issues market, companies can raise the funds they need to grow their businesses.

Price discovery

The new issues market helps to establish the fair market value of newly issued securities by setting the initial price through the IPO or other mechanisms. This process helps to ensure that investors are paying a fair price for the securities they are buying.

Facilitating the transfer of risk

In the primary market, the risk is transferred from the company to the investors who purchase the newly issued securities. This allows companies to reduce their financial risk and transfer it to investors who are willing to take on that risk in exchange for the potential for higher returns.

Providing investment opportunities

The new issues market offers a range of investment opportunities to investors, including equity shares, bonds, and other debt instruments. These securities can be purchased by individuals, institutional investors, and other market participants who are looking to diversify their portfolios and achieve their investment objectives.

Regulations of primary market

The primary market is regulated by government bodies such as the Securities and Exchange Board of India (SEBI) in India. These regulatory bodies are responsible for ensuring that securities issuances are conducted in a fair, transparent, and efficient manner. Furthermore, that investors are protected from fraud and other abuses.

3.1.2 Types of Primary Markets

There's a primary market for just about every sort of financial asset out there. The biggest ones are the primary stock market, the primary bond market, and the primary mortgage market.

The most common type of primary market issues include:

- **Initial public offering (IPO):** when a company issues shares of stock to the public for the first time
- **Rights issue/offering:** an offer to the company's current stockholders to buy additional new shares at a discount.
- **Private placement:** an issue of company stock shares to an individual person, corporate entity, or a small group of investors—usually institutional or accredited ones—as opposed to being issued in the public marketplace

- **Preferential allotment:** shares offered to a particular group at a special or discounted price, different from the publicly traded share price

NIM Vs Secondary Market

A market in which securities are sold for the first time is known as a **Primary Market.** It means that under the primary market, new securities are issued from the company. Another name for the primary market is **New Issue Market.** This market contributes directly to the capital formation of a company, as the company directly goes to investors and uses the funds for investment in machines, land, building, equipment, etc.

A market in which the sale and purchase of newly issued securities and second- hand securities are made is known as a **Secondary Market.** In this market, a company does not directly issue its securities to investors. Instead, the existing investors of the company sell the securities to other investors. The investor who wants to sell the securities and the one who wants to purchase meet each other in the secondary market and exchange the securities for cash with the help of an intermediary, a **broker**, is done.

Basis	Primary Market	Secondary Market
Meaning	A market in which securities are sold for the first time is known as a Primary Market.	A market in which the sale and purchase of newly issued securities and second-hand securities are made is known as a Secondary Market.
Types of Securities	In the primary market, the sale of new securities takes place.	In the secondary market, the sale and purchase of existing or second-hand securities take place.

Issued by	In the primary market, the securities are directly issued by companies.	In the secondary market, the securities are transferred between the investors only.
Capital Formation	A primary market directly contributes to the capital of a company as it involves the transfer of funds from surplus units to deficit units.	A secondary market indirectly contributes to the capital of a company as it involves an exchange of funds between surplus units only.
Entry	The companies enter a primary market for raising capital for their operations.	The securities of listed companies only are bought and sold in this market.
Geographical Location	There is no fixed geographical location of a primary market. Every bank, institution, foreign investor, etc., contribute to this market.	There is a fixed geographical location of a secondary market and it also has fixed working hours.
Price	The price of securities in a primary market is fixed by the management of the company issuing them.	The price of securities in a secondary market is fixed by the demand and supply of the stock exchange market.

Lets Sum Up

Primary market is fundamental in facilitating capital formation and providing investment opportunities through various types of securities offerings. It differs from the secondary market, where previously issued securities are traded, offering liquidity and continuous price discovery. Together, these markets contribute to a dynamic and efficient financial system, supporting economic growth and development.

Check Your Progress – QUIZ 1

1. **What is the primary function of the primary market?**

   A) Trading existing securities

   B) Issuing new securities

   C) Providing loans to investors

   D) Regulating the stock market

2. **Which of the following is NOT a function of the primary market?**

   A) Capital formation

   B) Providing liquidity to existing securities

   C) Price discovery for new issues

   D) Facilitating investment opportunities

3. **What is an Initial Public Offering (IPO)?**

   A) The sale of new securities to existing shareholders
   B) The sale of securities in the secondary market

   C) The first sale of a company's shares to the public

   D) A private placement of securities

4. **Which type of primary market involves issuing additional shares to the public by an already listed company?**

   A) Rights issue

   B) Initial Public Offering (IPO)

C) Follow-on Public Offering (FPO)

D) Private placement

5. **In a rights issue, who are the new shares offered to?**

A) The general public

B) A select group of institutional investors

C) Existing shareholders

D) Company employees

6. **What distinguishes a primary market from a secondary market?**

A) The primary market deals with existing securities, while the secondary market deals with new issues.

B) The primary market involves trading among investors, while the secondary market involves issuing new securities.

C) The primary market deals with new issues, while the secondary market deals with existing securities.

D) The primary market is more liquid than the secondary market.

3.2 New Issue Market

A primary market is a source of new securities. Often on an exchange, it's where companies, governments, and other groups go to obtain financing through debt-based or equity-based securities. Primary markets are facilitated by underwriting groups consisting of investment banks that set a beginning price range for a given security and oversee its sale to investors.

3.1.2 Methods of New Issue

1. Public Issue or Initial Public Offer (IPO):

Under this method, the company issues a prospectus to the public inviting offers for subscription. The investors who are interested in the securities apply for the securities they are willing to buy. Advertisements are also issued in the leading

newspapers.

Under the Company Act it is obligatory for a public limited company to issue a prospectus or file a statement in lieu of prospectus with the Registrar of Companies.

2. Private Placement:

In this method, the issuing company sells its securities privately to one or more institutional brokers who in tum sell them to their clients and associates. This method is quite convenient and economical. Moreover, the company gets the money quickly and there is no risk of non-receipt of minimum subscription.

3. Offer for Sale.

Under this method, the issuing company allots or agrees to allot the security to an issue house at an agreed price. The issue house or financial institution publishes a document called an 'offer for sale'. It offers to the public shares or debentures for sale at higher price. Application form is attached to the offer document. After receiving applications, the issue house renounces the allotment in favour of the applicants who become direct allottees of the shares or debentures.

This method saves the company from the cost and trouble of selling securities directly to the investing public. It ensures that the whole issue is sold and stamp duty payable on transfer of shares is saved. But the entire premium received is retained by the offerer and not the issuing company.

4. Sale through Intermediaries:

In this method, a company appoints intermediaries like stock brokers, commercial banks and financial institutions to assist in finding market for the new securities on a commission basis. The company supplies blank application forms to each intermediary who affixes his seal on them and distributes the among prospective investors. Each intermediary gets commission on the amount of security applications bearing his seal. However, intermediaries do not guarantee the sale of securities. This method is useful when a company has already offered 49 per cent of issue to the general public which is essential for listing of securities. The pace of sale of securities may be very slow and there is uncertainty about the sale of whole lot of securities offered through intermediaries. But this method saves the administrative problems

and expenses involved in direct selling of securities to the public.

5. Sale to Inside Coterie:

A company may resort to subscription by promoters and directors. This method helps to save the expenses of public issue. Generally, a percentage of new issue of securities is reserved for subscription by the inside coterie who can in this way share the future prosperity of the company.

6. Sale through Managing Brokers:

Sale of securities through managing brokers is becoming popular particularly among new companies. Managing brokers advise companies about the proper timing and terms of the issue of securities. They assist companies in pre-issue publicity, drafting and issue of prospectus and getting stock exchange listing. They also enlist the support and cooperation of share brokers.

3.1.3 Intermediaries in the new issues market

An intermediary in a stock market is a person or an organization which helps people to invest their money in various company stocks. A person involved in such intermediary activities is usually called a fund manager.
Generally, among the types of Intermediaries in stock market, it can be one of the following -

- **Underwriter:** As the name implies, underwriters are entities directly associated with a company or an organization. Their primary function is to manage people and talk to them regarding investment in multiple schemes or so.

  In India, for instance, an insurance company can be an underwriter. It charges a certain fee for providing you with insurance services under certain terms and conditions.

- **Merchant bankers:** These are institutions that extend funds to a company in place of loans and share the ownership of that particular company. So, they gain a right to have a say in the corporate affairs of that organization where

they have invested.

Hence, merchant bankers become a link between large organizations and external markets. For instance, in India, State Bank of India, ICICI Bank, Punjab National Bank are some of the merchant bankers.

- **Portfolio Managers:** It can be a person or a group of people or even an institution that manages money to be traded in the stock market. These intermediaries discuss the entire plan of investment with their team or with the organization and then they trade in stocks or securities in the market.

  Also, these types of Intermediaries invest in bonds, derivatives, mutual funds, etc to make more money out of their investments.

- **Debenture Trustees:** These personnel are registered with the Securities and Exchange Board of India (or SEBI) and function based on the rules cited in SEBI Guidelines, 1993. These personnel are monitored by SEBI on their functions of creating security, complaints redressal, interest payments and debenture redemption.

  They act as the connecting links between debenture holders and the organization or company whose debentures have been purchased by those holders.

- **Sub Broker:** A sub-broker is not directly linked to the stock exchanges but is a proxy member who has the necessary knowledge to act on behalf of the trading member. He can assist trading members and also investors in matters of securities dealing.

- **Stockbroker:** Such brokers are part of the stock market as they assist in trading of securities. Although they charge a specific fee for facilitating such trading, their work is more effective than others. One of the most viable reasons behind such efficiency is their knowledge of the stock market. A trader lacks such knowledge and is likely to end up buying or selling securities at a higher price than it should be. In such conditions, an intermediator can help in linking the stock exchanges and traders rightfully.

3.1.4 SEBI guidelines on Primary Market

1. **IPO spending**

Companies filing their Draft Red Herring Prospectus (DRHP) for an IPO will have more flexibility with capital allocations. SEBI has announced that for companies aiming for inorganic growth through mergers and acquisitions but have not identified a target, 25% of the raised amount can be used for the same. Further, a 35% quota has been granted for general corporate purposes and inorganic growth combined.
On the other hand, if the company has identified its strategic investment opportunity, no limits will be applied.

2. **Offer for Sale conditions**

The majority shareholders, who hold more than 20% of the pre-issue shareholding, can sell only up to half of their shareholding when going public. If they own below 20%, the limit to sell is set up to 10% shareholding in IPO via OFS (Offer for Sale).

3. **Monitoring of funds raised through IPO**

As part of its primary changes, SEBI has permitted Credit Rating Agencies to monitor the utilisation of funds raised through IPO. They need to submit the quarterly report to the audit committee on the fund utilisation. At present, Scheduled Commercial Banks have this responsibility. The credit rating agencies will also monitor funds raised for general corporate purposes until the last rupee is used.

4. **Lock-in period for Anchor investors**

Starting April 1, 2022, the lock-in period for anchor investors has been extended. The current 30-day lock-in period will be applicable for 50% of the shares they own. The remaining 50% will have to be held for a minimum of 90 days.

5. **Changes to preferential issues**

The lookback period to set the floor price for preferential shares has been shortened to 60 days from the current 26 weeks, on the other hand, the lock-in period for promoters has been cut down to 18 months from three years. The lock-in period has been set to 6 months from one year for other investors.

6. Changes to IPO allocation norms

SEBI revised the allocation norms for non-institutional investors (NII). Now, two- thirds of the NII quota will be reserved for those investors applying for more than Rs. 10 lakh in the IPO. Rest will be available for those whose bidding value will be between Rs. 2 lakh to Rs. 10 lakh.

7. Other Primary Market and Secondary Market changes

Apart from these, SEBI has also introduced a minimum price band of at least 105% of the floor price for all book building issues. In addition, SEBI has introduced some significant changes in mutual funds. When a mutual fund scheme wants to wind up prematurely, most of the trustees and unitholders will have to grant their approval for the same. The vote results have to be published within 45 days after the winding-up announcement has been published. If the votes are against winding up, the scheme will continue.

Lets Sum Up

Understanding the New Issue Market, its methods, intermediaries, and SEBI guidelines is crucial for anyone participating in the financial markets. The primary market plays a vital role in capital formation, providing opportunities for companies to raise funds and for investors to participate in new investment opportunities. The regulatory framework ensures a transparent and fair process, safeguarding the interests of all market participants.

Check Your Progress – QUIZ 2

1. **What is the primary function of the New Issue Market?**

    A) Trading existing securities

    B) Issuing new securities

    C) Providing loans to investors

    D) Regulating the stock market

2. **Which method of new issue involves a company offering its shares to the public for the first time?**

   A) Rights Issue

   B) Follow-on Public Offering (FPO)

   C) Initial Public Offering (IPO)

   D) Private Placement

3. **What distinguishes a private placement from other methods of new issues?**

   A) Shares are offered to the general public

   B) Shares are issued at a discounted price to existing shareholders

   C) Shares are sold directly to a select group of investors

   D) Shares are listed on a stock exchange

4. **Which method allows existing shareholders to buy additional shares at a discount?**

   A) IPO

   B) Rights Issue

   C) FPO

   D) Preferential Allotment

5. **What is a Follow-on Public Offering (FPO)?**

   A) The first sale of a company’s shares to the public

   B) Additional shares issued by an already listed company

   C) Private sale of securities to institutional investors

   D) Shares issued to existing employees of the company

6. **Who are the primary intermediaries responsible for managing the issuance process in the primary market?**

   A) Brokers

   B) Merchant Bankers

C) Registrars

D) Credit Rating Agencies

3.3 LISTING OF SECURITIES

The 'listing of securities' can be defined as the formal admission of the securities of a company on the trading platform of a stock exchange, so that they are available for the general public for trading purposes. Listing of the securities on a stock exchange indicates that the securities have met the exchange's requirements and standards for listing. These requirements may include minimum capitalization, a specific level of profitability, adherence to the norms of corporate governance, and compliance with financial reporting standards.

Agreement: The listing agreement is a contract between the issuing company and the stock exchange, outlining the terms and conditions of listing, including compliance with regulations and disclosure requirements.

3.3.1 Benefits of Listing

1. **Comprehensive marketplace**

NSE offers comprehensive coverage of the Indian capital markets across asset classes, including equity, fixed income and derivative securities. It has a fully-integrated business model comprising exchange listings, trading services, clearing and settlement services, indices, market data feeds, technology solutions and financial education offerings.

2. **Scale of operations**

The scale and breadth of NSE's products and services, its sustained leadership positions across multiple asset classes in India it's leadership positions in trading volumes help to attract additional participants to the exchange, which in turn results in more efficient price discovery.

NSE's trading technology and risk management framework offers faster and automated execution of orders, which contributes to reduced impact costs for large trade orders.

3. **Visibility**

The trading system provides high level of trade and post-trade information. The best 5 buy and sell orders are displayed on the trading system and the total number of securities available for buying and selling is also displayed. This helps the investor to know the depth of the market. Further, corporate announcements, results, corporate actions etc. are also available on the trading system.

4. **Largest exchange**

NSE is the leading stock exchange in India and the fourth largest in the world by equity trading volume in 2015, according to WFE.

5. **Unprecedented reach**

NSE has a pan-India, high-speed network, which supports more than 181,524 terminals through VSAT-based connectivity, leased line terrestrial-based connectivity and multiprotocol label switching transactions on the exchange, as of September 30, 2016.

6. **Settlement Guarantee**

NSE Clearing assumes the credit risk of each party to the trade, which is the risk that a clearing member defaults on its obligations in respect of the trade.

7. **Broadcast facility for corporate announcements**

The NSE network is used to disseminate information and company announcements across the country. Important information regarding the company is announced to the market through the Broadcast Mode on the NEAT System as well as disseminated through the NSE website. Corporate developments such as financial results, book closure, announcements of bonus, rights, takeover, mergers etc. are disseminated across the country thus minimizing scope for price manipulation or misuse.

3.3.2 Delisting of Securities

Regulation 2(j) of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2021 (2021 Regulations) defines “delisting” as the permanent removal of the equity shares of the company from the trading platform of an RSE, either by way of voluntary or compulsory method. Thus, delisting of securities refers to the removal of the shares or other securities of a company from a stock exchange, so that they are no longer available for trading on that exchange.

Delisting can be either voluntary or involuntary:

VoluntaryDelisting

In voluntary delisting, a company on its own may choose to delist its securities from a stock exchange. The reason could be a desire to go private, where the company’s shares are bought back and ownership is consolidated among a smaller group of investors; or because the company finds the costs and regulatory requirements of being publicly listed burdensome, or it may plan to consolidate its listings to fewer exchanges.

Involuntary or compulsory delisting

In involuntary or compulsory delisting, an exchange may forcibly delist a company’s securities due to non-compliance with the listing requirements eg. minimum market capitalization, shareholder equity thresholds, or failure to submit timely financial reports. Other reasons might include bankruptcy, merger or acquisition, or failure to meet the standards of corporate governance.

3.3.3 Consequences of delisting

Reduced Liquidity

After delisting, the securities typically trade on less regulated platforms, resulting in lower trading volumes and reduced liquidity, which makes it harder for the investors to buy or sell the securities.

Impact on Investors

Delisting of the securities can negatively impact the investors by reducing the visibility and potentially the value of their investments.

Access to Capital

Delisting might limit the concerned company's ability to raise funds through the public market.

Let's Sum Up

The listing of securities is a process where a company's shares are included on a stock exchange, making them available for trading by the public. This process is crucial for companies seeking to access a broader investor base and improve their liquidity. Listing provides companies with increased visibility, credibility, and the ability to raise additional capital by issuing new shares. For investors, listed securities offer the benefits of regulated and transparent trading, easier access to company information, and liquidity for their investments. The listing process typically involves meeting the stringent requirements set by stock exchanges and regulatory bodies, such as the Securities and Exchange Board of India (SEBI), which ensures that listed companies adhere to high standards of corporate governance, financial reporting, and disclosure. issues, difficulties in raising capital, and diminished investor confidence.

Check your Progress – QUIZ 3

1. **What is the primary purpose of listing securities on a stock exchange?**

    A) To limit the number of shareholders

    B) To make securities available for public trading

    C) To decrease the company's capital

    D) To reduce the company's visibility

2. **Which of the following is a key benefit for a company when its securities are listed on a stock exchange?**

    A) Decreased regulatory requirements

B) Increased liquidity and marketability of its shares

C) Limited access to capital markets

D) Reduced public scrutiny

3. **Which organization typically sets the requirements for listing securities on an exchange in India?**

   A) Reserve Bank of India (RBI)

   B) Ministry of Finance

   C) Securities and Exchange Board of India (SEBI)

   D) Indian Stock Market Association

4. **What must a company provide as part of the listing requirements on a stock exchange?**

   A) Detailed marketing strategy

   B) Financial statements and disclosures

   C) Personal information of all shareholders

   D) Proof of international operations

5. **Which of the following is NOT a benefit of listing securities?**

   A) Enhanced corporate reputation

   B) Greater access to capital

   C) Decreased transparency requirements

   D) Improved liquidity for shareholders

6. **How does listing on a stock exchange improve a company's visibility and credibility?**

   A) By reducing the number of regulations the company must follow

   B) By increasing the number of shareholders

   C) By adhering to stringent regulatory standards and public disclosure norms

   D) By limiting the company's operations to domestic markets

3.4 Unit Summary

The New Issue Market (NIM) is the primary market where new securities are issued for the first time to raise capital, while the Secondary Market involves trading existing securities among investors. Methods of New Issue include Initial Public Offerings (IPOs), rights issues, preferential issues, and private placements, facilitated by intermediaries like merchant bankers, underwriters, and registrars. SEBI's guidelines on the Primary Market ensure fair practices, disclosure norms, and investor protection. Listing on stock exchanges follows regulatory approval, requiring companies to adhere to exchange rules and provide regular financial disclosures. Benefits of listing include enhanced liquidity, access to capital for expansion, improved visibility, and increased investor confidence. Conversely, non-listing restricts access to capital markets, limits liquidity for shareholders, reduces visibility, and potentially lowers valuation and growth prospects compared to listed peers. Thus, NIM serves as a crucial avenue for initial capital raising, while listing offers significant advantages in accessing financial markets and investor trust.

3.4.1 Glossary

New Issue Market (NIM)	Primary market where new securities are issued for the first time to raise capital.
Secondary Market	Market where existing securities are bought and sold among investors after their initial issuance in the primary market.
Methods of New Issue	Various mechanisms such as Initial Public Offerings (IPOs), rights issues, preferential issues, and private placements used to issue new securities.
Intermediaries in New Issues Market	Entities like merchant bankers, underwriters, registrars, and stockbrokers that facilitate the issuance of new securities and compliance with regulatory requirements.
SEBI Guidelines on Primary Market	Regulations set by the Securities and Exchange Board of India (SEBI) governing the issuance of securities in the primary market, ensuring fairness and investor protection.

Listing	Process of admitting a company's securities for trading on a stock exchange after meeting regulatory requirements.
Agreement	Commitment made by companies to adhere to stock exchange rules and provide regular financial disclosures post-listing.
Benefits of Listing	Advantages such as enhanced liquidity, access to capital markets, increased visibility, and improved credibility among investors.
Consequences of Non-listing	Drawbacks including limited access to capital, reduced liquidity for shareholders, lower visibility, and potentially lower valuation compared to listed peers.

3.4.2 Self-Assessment Question

Short Answers:

Sl.No	Questions	Level
1	Compare and contrast the roles of NIM and the secondary market in capital markets.	K3
2	Discuss the methods of new issue in detail, highlighting the advantages and disadvantages of each method.	K4
3	Analyze the significance of intermediaries like merchant bankers and underwriters in facilitating new issues.	K4
4	Evaluate SEBI's role in regulating the primary market. How do SEBI guidelines ensure fair practices and investor protection in new issues?	K4

Long Answer Questions:

Sl.No	Questions	Level
1	Evaluate the benefits of listing a company's securities on a stock exchange, considering the impact on liquidity and investor confidence.	K5
2	Critically assess the consequences of a company opting not to list its securities on a stock exchange. What strategic implications does this decision have for the company's growth and financing options?	K5

3	Evaluate the consequences of a company choosing not to list its securities on a stock exchange, considering both advantages and disadvantages.	K6
4	How does listing on a stock exchange benefit a company?	K6

3.4.3 Reference Book

1. Indian Financial System by M.Y. Khan and P.K. Jain - McGraw Hill Education
2. Securities Markets in India by S.K. Bhattacharyya - Oxford University Press
3. Financial Markets and Institutions in India by Praveen Kumar - Pearson Education
4. Indian Financial System: Markets and Services by Bharti Pathak - Pearson Education

Unit IV: Stock Exchange

History - Meaning - Functions - Stock Exchange Vs Commodity Exchange - Stock Exchange Traders - Regulation of Stock Exchanges - Steps in Stock Trading - BSE and NSE - World Stock Exchanges - New York, London, Hong Kong and Tokyo Stock Exchanges.

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UNIT IV

STOCK EXCHANGE

4.1 STOCK EXCHANGE

The stock market, also known as the equity market, is a crucial component of the global financial system. It serves as a platform where shares of publicly held companies are issued, bought, and sold. These transactions typically occur on stock exchanges or over-the-counter (OTC) markets, and they are governed by a framework of regulations designed to ensure fairness and transparency. The stock market provides companies with access to capital in exchange for giving investors a slice of ownership in the company. This market plays a vital role in economic development by facilitating the efficient allocation of resources, offering liquidity to investors, and serving as a barometer for the overall economic health.

4.1.1 Stock Exchange- Meaning

The stock exchange is a virtual market where buyers and sellers trade in existing securities. It is a market hosted by an institute or any such government body where shares, stocks, debentures, bonds, futures, options, etc are traded.

A stock exchange is a meeting place for buyers and sellers. These can be brokers, agents, individuals. The price of the commodity is decided by the rules of demand and supply. In India, the most prominent stock exchange is the Bombay Stock Exchange. There are a total of twenty-one stock exchanges in India.

4.1.2 Functions of the Stock Exchange

Liquidity and Marketability: One of the main drawing factors of the stock exchange is that it enables high liquidity. The securities can be sold at a moment's notice and be converted to cash. It is a continuous market and the investors can divest and reinvest

with ease as per their wishes.

Price Determination: In a secondary market, the only way to determine the price of securities in via the rules of supply and demand. A stock exchange enables this process via constant valuation of all the securities. Such prices of shares of various companies can be tracked via the index we call the Sensex.

Safety: The government strictly governs and regulates the stock exchanges. In the case of the BSE, the Securities Board of India is the governing body. All transactions occur within the legal framework. This provides the investor with assurances and a safe place to transact in securities.

Contribution to the Economy: As we know the stock exchange deals in already-issued securities. But these securities are continuously sold and resold and so on. This allows the funds to be mobilized and channelized instead of sitting idle. This boosts the economy.

Spreading of Equity: The stock exchange ensures wider ownership of securities. It educates the public about the safety and the benefits of investing in the stock market. It ensures a better quality of transactions and smooth functioning. The idea is to get more public investors and spread the ownership of securities for the benefit of everyone.

Speculation: One often hears that the stock exchange is a speculative market. And while this is true, the speculation is kept within the legal framework. For the stake of liquidity and price determination, a healthy dose of speculative trading is necessary, and the stock exchange provides us with such a platform.

4.1.3 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 recognised 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.

4.1.4 Evolution and Growth: Major Milestones in the History of Indian Stock Market

The evolution of the Indian stock market has been a fascinating journey, marked by significant milestones that have shaped its growth. From humble beginnings to becoming one of the fastest-growing markets in the world, the Indian stock market has come a long way.

One of the major milestones in the history of Indian stock market was the establishment of the Bombay Stock Exchange (BSE) in 1875. It started as an association for brokers and gradually evolved into a fully-fledged exchange, playing a crucial role in facilitating trade and investment activities.

Another significant milestone in the history of the Indian stock market was when India embarked on economic liberalization in 1991. This shift towards a more open economy significantly impacted the stock market, attracting foreign investors and improving liquidity. The introduction of electronic **trading platforms** further revolutionized how transactions were conducted, making it easier for investors to participate.

In 2000, the National Stock Exchange (NSE) emerged as a strong competitor to BSE by introducing innovative practices like electronic order matching systems and online trading services. This competition stimulated growth and improved efficiency within

the Indian stock market.

The year 2014 witnessed another milestone with SEBI's implementation of various reforms to promote transparency and protect investor interests. These measures included stricter regulations on insider trading, enhanced corporate governance norms, and greater disclosure requirements — all contributing to increased confidence among investors.

More recently, India's inclusion in global indices like the MSCI Emerging Markets Index has attracted substantial inflows from international funds. This recognition reflects not only India's growing stature but also signifies opportunities for domestic and foreign investors.

Each milestone in this journey shapes India's stock market. Continuous innovation is vital for its growth, addressing volatility, regulations, technology, and changing preferences. The story is ongoing, with each year bringing new opportunities and challenges. With a strong foundation and a growing economy, the future of India's stock market looks promising for investors.

Lets Sum Up

A stock exchange is a marketplace where securities, such as stocks and bonds, are bought and sold. It provides a platform for companies to raise capital by issuing shares to the public, and for investors to buy and sell these shares. The stock exchange ensures liquidity, price transparency, and regulatory oversight in the

trading of securities. he growth of stock exchanges has been driven by globalization, technological advancements, and regulatory reforms, making them integral to the global financial system.

Check Your Progress – QUIZ 1

1. **What is a stock exchange?**

    A) A marketplace for buying and selling securities

    B) A place where banks store money

    C) A type of savings account

D) An insurance company

2. **Which of the following is a primary function of a stock exchange?**

   A) Printing currency

   B) Facilitating the trading of securities

   C) Providing health insurance

   D) Manufacturing goods

3. **How does a stock exchange help in raising capital for businesses?**

   A) By providing loans to companies

   B) By allowing companies to issue shares to the public

   C) By offering tax incentives

   D) By reducing business regulations

4. **What role does a stock exchange play in price discovery?**

   A) Setting fixed prices for goods

   B) Determining the price of securities through supply and demand

   C) Controlling inflation rates

   D) Regulating interest rates

5. **Which of the following is a feature of a stock exchange?**

   A) Unregulated trading environment

   B) Continuous trading during operating hours

   C) Fixed prices for all securities

   D) Limited access for the public

6. **What ensures transparency in a stock exchange?**

   A) Confidential trading information

   B) Publicly available prices and trading volumes

   C) Restricted access to financial data

D) Manual transaction recording

4.2 Stock Exchange Vs Commodity Exchange

A stock exchange is a platform where shares of publicly listed companies are bought and sold. It enables companies to raise capital by issuing shares to the public, and it provides a regulated environment for investors to trade these shares. Stock exchanges, such as the New York Stock Exchange (NYSE) and the London Stock Exchange (LSE), offer liquidity, price discovery, and transparency in the trading of securities, which include stocks, bonds, and other financial instruments. The primary focus of stock exchanges is on equity and debt instruments.

In contrast, a commodity exchange is a marketplace where various commodities and their derivatives are traded. These commodities include physical goods such as agricultural products (wheat, coffee, and corn), metals (gold, silver, and copper), and energy resources (oil, natural gas). Commodity exchanges facilitate the buying and selling of these goods through standardized contracts. The main purpose of a commodity exchange is to enable producers, consumers, and investors to hedge against price volatility in commodities

4.2.1 Difference Between Stock Exchange and Commodity Exchange

The main difference between the stock exchange and commodity exchange is that the stock exchange enables traders to trade in various securities such as stocks, ETFs, derivatives, etc..

On the other hand, commodity exchange enables the trading of commodities such as agricultural products, metals, energy, and other raw materials.

Factors	**Stock exchange**	**Commodity exchange**
Definition	Marketplace for trading stocks, ETFs, etc.	Marketplace for trading commodities
Products	Securities such as stocks and bonds	Commodities like agricultural products, metals, energy
Participants	Investors, traders, brokers, and listed companies	Farmers, producers, consumers, traders, and speculators
Focus	deal with the trading of ownership interests in companies	deal with the trading of physical goods or their derivatives
Ownership	Ownership shares of companies	Contracts for future delivery of commodities
Investment Duration	Typically long-term	It can be short-term or long-term
Risks	Generally less volatile in the long run	More volatile due to commodity price fluctuations
Examples	NSE (National Stock Exchange), BSE (Bombay Stock Exchange)	MCX (Multi Commodity Exchange)

4.2.2 Stock Exchange Traders

A stock trader is a person who attempts to profit from the purchase and sale of securities such as stock shares. Stock traders can be professionals trading on behalf of a financial company or individuals trading on behalf of themselves. Stock traders participate in the financial markets in various ways.

Individual traders, also called retail traders, often buy and sell securities through a brokerage or other agent. Institutional traders are often employed by management investment companies, portfolio managers, pension funds, or hedge funds. As a result, institutional traders can have a greater influence on the markets since their trades are much larger than those of retail traders.

Becoming a stock trader requires an investment of capital and time, as well as research and knowledge of the markets.

4.2.3 Role of a Stock Trader

Stock traders, as the name suggests, are individuals who trade shares and equities. The primary objective of a stock trader is to trade, i.e., purchase and sell shares of different companies at the right time and the right price and make a profit out of the transactions for both the clients as well as themselves. Traders are pivotal when it comes to maintaining liquidity in the financial markets. Stock traders are required to stay up to date on various key factors that can influence the price of stocks in the markets.

4.2.4 Types of Stock Trader

Stock traders can be categorised into three types - informed, uninformed, and intuitive traders.

Informed Traders

Informed traders can be classified as fundamental and technical traders and make trades designed to beat the broader market. A fundamental trader might focus on earnings, economic data, and financial ratios. A fundamental trader might initiate trades using this analysis to predict how good or bad news will impact certain stocks

and industries. Technical traders, on the other hand, rely on charts, moving averages, patterns, and momentum to make key decisions.

Uninformed Traders

Uninformed traders take the opposite approach to informed traders and are also called noise traders. Uninformed traders do not act on fundamental analysis but rather the noise or goings-on in the markets at that moment. Price action or price movements is synonymous with noise. Uninformed traders make decisions sometimes based on volatility and try to capitalize on it for financial gain. However, some noise traders use technical analysis as well.

Intuitive Traders

Intuitive traders tend to hone and use their instincts to find opportunities to execute a trade. While they may use tools like charts and research reports, they generally rely on their own experience. For example, intuitive traders might have experience seeing how the markets are impacted by major players, events, and mergers leading them to understand and possibly trade them.

Stock market regulations in India

The Indian stock markets are efficiently regulated and tracked by The Securities and Exchange Board of India (SEBI), The Reserve Bank of India, and the Ministry of Finance. The Ministry of Finance operates via the Department of Economic Affairs (Capital Markets Division).

The Ministry formulates rules and regulations required for the functioning of the capital markets. It also develops laws necessary for safeguarding the interests of the investors in the stock market.

Securities Contracts (Regulation) Act, 1956 (SCRA)

- SCRA is an Act of the Parliament of India enacted to prevent undesirable exchanges in securities and to control the working of the stock exchange in India
- It provides the legal framework for the regulation of securities contracts in

India.

- It also covers the listing and trading of securities, the registration and regulation of stockbrokers and sub-brokers, and the prohibition of insider trading.

Securities and Exchange Board of India Act, 1992 (SEBI Act)

- The Capital Markets Division of the Department of Economic Affairs sees to the administration of rules made within the bounds of the SEBI Act of 1992.
- This is the act that established the Securities and Exchange Board of India, or SEBI, the main authorized regulatory body that regulates Indian stock exchanges.
- The key function of SEBI is to keep the interests of investors/traders protected.
- While trading in the Indian stock market, investors and traders have to execute trades while abiding by rules, to promote fairness. SEBI monitors the rules.

Depositories Act, 1996

- The Depositories Act, of 1996 regulates the depositories of securities in India.
- It sets out the procedures for the dematerialization and transfer of securities held in electronic form.

Companies Act, 2013

- This act regulates the incorporation of a company, responsibilities of a company, directors, and dissolution of a company.
- The act enabled companies to be formed by registration, set out the responsibilities of the companies, their executive director, and secretaries, and also provided for the procedures for its winding.

- The amendment to the act was passed in 2020. Ministry of Corporate Affairs governs this act.
- It also sets out the rules for the issue and transfer of securities by companies.

4.2.5 Steps of Trading Procedure

The trading procedure involves the following five steps:

Selecting a Broker: The stock market involves trading through only authorised brokers. These brokers can be individuals, companies, or even partnerships. To begin the trading process, one should select a registered broker.

Opening a Demat Account: De mat is short for dematerialised. The Demat account is opened with the help of depositories, which include brokers and banks. It is through this account that trading activities take place. This is an electronic system. The depository helps keep the investor or account holder informed about their transactions and the status of their investments.

Placing an Order: Once a Demat account is opened, investors can place orders in different ways, such as through brokers or themselves. The order comprises the buying and selling of shares in the stock market.

Execution of the Order: Once an order is placed, it is executed by the broker. Once executed, a contract note is issued, which informs the investor of all transaction details or orders, such as date, time, and amount.

Settlement: This is the final step in the trading procedure. It involves the actual transfer of securities between the buyer and the seller. This also needs to be carried out by the broker. The two main kinds of settlement are On-the-spot settlement, where funds are immediately transferred and exchanged on the second working day of the transaction, and Forward settlement, which implies that the transfer or exchange will be carried out at some point in the future.

Lets Sum Up

The Learner can understand both stock exchanges and commodity exchanges are vital components of the financial market, they cater to different assets and purposes. Stock traders play an essential role in the stock exchange by analysing the market, executing trades, managing risks, and staying informed. They can be categorized into day traders, swing traders, position traders, and scalpers, each employing different strategies and holding periods. The trading procedure involves several steps, from research and choosing a broker to placing orders and reviewing performance, ensuring that traders operate efficiently and effectively in the market.

Check Your Progress – QUIZ 2

1. **What is the primary difference between a stock exchange and a commodity exchange?**

   A) Stock exchanges trade physical goods, while commodity exchanges trade financial instruments.

   B) Stock exchanges facilitate trading of shares and bonds, while commodity exchanges trade physical goods and their derivatives.

   C) Stock exchanges are not regulated, while commodity exchanges are.

   D) There is no difference between stock and commodity exchanges.

2. **Which of the following is an example of a commodity exchange?**

   A) New York Stock Exchange (NYSE)

   B) NASDAQ

   C) Chicago Mercantile Exchange (CME)

   D) London Stock Exchange (LSE)

3. **Who are stock exchange traders?**

   A) Individuals or entities that buy and sell stocks within a stock exchange.

   B) Organizations that manufacture and sell goods.

   C) Entities that issue government bonds.

D) Regulators overseeing the financial markets.

4. **What is a primary responsibility of a stock trader?**

    A) Manufacturing goods

    B) Conducting market analysis to identify trading opportunities

    C) Issuing government regulations

    D) Providing banking services

5. **Which of the following best describes risk management in stock trading?**

    A) Ignoring market volatility

    B) Using strategies to minimize potential losses

    C) Maximizing losses for tax purposes

    D) Avoiding all trading activities

6. **Which type of trader typically holds stocks for a few days to weeks to capitalize on short-term price movements?**

    A) Day Trader

    B) Swing Trader

    C) Position Trader

    D) Scalper

4.3 BSE and NSE

When it comes to the equity market in India, there are two main stock exchanges that enjoy the bulk of the trading volume. One is the Bombay Stock Exchange, abbreviated as BSE, while the other is the National Stock Exchange, also known as NSE. These are two of the biggest stock exchanges in India and are among the largest in all of Asia, after Japan, China, and Hong Kong.

Whether you are an investor or a trader, it is essential to understand what these stock exchanges are and learn the key differences between BSE and NSE. In this article,

we'll discuss these two stock exchanges and better understand the difference between the NSE and BSE.

4.3.1 National Stock Exchange (NSE)

The National Stock Exchange (NSE) is a prominent stock exchange in India, situated in Mumbai. It's the largest stock exchange in India and the second-largest globally in terms of equity share trades. NSE was founded in 1992 as the first electronic exchange without member ownership.

Leading institutions such as IDBI, IFCI, LIC and others established NSE to create a modern, fully automated, nationwide trading platform. In 1994, it commenced operations in the wholesale debt market segment. The Nifty and Bank Nifty serve as important benchmark indices for the NSE.

The NSE has several indices: Nifty, Bank Nifty, Nifty 500, Nifty Midcap150, Nifty Smallcap250 and Nifty MidSmallcap 400. The flagship index of the NSE is the NIFTY 50, which comprises 50 major stocks and is widely used by investors in India and around the world to gauge the Indian capital markets. As of August 2023, NSE boasts a total market capitalisation of over $3.5T trillion, ranking it as the 8th largest stock exchange globally.

The NIFTY 50 index is widely used by investors worldwide to understand the dynamics of the Indian stock markets. In 2019, 2020, and 2021, the NSE was the world's largest derivatives exchange. As of September 2023, NSE had 33.3 million active investors.

4.3.2 Bombay Stock Exchange (BSE)

The Bombay Stock Exchange (BSE) is another prominent stock exchange in India, located in Mumbai. It's one of the oldest stock exchanges in the country and plays a significant role in India's financial markets. BSE was established in 1875 and has a rich history of trading.

BSE was originally an open-outcry system, but it has evolved over the years to incorporate electronic trading. It's known for its iconic Phiroze Jeejeebhoy Towers,

which are a symbol of India's financial markets.

Over the years, BSE has diversified its range of financial products and services to encompass a wide array of financial instruments. This expansion has included the introduction of bonds, derivatives, mutual funds, and exchange-traded funds (ETFs) among its offerings.

BSE's benchmark index is the SENSEX, which includes 30 of the largest and most actively traded stocks on the exchange. The SENSEX is a key indicator of the performance of Indian stocks and is closely followed by investors in India and globally. Other indices of BSE include S&P BSE Auto, S&P BSE Bankex, S&P BSE 500, etc.

As of November 9, 2023, the Bombay Stock Exchange had a total market capitalisation of ₹3,20,76,062 crore with 4,812 companies, cementing its position as one of the most prominent stock exchanges in India and around the world.

4.3.3 Difference between NSE and BSE

Now that you know more about these two stock exchanges, here's some more information that clearly highlights the difference between BSE and NSE.

Comparison Aspect	**Bombay Stock Exchange (BSE)**	**National Stock Exchange (NSE)**
Introduction	Being the oldest stock exchange, BSE boasts a rich history.	NSE, a relatively younger stock exchange, is a pioneer in introducing a fully automated electronic trading system.

Year of Establishment	BSE was founded in 1875.	NSE was established in 1992.
Management	Mr Ashishkumar Chauhan, Managing Director and CEO.	Mr Vikram Limaye, Managing Director and CEO
Key Index	BSE's benchmark index is known as Sensex 30.	NSE's benchmark index is the Nifty 50.
Listed Companies	BSE has more than 4,000 listed companies.	NSE has more than 1,600 listed companies.
Global Ranking (2023)	BSE is ranked 9th globally.	NSE holds the 8th position in the global ranking.
Electronic Trading Platform	BOLT (BSE Online Trading) was incorporated in 1995.	NSE started the electronic trading platform in 1992.
Depository	CSDL	NSDL
Trading Network Coverage	BSE facilitates trading across 419 cities.	NSE's network extends to over 1500 cities.
Liquidity Comparison	BSE generally exhibits lower liquidity compared to NSE.	NSE enjoys higher liquidity due to significantly higher trading volumes.

Lets Sum Up

Learners understand National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) are the two principal stock exchanges in India, each playing a crucial role in the Indian financial market. The NSE, established in 1992, introduced a modern, fully automated electronic trading system and is known for its Nifty 50 index. The BSE, the oldest stock exchange in Asia, established in 1875, is renowned for its SENSEX index. The key differences between the two include their establishment dates, benchmark indices, trading volumes, market capitalizations,

technological advancements, range of financial products offered, and their geographical reach.

Check Your Progress – QUIZ 3

1. **When was the National Stock Exchange (NSE) established?**

    A) 1875

    B) 1992

    C) 1985

    D) 2000

2. **What is the benchmark index of the NSE?**

    A) SENSEX

    B) Nifty 50

    C) Dow Jones

    D) FTSE 100

3. **Which of the following is a notable feature of the NSE?**

    A) Manual trading system

    B) Electronic trading system

    C) Commodity trading only

    D) Real estate trading

4. **When was the Bombay Stock Exchange (BSE) established?**

    A) 1875

    B) 1992

    C) 1985

    D) 2000

5. **What is the benchmark index of the BSE?**

    A) Nifty 50

    B) SENSEX

C) NASDAQ

D) Nikkei 225

6. **Which characteristic is associated with the BSE?**

A) Oldest stock exchange in Asia

B) Largest trading volume

C) First to introduce electronic trading in India

D) Exclusive trading of government bonds

7. **Which exchange typically has higher trading volume and liquidity?**

A) BSE

B) NSE

C) Both have equal trading volume

D) Neither has significant trading volume

4.4 WORLD STOCK EXCHANGES

A stock exchange is a marketplace for the buying and selling of shares, bonds and securities. Stock exchanges can serve as a measure for the health of the national economy and can also be a key indicator of world economic strength. This is because the growth of the financial market equates to higher standards of living and employment rates.

Traditionally, stock exchanges were physical buildings in each country of operation, but with the shift toward electronic trading many have closed their trading floors and switched to online platforms. However, the institutions themselves are still around, and some of them are bigger than ever with market capitalisations of trillions of dollars.

4.4.1 New York Stock Exchange

The New York Stock Exchange (NYSE) is located on Wall Street in New York. It was founded in 1817, but it didn't operate under the NYSE name until 1963. The New York Stock Exchange Group had a turbulent road to its top spot, with infamous events such as the Wall Street Crash in 1929 and Black Tuesday in 1987. But it has

remained the largest stock exchange in the world by market capitalisation ever since the end of World War I, when it overtook the London Stock Exchange. In 2012, the NYSE was taken over by an American futures exchange group, Intercontinental Exchange.

The New York Stock Exchange's market capitalisation was $23.12 trillion in March 2018 — this is nearly 40% of the total world stock market value. There are over 2400 companies listed on the New York Stock Exchange, which span sectors such as finance, healthcare, consumer goods and energy. Some of its more famous companies include Exxon Mobil Corp (XOM), Citigroup Inc (C) and Pfizer Inc (GE) — the Dow Jones is the most used index for tracking the value of the NYSE, but components can also be listed on the NASDAQ.

NASDAQ

The NASDAQ stock exchange is also in New York, located in the famous Times Square. It stands for National Association of Securities Dealers Automated Quotations and was founded by a group of local stockbrokers in 1971. The NASDAQ is unusual in that it never operated on an open outcry system; instead it has always used a computer and telephone-based system of trading, which made it the first electronic stock exchange.

The NASDAQ market capitalisation reached $10.93 trillion in March 2018, which places it as the second largest stock exchange. However, it has the largest market capitalisation of technology stocks — some of the NASDAQ's top listed companies include Apple (APPL), Microsoft (MSFT), Facebook (FB) and Tesla (TSLA). The index used to measure the performance of the exchange is the Nasdaq 100.

4.4.2 Tokyo Stock Exchange

The Tokyo Stock Exchange (TSE) was founded in 1878 and is the largest stock exchange in Japan. The TSE did face problems post World War II — and was even suspended between August 1945 and April 1949 – due to the country's involvement in the war. It was rebranded in 1949, and is now commonly known under the name of its owner: Japan Exchange Group. The group was formed in the merger between the Osaka Securities Stock Exchange and the TSE in 2013. The Tokyo Stock

Exchange now partners with other exchanges all over the world, including the London Stock Exchange.

Today, there are over 3575 companies listed on the Tokyo Stock Exchange, which has taken the TSE's market capitalisation to $6.22 trillion as of March 2018. The Tokyo Stock Exchange's benchmark index is the Nikkei 225, which includes the top companies listed on the TSE such as Honda Motor Co, Toyota Motor Corp and Sony Corp.

Shanghai Stock Exchange

The Shanghai Stock Exchange (SSE) is one of three independent stock exchanges in the People's Republic of China — the other two being Shenzhen and Hong Kong, which also feature on this list. The Shanghai Stock Exchange is the fourth largest stock exchange in the world, despite the fact it was only founded in 1990. The exchange's origins do actually date back to 1866, but it was suspended in 1949 due to the Chinese revolution.

Each stock listed on the SSE has 'A' shares that are priced in the local yuan currency, and 'B' shares that are quoted in US dollars. 'A' shares are for domestic investment only, with the exception of investors who qualify for the foreign investment scheme, while 'B' shares are available to both domestic and foreign investors.

The Shanghai Stock Exchange's market capitalisation reached $5.01 trillion in March 2018. Traders can track the performance of stocks listed on the Shanghai Stock Exchange using the SSE Composite index, also known as the Shanghai Composite. This includes the largest stocks on the Shanghai Stock Exchange, such as PetroChina, the Industrial and Commercial Bank of China and the Agricultural Bank of China.

4.4.3 Hong Kong Stock Exchange

The Hong Kong Stock Exchange (SEHK) was founded in 1891 by the Association of Stockbrokers in Hong Kong — it was renamed the Hong Kong Stock Exchange in 1914. The SEHK is one of the three stock exchanges in China, but the physical trading floor of the SEHL was closed in 2017 because of the shift toward electronic trading.

The Stock Exchange of Hong Kong is the third-largest stock exchange in Asia, and the fifth largest in the world with a market capitalisation of $4.46 trillion in March 2018. The Hong Kong Stock Exchange trades in Hong Kong Dollars (HKD), as the companies listed are primarily based in Hong Kong. There are 1955 companies listed on the Hong Kong Stock Exchange — a large portion of the Hong Kong Stock Exchange's market capitalisation comes from its 20 largest stocks, which include AIA, Tencent Holdings and HSBC Holdings.

4.4.4 London Stock Exchange

The London Stock Exchange (LSE) was founded in 1801, but its origins date back to 1698 when the LSE's service was nothing more than a twice-weekly paper publication of market prices. This makes it the one of the oldest stock exchanges in the world. It was actually the largest stock exchange in the world up until the end of World War I, when it was dethroned by the NYSE. The LSE is now the sixth largest stock exchange in the world, and the largest stock exchange in Europe.

The LSE is owned by the London Stock Exchange Group, which was created in 2007 when the LSE merged with the Borsa Italiana. It is the most international stock exchange, with over 3000 companies across 70 countries.

The market capitalisation of the London Stock Exchange was $4.38 trillion in March 2018. Traders can track the performance of the LSE, and its market capitalisation, with the Financial Times Stock Exchange Index 100 Share Index, or FTSE 100. The index contains the top 100 companies listed on the London Stock Exchange — including Barclays, BP and GlaxoSmithKline. There are other indices that can be used to track the London Stock Exchange-listed companies, including the FTSE 250, the FTSE Small Cap and the FTSE All-Share.

Euronext Stock Exchange

The Euronext Stock Exchange is based in Amsterdam, Netherlands, but it is a pan-European exchange — it spans the Netherlands, Portugal, Belgium, France, Ireland and the UK. It was founded in 2000 to represent the economy of Europe as a whole, which is why it operates in euros.

In 2007, Euronext merged with the NYSE Group to form NYSE Euronext, and in 2013, Intercontinental Exchange took over the exchange completely. Then, in June 2014, Euronext went public in order to become a standalone company again.

Euronext is the seventh largest stock exchange in the world, with a market capitalisation of $4.36 trillion. Because the exchange includes several countries, there are 1300 listed companies and 30 stock indices that can be used to track its performance. However, the dominant stock index for Euronext-listed companies is the Euronext 100, which is made up of the largest and most liquid stocks on the Euronext Stock Exchange — including AXA, Christian Dior and Renault.

Shenzhen Stock Exchange

The Shenzhen Stock Exchange (SZSE) is the third exchange of the People’s Republic of China. Although it was founded in 1987, it wasn’t formally operational until 1990. The SZSE is a self-regulated body, but it is supervised by the China Securities Regulatory Commission (CSRC).

The Shenzhen Stock Exchange had a market capitalisation of $3.49 trillion in March 2018, which made it the eighth largest stock exchange in the world.

The SZSE trades shares in Chinese yuan because the companies listed on the Shenzhen Stock Exchange are primarily based in China. The Shenzhen Stock Exchange is also home to the SME Board established in 2004 for businesses in the manufacturing sector, and the ChiNext board, which was launched in 2009 to replicate the NASDAQ’s focus on technology start-ups.

Toronto Stock Exchange

The Toronto Stock Exchange (TSX) was founded in 1852. It is the largest stock exchange in Canada, with over 1500 companies listed. In 2009, the TSX merged with the Montreal Stock Exchange and so the parent company was renamed from TSX Group to TMX Group. The TMX Group was in talks to merge with the London Stock Exchange in 2011, but this fell through after it failed to get approval from shareholders.

The TSX is the third-largest stock exchange in North America by market capitalisation, and the ninth largest in the world — in March 2018, the market capitalisation of the

Toronto Stock Exchange was $2.29 trillion. Some of the most significant companies listed on the Toronto Stock Exchange include the Royal Bank of Canada and Suncor Energy Inc. The top 100 companies on the TSX can be tracked using the S&P/TSX Composite Index, which accounts for roughly 70% of the Toronto Stock Exchange market capitalisation.

Frankfurt Stock Exchange

The Frankfurt Stock Exchange (FWB) was founded in 1585 to fix currency rates, but in the following centuries it became considered as one of the first stock exchange's in the world — alongside the London Stock Exchange and Paris Stock Exchange. It was only after World War II that the Frankfurt Stock Exchange was officially established as Germany's leading stock exchange.

In 1993, ownership of the Frankfurt Stock Exchange was transferred to the company Deutsche Börse AG, which was also in talks to take over the London Stock Exchange. These talks fell through in 2005.

The market capitalisation of the Frankfurt Stock Exchange was $2.22 trillion in March 2018, which places it as the tenth largest stock exchange in the world. The companies listed on the Frankfurt Stock Exchange are primarily based in Germany and other countries that trade using the euro. The primary index used to track the performance of the Frankfurt Stock Exchange is the DAX — a blue-chip stock market index for the top 30 companies on the FWB, which includes companies such as Adidas, BMW and E.ON.

Let's Sum Up

Understanding the stock market involves exploring its historical development, fundamental functions, and the differences between stock and commodity exchanges. It includes knowing the types of traders, regulatory frameworks, and detailed steps involved in trading. Studying key stock exchanges like BSE and NSE in India, as well as prominent global exchanges, provides insights into the global financial ecosystem. This comprehensive knowledge highlights the stock market's critical role in economic development, investment opportunities, and global economic indicators.

Check Your Progress – QUIZ 4

1. **What is considered the first official stock exchange in the world?**

   A. New York Stock Exchange (NYSE)

   B. Bombay Stock Exchange (BSE)

   C. Amsterdam Stock Exchange

   D. Tokyo Stock Exchange (TSE)

2. **What is the primary function of a stock market?**

   A. Trading commodities like gold and oil

   B. Facilitating the buying and selling of equity securities

   C. Trading foreign currencies

   D. Regulating interest rates

3. **Which of the following is NOT a function of the stock market?**

   A. Capital Formation

   B. Liquidity

   C. Price Discovery

   D. Providing loans to investors

4. **How does a stock exchange differ from a commodity exchange?**

   A. Stock exchange trades commodities; commodity exchange trades stocks

   B. Stock exchange trades foreign currencies; commodity exchange trades derivatives

   C. Stock exchange trades equity securities; commodity exchange trades raw materials

   D. There is no difference

5. **Who are considered market makers in the stock market?**

   A. Retail investors

B. Institutional investors

C. Firms or individuals providing liquidity by buying and selling securities

D. Regulatory bodies

6. **Which organization regulates stock exchanges in India?**

A. Reserve Bank of India (RBI)

B. Ministry of Finance

C. Securities and Exchange Board of India (SEBI)

D. Indian Bankers Association (IBA)

7. **Which of the following is NOT a step in stock trading?**

A. Opening a trading account

B. Placing an order

C. Executing the order

D. Applying for a loan

8. **Which stock exchange is Asia's oldest and located in Mumbai?**

A. National Stock Exchange (NSE)

B. Shanghai Stock Exchange

C. Hong Kong Stock Exchange (HKEX)

D. Bombay Stock Exchange (BSE)

4.5 Unit Summary

Stock exchanges serve as crucial platforms where securities are bought and sold, facilitating capital formation and liquidity for investors. They differ from commodity exchanges, focusing on trading stocks and other financial instruments rather than commodities. Traders at stock exchanges execute transactions, influenced by market regulations that ensure fairness and transparency. Steps in stock trading involve order placement, execution, clearing, and settlement. In India, the Bombay Stock Exchange

(BSE) and National Stock Exchange (NSE) are prominent, driving the country's financial markets. Globally, major exchanges like the New York Stock Exchange (NYSE), London Stock Exchange (LSE), Hong Kong Stock Exchange (HKEX), and Tokyo Stock Exchange (TSE) play pivotal roles in international finance, influencing global market trends and investor sentiment.

4.5.1 Glossary

Stock Exchange Traders	Individuals or institutions involved in buying and selling securities on behalf of themselves or clients, influencing market liquidity and price movements.
Regulation of Stock Exchanges	Rules and oversight by regulatory bodies (e.g., SEBI in India, SEC in the US) to ensure fair trading practices, transparency, and investor protection.
Steps in Stock Trading	Process including order placement, order matching, execution, clearing, and settlement, ensuring efficient and secure transaction processing.
BSE (Bombay Stock Exchange)	Oldest stock exchange in Asia, located in Mumbai, India, facilitating trading of stocks and other financial instruments.
NSE (National Stock Exchange)	Leading stock exchange in India, located in Mumbai, known for its electronic trading platform and various indices such as Nifty 50.
World Stock Exchanges	Major global financial hubs facilitating international capital flows and trading activities, including NYSE, LSE, HKEX, and TSE, influencing global market trends.
New York Stock Exchange (NYSE)	Largest stock exchange in the world by market capitalization, located in New York City, pivotal in global finance and home to numerous multinational corporations.
London Stock Exchange (LSE)	Leading exchange in Europe, offering trading in equities, fixed income, derivatives, and providing access to global capital markets.

4.5.2 Self-Assessment Question

Short Answers:

Sl.No	Questions	Level
1	Compare the functions of stock exchanges and commodity exchanges, emphasizing their roles in financial markets.	K3
2	Explain the steps involved in stock trading, highlighting the importance of clearing and settlement processes.	K3
3	Differentiate between BSE and NSE in terms of their market structure and indices.	K3
4	Analyze the impact of stock exchange traders on market liquidity and price discovery, citing examples.	K4
5	Discuss the regulatory measures implemented by SEBI to ensure fair practices on stock exchanges in India.	K4

Long Answer Questions

Sl.No	Questions	Level
1	Compare and contrast the functions and regulatory frameworks of stock exchanges and commodity exchanges.	K5
2	Evaluate the steps involved in stock trading, focusing on the significance of each step in maintaining market integrity and ensuring efficient transaction processing.	K5
3	Design a strategic plan for a company looking to list on both the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE) in India. Include considerations such as regulatory compliance, market positioning, investor outreach, and the benefits of dual listing. Justify your recommendations with insights into market dynamics and investor behavior.	K6

4.5.3 Reference Book

1. "Investments" by Zvi Bodie, Alex Kane, Alan Marcus - McGraw-Hill Education
2. "Financial Markets and Institutions" by Frederic S. Mishkin, Stanley G.

Eakins — Pearson

3. "Financial Markets and Services" by S. B. Gupta - Sultan Chand & Sons

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UNIT V

UNDERWRITING AND IPO

The objective for the topic of Underwriting and Initial Public Offering (IPO) is to provide learners with a comprehensive understanding of the processes, mechanisms, and implications of underwriting and IPOs in capital markets. Through this unit, learners will delve into the intricate details of underwriting, exploring the roles of underwriters, issuers, and investors, along with the associated risks and strategies for risk mitigation. Furthermore, learners will gain insights into the mechanics of IPOs, including the steps involved, pricing methods, and regulatory compliance requirements.

5.1 UNDERWRITING

5.1.1 Definition

Underwriting is the process of determining and quantifying the financial risk of an individual or institution. Typically, this risk usually involves loans, insurance or investments. Financial institutions, such as banks, insurance agencies, investment firms and loan companies, employ underwriters who conduct risk analysis to determine a potential borrower's creditworthiness. Underwriting has an important function in the financial sector because it:

- Assesses the potential risk of the person or investment
- Establishes fair rates on loans
- Sets the correct premiums to cover the actual cost of insuring policyholders
- Prices investment risk accurately to establish a market for securities
- Ensures proper assessment and coverage
- Helps investors make sound investment decisions

During the underwriting process, an underwriter evaluates different factors to determine the estimated risk of approving a loan or policy. An underwriter may choose to recommend approval if a potential borrower scores high in one or several areas. If the borrower scores low in these areas, the underwriter may deny the application. In

this case, the underwriter provides the loan candidate with a valid reason for the denial. There are four basic elements that an underwriter evaluates, which are:

1. Income

Income refers to both gross and net income. Gross income is the amount a person earns before deductions, such as taxes, while net pay is the amount remaining. Underwriters use income to estimate whether a borrower's income can cover the monthly payments for a loan. Borrowers typically submit a variety of documents, such as personal or business tax returns, to help underwriters assess their income.

2. Appraisal

Appraisals ensure the property or other purpose of the loan is worth the requested amount. In this part of the process, an appraiser visits the property or evaluates the purpose of the loan to collect determining information, such as viability or quality of the investment. An appraisal ensures a borrower can only secure a loan worth the actual amount of the property. Underwriters commonly use appraisals when determining whether to approve a mortgage application for a home.

3. Credit score

Knowing the borrower's credit score helps an underwriter determine if the borrower is reliable in paying on credit, including loans and credit cards. The credit score also provides a borrower's debt-to-income (DTI) ratio. Underwriters calculate this ratio to estimate whether the borrower can pay back the loan, along with other existing debts they may have. If a borrower has a good credit score, they may benefit from a lower interest rate.

4. Assets

Assets are valuable items a borrower owns and can sell if they are unable to pay back their loan. Assets may include buildings, federal treasury notes, corporate bonds, guaranteed investment accounts, mutual funds and land. To evaluate a borrower's assets, an underwriter may assess their savings accounts, stocks or real estate.

5.1.2 Different Types of Underwriters

In the financial industry, there are four distinct types of underwriters, each with their unique roles and responsibilities:

1. Insurance Underwriter

Insurance underwriters evaluate the risk involved in insuring properties such as homes, cars, or drivers, as well as individuals seeking life insurance policies. Their main objective is to determine whether the insurance contract is profitable for the insurer by assessing whether the applicant satisfies the criteria necessary to qualify for the policy. Based on their evaluation, they determine the type of policy for which the applicant is eligible and provide a detailed breakdown of what the policy entails for the individual's particular situation.

Insurance underwriters possess extensive knowledge about insurance risks and are adept at avoiding them. They employ their risk assessment skills to decide whether to provide insurance coverage to an individual and under what conditions. In typical cases, underwriting is executed via an automated system, which functions similarly to a quoting system, capable of determining whether an applicant satisfies the insurer's specific coverage requirements.

2. Mortgage Underwriter

The role of mortgage underwriters is to evaluate the risk involved in approving a mortgage application, even if the applicant has a good income and credit score. This is because buying a home is considered a risky venture, and the underwriter needs to conduct a comprehensive risk assessment to determine whether the loan is feasible for the applicant.

To determine the applicant's risk, the underwriter reviews various factors, such as the company's mortgage history, the applicant's credit score, income stability, debt- to-income ratio, savings, and other essential criteria. Furthermore, the underwriter evaluates external factors that may affect the loan, such as the property's value and type, to ensure the mortgage terms are equitable for everyone involved.

In the event that the mortgage application is denied, the applicant can file an appeal. However, this process can be protracted and usually necessitates a considerable amount of evidence to overturn the decision.

3. Loan Underwriter

Loan underwriters, like their counterparts in mortgage underwriting, evaluate the risk associated with approving a loan application, such as for a car loan, with the goal of ensuring the safety of all parties involved. To assess the risk of lending funds to a

borrower, large financial institutions often rely on a combination of underwriting software and human underwriters. This approach is commonly used by both small and large banks. Additionally, in situations where business loans are involved, underwriters may be required to provide their expertise to multiple financial institutions, depending on the size of the business.

4. Securities Underwriter

Securities underwriters specialise in working with initial public offerings (IPOs). Their primary responsibility is to evaluate the risk associated with an investment, in order to determine an appropriate price for the IPO. Typically, these individuals are employed by investment banks or other specialised firms.

The sales period is one of the most significant risks involved in securities underwriting. If the security fails to sell at the suggested price, the investment bank becomes responsible for the difference. To make well-informed decisions regarding pricing and sales, securities underwriters must possess a thorough understanding of market trends, financial statements, and other relevant indicators.

5.1.3 Functions of Underwriters

As a crucial part of the financial industry, underwriters perform various functions to ensure the safe and profitable distribution of risks. These functions include:

1. Risk Selection

The first function of an underwriter is to select the risks that the insurer will accept. This involves gathering factual information from the applicant and evaluating it to determine whether the risk is acceptable. Underwriters rely on lists of acceptable and prohibited risks to help them make these decisions.

2. Classification and Rating

Once a risk has been accepted, the underwriter assigns a classification and rating to it. This involves assigning the risk to a specific group or class and assigning a rate based on the level of risk. Insurers may have their own classification and rating system, or they may use a system provided by a rating bureau.

3. Policy Forms

After determining the acceptability of an applicant and assigning the proper classification and rating, the underwriter issues an insurance policy. It is essential for the underwriter to have knowledge about the various policy types that exist and have the ability to adapt the policy format to match the requirements of the applicant.

4. Retention and Reinsurance

The final function of underwriting is retention and reinsurance. The underwriter determines the level of risk that the insurer can retain and secures reinsurance for the remaining risk. This helps to protect the insurer from undue financial strain in the event of a loss.

5.1.4 Advantages

There are a few advantages of underwriting that make it a popular method for raising capital:

1. Underwriting allows companies to avoid the costs associated with traditional fundraising methods, such as issuing debt or equity.
2. Underwriting allows companies to raise money without going through the lengthy and expensive process of going public.
3. Underwriting gives companies access to a larger pool of potential investors than they would have if they relied on private equity or venture capital firms.

Let's Sum Up

Underwriting is a critical process in the financial industry, encompassing various types of underwriters such as insurance, loan, securities, and real estate underwriters. Each type plays a vital role in assessing and managing risk, approving policies or loans, setting pricing, monitoring compliance, and ensuring market stability. The advantages of underwriting include effective risk management, capital raising, market stability, informed decision-making, and customized solutions, all of which contribute to the efficiency and reliability of financial markets and institutions.

Check Your Progress – QUIZ 1

1. **What is underwriting?**

   a) The process of selling securities in the stock market.

   b) The process by which an individual or institution takes on financial risk for a fee.

   c) The act of borrowing money from a bank.

   d) The evaluation of stock performance over time.

2. **Which type of underwriter evaluates the risk of insuring clients and determines the premium that should be charged?**

a) Loan Underwriter

b) Securities Underwriter

c) Insurance Underwriter

d) Real Estate Underwriter

3. **Who typically assesses the value and risk associated with real estate investments?**

a) Insurance Underwriter

b) Loan Underwriter

c) Real Estate Underwriter

d) Securities Underwriter

4. **Which type of underwriter is involved in managing the process of issuing new securities?**

a) Loan Underwriter

b) Securities Underwriter

c) Insurance Underwriter

d) Real Estate Underwriter

5. **What is one of the primary functions of an underwriter?**

a) Buying and selling stocks in the open market.

b) Assessing and managing financial risk.

c) Providing loans to businesses.

d) Auditing financial statements.

6. **Underwriters are responsible for:**

a) Setting appropriate premiums and interest rates.

b) Conducting marketing campaigns for new products.

c) Handling customer service inquiries.

d) Designing insurance policies.

5.2 Book Building

Meaning of book building

Book Building is the process by which an underwriter determines the price at which the shares must be sold in an Initial Public Offer (IPO). The process of price discovery requires the underwriter to call forth bids from various institutional investors such as fund managers and others. However, there always exists a risk of overpricing or undervaluing the shares.

5.2.1 Book Building Process

- The issuing company hires an investment bank to act as an underwriter who decides the price range of the security.
- The investment bank then, invites large scale buyers, fund managers and others, to submit bids on the shares.
- The book is then built through the listing and evaluation of the aggregated demands for the issue from the submitted bids. The final price of the security is termed as the cut-off price.
- The underwriter publicises the details of the bids in order to maintain transparency in the entire process.
- Shares are allocated to the accepted bidders, thereafter.
- The prices determined in the book building process does not suggest that the price is the best price, nor is it mandatory for the company to use the said price in an IPO.

5.2.2 Types of Book Building

1. **Accelerated book building**

Accelerated book building is a swift process used primarily by companies to raise capital quickly. It is characterised by a shortened timeline, often completed within one to two day

Speed and efficiency: The process is expedited to quickly gauge investor interest and secure funds. This is particularly useful in volatile market conditions or when the company needs funds urgently.

Targeted investors: The process mainly targets institutional investors who can make quick decisions and commit large sums of money. These investors are typically contacted directly by the underwriters.

Limited publicity: Unlike traditional book building, accelerated book building involves less public marketing. Instead, it relies on direct communication with a select group of investors.

Pricing and allocation: Given the rapid nature of this method, the pricing and allocation decisions are made swiftly based on the bids received within a very short timeframe.

2. **Partial book building**

Partial book building, also known as partial subscription book building, allows for a combination of both fixed-price offerings and book building elements.

Fixed and variable components: A portion of the shares is offered at a fixed price, while the remaining shares are subject to the book building process. This hybrid approach allows the company to secure a base level of funding while still benefiting from market-driven pricing.

Investor segmentation: Typically, the fixed-price component is targeted at retail investors, while the book building portion is aimed at institutional investors. This segmentation can help balance the investor base and ensure broader participation.

Price discovery: The book building part of the process helps in discovering the market price for the shares, ensuring that the final IPO price reflects actual demand.

Flexibility: This method offers more flexibility in terms of pricing and allocation, allowing the company to adjust based on market conditions and investor interest.
Both accelerated and partial book building methods provide companies with alternative ways to approach to different needs for speed, investor engagement and

pricing strategies.

5.2.3 Significance of Book Building

Determining the Intrinsic Value of Shares: Companies can find the intrinsic value of their IPO shares by allowing investors to submit their bids. An issuer can determine the fair value for their securities based on investor demand.

Highly Transparent: This issue is highly transparent to support informed decision-making. One can track the changes in the order book and see the bids submitted by investors. One can observe the demand for IPO shares and invest in IPO accordingly.

Generates Demand: This issue helps companies generate demand and interest among investors. As investors submit their bids, others can track the changes in the order book. When bids arrive, the demand for this IPO increases in the market, thus attracting more investors.

5.2.4 Advantages and Disadvantage of book building

Advantage of book building

Book building offers several advantages over traditional fixed-price offerings:

Price discovery: Book building facilitates the discovery of the optimal price for securities by assessing investor demand. This ensures that the securities are priced competitively, maximising the issuer's proceeds.

Efficient capital allocation: By allowing investors to indicate their willingness to pay for the securities, book building ensures efficient capital allocation, as the securities are allocated to those investors who value them the most.

Flexibility: Book building provides flexibility to adjust the offering price within a predetermined range based on investor demand, thereby accommodating market conditions and maximising investor participation.

Reduced price fluctuations: Since the offering price is determined through a consensus of investor bids, book building can help mitigate price volatility in the

secondary market post-listing.

Enhanced transparency: The book building process enhances transparency by providing investors with insights into demand dynamics and pricing considerations, enabling informed investment decisions.

Disadvantages of book building

While book building offers advantages such as price discovery and flexibility, it also presents several challenges and disadvantages as follows:

Limited transparency for retail investors:

Book building primarily involves institutional investors and high-net-worth individuals who have access to detailed information and can participate actively in the bidding process. This can disadvantage retail investors who may not have the same level of access or understanding, leading to a perceived lack of transparency in the pricing mechanism.

Potential for price manipulation:

There is a risk that sophisticated investors or underwriters could manipulate the bidding process to artificially inflate or deflate the IPO price. This can disadvantage other investors and lead to pricing that does not accurately reflect market demand.

Exclusion of small investors:

Retail investors, particularly those with limited financial resources or expertise, may feel excluded from participating effectively in the book building process. This can limit their ability to acquire shares at a fair price or to participate in IPOS of potentially promising companies.

Higher costs and fees:

Engaging underwriters and investment banks for book building can incur higher costs for the issuing company compared to other methods, such as a fixed-price offering. These costs may include underwriting fees, legal fees, and marketing expenses, which can reduce the net proceeds received from the IPO.

Market volatility and uncertainty:

The book building process can lead to uncertainty in pricing and market volatility, especially if there is significant variation in investor bids or if market conditions change rapidly during the IPO period. This volatility can affect investor confidence and the post-IPO performance of the company's shares.

5.2.5 Reverse book building

Reverse book building is a mechanism primarily used for buybacks of shares by companies. This process helps a company determine the price at which it can buy back its shares from existing shareholders. Unlike traditional book building, where the goal is to price new shares for an IPO or other issuance, reverse book building focuses on acquiring already issued shares.

Key Characteristics of Reverse Book Building

1. **Purpose**:

Share Buyback: The primary purpose is for a company to repurchase its own shares from the market.

2. **Price Discovery**:

Bid Collection: The process involves collecting bids from shareholders who indicate the number of shares they want to sell and the price at which they are willing to sell.

Market-Based Pricing: Helps in discovering a fair market price for the buyback based on actual shareholder interest and market conditions.

3. **Regulation**:

Compliance: The process is regulated by securities market authorities to ensure fairness and transparency.

Public Announcement: Companies must announce their intention to buy back shares, including details about the reverse book-building process.

4. **Transparency**:

Bid Visibility: Shareholders can see the bids being placed, providing transparency in the pricing process.

Real-Time Updates: Bids are often updated in real-time, allowing all participants to have current information.

5. **Flexibility**:

Price Range: Companies can set a price range within which they are willing to buy back shares, providing flexibility in managing their buyback program.

Shareholder Participation: All shareholders have the opportunity to participate, ensuring an inclusive process.

Lets Sum Up

Book building is an essential process in the issuance of new shares, allowing for efficient price discovery and market feedback. It involves setting a price band, collecting bids, determining the final price based on demand, and allocating shares accordingly. The method provides significant advantages such as price efficiency and market insight but also has drawbacks like complexity and higher costs. Reverse book building serves a similar purpose for share buybacks, allowing companies to determine the buyback price based on shareholder bids.

Check Your Progress – QUIZ 2

1. **What is the primary purpose of book building?**

   a) To determine the company's financial health

   b) To discover the price at which shares will be issued during an IPO

   c) To conduct internal audits

   d) To calculate the company's net profit

2. **Which characteristic of book building allows for a flexible pricing mechanism based on investor demand?**

   a) Fixed pricing

   b) Market-based pricing

   c) Random pricing

   d) Cost-based pricing

3. **Who are the primary participants targeted in the book building process?**

   a) Government agencies

   b) Retail customers

   c) Institutional investors

   d) Internal employees

4. **What is the first step in the book building process?**

   a) Collecting bids from investors

   b) Setting a price band

   c) Allocating shares

   d) Announcing the final price

5. **What happens after the book building period closes?**

   a) Bids are collected

   b) The price band is announced

   c) The final price is determined and shares are allocated

   d) The company's financial reports are audited

6. **Which type of book building is usually completed in one or two days and is often used for follow-on offerings?**

   a) Traditional book building
   b) Accelerated book building

   c) Reverse book building

   d) Fixed-price offering

5.3 IPO INCLUDING E-IPO

5.3.1 IPO-meaning

An IPO is an initial public offering, in which shares of a private company are made available to the public for the first time. An IPO allows a company to raise equity 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 a share premium for current private investors. Meanwhile, it also allows public investors to participate in the offering.

5.3.2 Advantages and Disadvantages of an IPO

Advantages and disadvantages of an IPO is listed out below:

Advantages:

- Increasing and diversifying equity base
- Cheaper avenues of raising capital
- More exposure, prestige and enhanced public image
- Ability to attract and hire better employees and the management to oversee them through liquidity participation
- To enable acquisitions
- Creating multiple financing opportunity through equity, convertible debt etc

Disadvantages:

- Rise in marketing and accounting costs that will munt as time goes on
- It is necessary to disclose sensitive financial and business information.
- More effort and attention is required of the management to ensure an IPO goes smoothly.
- Chances of additional funding might not be acquired in case the company does not perform well
- Public disclosure of information might be exploited by competitors or even

customers

- The initial shareholders may lose independence as new ones will come in through the ability to buy new shares.
- The company will be exposed to risk of litigation, private securities and other forms of derivative actions.

5.3.3 Types of IPOs

There are two major categories of IPOs offered by companies.

Fixed Price Offering

Fixed price offering is pretty straightforward. The company announces the price of the initial public offering in advance. So, when you partake in a fixed price initial public offering, you agree to pay in full.

Book Building Offering

In book building offering, the stock price is offered in a 20 percent band, and interested investors place their bid. The lower level of the price band is called the floor price, and the upper limit, cap price. Investors bid for the number of shares and the price they want to pay. It allows the company to test interest for the initial public offering among investors before the final price is declared.

The Reverse Book Building is a mechanism provided for capturing the sell orders on online basis from the shareholders through respective Book Running Lead Managers (BRLMs) which can be used by companies intending to delist its shares

through buy back process. In the Reverse Book Building scenario, the Acquirer/Company offers to buy back shares from the shareholders. The Reverse Book Building is basically a process used for efficient price discovery. It is a mechanism where, during the period for which the Reverse Book Building is open, offers are collected from the shareholders at various prices, which are above or equal to the floor price. The buyback price is determined after the offer closing date

Lets Sum Up

An IPO is a significant event for a private company seeking to raise capital and expand

its operations by offering shares to the public. While an IPO provides various advantages such as capital raising, increased public awareness, and liquidity for shareholders, it also presents challenges like high costs, regulatory compliance, and market pressure. There are different types of IPOs, including fixed price offerings, book building offerings, best efforts offerings, and Dutch auctions. An e-IPO further modernizes the IPO process by making it more accessible and efficient through online platforms, though it also introduces technological and security challenges.

Check Your Progress – QUIZ 3

1. **What does IPO stand for?**

   a) Initial Private Offering

   b) Initial Public Offering

   c) Institutional Public Offering

   d) Immediate Public Offering

2. **What is the primary purpose of an IPO?**

   a) To buy back shares from existing shareholders

   b) To issue shares to the public for the first time

   c) To merge with another company

   d) To liquidate the company

3. **Which of the following is an advantage of an IPO?**

   a) Increased regulatory compliance

   b) Higher costs of raising capital

   c) Enhanced liquidity for existing shareholders

   d) Reduced public awareness

4. **What is a potential disadvantage of an IPO?**

   a) Access to capital markets

   b) Reduced disclosure requirements

c) Loss of control for founders

d) Lower visibility in the market

5. **Which type of IPO involves setting a fixed price for shares before offering them to the public?**

    a) Book Building Offering

    b) Dutch Auction

    c) Fixed Price Offering

    d) Best Efforts Offering

6. **In which type of IPO do investors bid for shares within a specified price range, and the final price is determined based on demand?**

    a) Fixed Price Offering

    b) Dutch Auction

    c) Book Building Offering

    d) Best Efforts Offering

5.4 DEPOSITORY SERVICES

A depository is a financial institution or organization that accepts deposits from businesses and individuals and assists in buying and selling financial instruments, such as stocks and bonds. The public can store their valuable assets with such financial institutions to eliminate the risk of holding them.

These organizations offer liquidity and security in financial markets. They utilize the currency deposits accepted by them to offer loans. Moreover, these institutions invest in different financial instruments besides offering a funds transfer system. There are primarily three types of depositories in the U.S. –– thrift banks or savings associations, commercial banks, and credit unions.

5.4.1 Benefits of Depository System

The advantages of depository system is that they help investors perform trading activities well. They provide a safe and efficient way to hold and transfer financial securities electronically. The key benefits make investing more convenient, cost-effective, and accessible compared to dealing with physical certificate documents.

Convenience and Security

A depository account (Demat) allows you to hold your stocks electronically instead of with physical share certificates. This can be very convenient for conducting transactions like buying and selling shares, and it is also more secure since there is no risk of losing or damaging physical certificates.

Time Saving

With a Demat account, you can buy or sell shares much faster compared to paper share transactions. Transferring physical shares can take several weeks, but electronic transfers are nearly instant.

Cost Effectiveness

Maintaining a Demat account costs less than holding physical certificates, which require expenses like stamp duties and locker rental fees.

Easy Access

You can log into your Demat account anytime to view your portfolio holdings and transaction details through regular account statements.

Collateral for Loans

The securities you hold in your Demat account can be used as collateral when applying for a loan from a bank. This makes the loan approval process quicker compared to using physical shares.

5.4.2 Functions of a Depository

Apart from the various services provided, there are certain functions that depositories carry out, and understanding them will help you know the meaning of depository.

Transactions: All securities transactions on the share market occur with the depositories' help, ensuring a seamless transfer of ownership. This process is carried out quickly, with shares and money exchanging hands in a short period of time.

Corporate Action: Depositories help out companies when they have to issue dividends, bonus shares, etc. They also assist in e-voting services and other functions that a depository carries out effortlessly.

Pledging of shares: Multiple investors tend to take loans against their shares by pledging them. Depositories tend to provide a collateral account where shares are held until the time when the borrowed money is repaid.

5.4.3 Types of Depository Systems in India

Central Depository Services Limited (CDSL) and National Securities Depository Limited (NSDL) are two different types of depository systems. Let's understand more about these depository systems.

CDSL, or the Central Depository Limited

Central Depository Services Limited (CDSL) was established in 1997 and began

operations in 1999. It is headquartered in Mumbai. CDSL is one of the two active depositories serving the Indian market. It provides depository services to investors through its network of Depository Participants (DPs) across the country.

NSDL, or the National Securities Depository

NSDL is the oldest depository in India, starting operations in 1996. It was set up as a joint venture between the Industrial Development Bank of India (IDBI) and the National Stock Exchange of India Limited (NSE). NSDL's head office is also located in Mumbai, and like CDSL, it offers depository services to investors via its countrywide network of DPs.

5.4.4 Role of Depository in Financial Markets

Depository services are essential to the financial markets. It offers a secure and effective way to store and transfer assets, lowering the danger of physical certificates being lost or stolen. Additionally, this lowers the transaction costs related to the actual transfer of securities. The depository also encourages the financial markets' efficiency and openness. It gives investors access to real-time data on

their stock ownership and trades, increasing transparency and lowering the possibility of fraud.

The depository also facilitates the integration of the financial markets. It allows investors to access securities markets across different regions and countries, which increases liquidity and diversifies investment opportunities.

Lets Sum Up

Depository services play a crucial role in modern financial markets by facilitating the electronic holding and transfer of securities. They offer numerous benefits, including convenience, reduced costs, faster settlement, and enhanced security. The functions of depositories include dematerialization, electronic book entry, settlement of trades, transfer of ownership, and handling corporate actions. In India, NSDL and CDSL are the two primary depository institutions. Their role in financial markets contributes to efficiency, market integrity, investor confidence, broader market access, and regulatory compliance.

Check Your Progress – QUIZ 4

1. **What is a primary benefit of a depository system compared to the traditional physical certificate-based system?**

    a) Higher transaction costs

    b) Reduced paperwork

    c) Increased settlement time

    d) Enhanced physical security

2. **Which of the following is NOT a benefit of using a depository system?**

    a) Faster settlement of securities transactions

    b) Enhanced security against physical theft

    c) Lower costs associated with stamp duty

    d) Increased risk of loss or forgery

3. **What is the primary function of a depository?**

    a) Issuing physical share certificates

    b) Dematerialization of securities

    c) Printing annual financial reports

    d) Marketing financial products

4. **Which function of a depository involves maintaining electronic records of securities ownership?**

    a) Dematerialization

    b) Settlement of trades

    c) Transfer of ownership

    d) Electronic book entry

5. **Which is the oldest depository system in India?**

 a) Central Depository Services Limited (CDSL)

 b) Bombay Stock Exchange (BSE)

 c) National Securities Depository Limited (NSDL)

 d) Securities and Exchange Board of India (SEBI)

5.5 Demat account

A Demat Account or Dematerialised Account provides the facility of holding shares and securities in an electronic format. During online trading, shares are bought and held in a Demat Account, thus, facilitating easy trade for the users. A Demat Account holds all the investments an individual makes in shares, government securities, exchange-traded funds, bonds and mutual funds in one place.

Demat enabled the digitisation process of the Indian stock trading market and enforced better governance by SEBI. In addition, the Demat account reduced the risks of storing, theft, damage, and malpractices by storing securities in electronic format. It was first introduced in 1996 by NSE. Initially, the account opening process was manual, and it took investors several days to get it activated. Today, one can open a Demat account online in 5 mins. The end-to-end digital process has contributed to popularising Demat, which skyrocketed in the pandemic.

5.5.1 Benefits of Demat Account

There are various benefits of opening a Demat Account and they are as follows:

No Paper Certificate

Prior to the existence of Demat Accounts, share used to exist as physical paper certificates. Once you purchased shares, you had to store several paper certificates for the same. Such copies were vulnerable to loss and damage, and also come attached with lengthy transfer processes. Demat Account turned all of it electronic, saving you much hassle.

Ease of Storage:

With a Demat Account you can store as many shares as you need to. This way, you can trade in volumes and keep track of the shares in your account. You can also rely on your Demat Account to execute quick transfer of shares.

Variety of Instruments:

Apart from stock market shares, you can also use your Demat Account to hold multiple assets including mutual funds, Exchange Traded Funds (ETFs), government securities, etc. Thus, with a Demat Account, you can approach your investment plans more holistically and easily build a diverse portfolio.

Easy Access:

Accessing your Demat Account is super easy. You can do so with the help of a smartphone or laptop and manage your investments from anywhere, at any time. A Demat Account truly makes investing for a financially secure future more easy and accessible than it has ever been before.

Nomination:

A Demat Account also comes with a nomination facility. The process of nomination is to be followed as has been prescribed by the depository. In case the investor passes away, the appointed nominee receives the shareholding in the account. This feature enables you to make plans for future eventualities and avoid legal disputes.

5.5.2 Types of Demat Accounts in India

In India, there are several types of Demat accounts to cater to various investor profiles.

Regular Demat Account:

Ideal for Indian residents, this account is managed by depository participants, and regulated by two depositories. It offers swift transactions, allowing you to buy or sell shares within minutes.

Minor Demat Account:

Specifically designed for minors, this account allows parents or guardians to manage investments on behalf of their children until they reach the legal age of 18. It offers

a secure way to build a financial foundation for the younger generation.

Corporate Demat Account: This type of Demat account is tailored for corporate entities and organizations. It enables businesses to hold and manage their securities electronically, facilitating smoother transactions and enhanced financial control. Corporate Demat accounts are instrumental in corporate actions and shareholder meetings.

Repatriable Demat Account (NRI Demat Account)

It's a type of demat account designed for NRIs so that they can leverage this account to transfer funds abroad . It requires an NRE bank account for operation.

Non-Repatriable Demat Account

This is also intended towards NRIs but unlike the repatriable demat account, in a non-repatriable demat account, funds cannot be transferred abroad. It necessitates an NRO bank account association.

Basic Services Demat Account

Designed to promote financial inclusion, the Basic Services Demat Account caters to individuals from economically disadvantaged backgrounds. Offering a simplified and cost-effective way to participate in the Indian securities market. This type of account is subject to certain restrictions and limitations, making it an accessible entry point for new investors with limited resources.

Let's Sum Up

A Demat account is essential for modern securities trading, providing numerous benefits such as safety, convenience, reduced costs, and efficient settlement. It allows investors to hold shares and other securities electronically, making the trading process seamless and secure. There are three main types of Demat accounts in India: Regular Demat accounts for resident Indians, Repatriable Demat accounts for NRIs allowing fund transfers abroad, and Non-Repatriable Demat accounts for NRIs where funds cannot be transferred out of India.

Check Your Progress – QUIZ 5

1. **What is the primary function of a Demat account?**

    a) To hold cash in electronic format

    b) To hold shares and securities in electronic format

    c) To provide loans to investors

    d) To issue physical share certificates

2. **Which of the following is NOT a benefit of a Demat account?**

    a) Safety against theft and loss of physical certificates

    b) Automatic credit of dividends and interest

    c) Reduced paperwork and administrative costs

    d) Increased risk of forgery and loss

3. **How does a Demat account enhance convenience for investors?**

    a) By requiring physical certificates for every transaction

    b) By allowing easy and quick electronic transaction

    c) By increasing the settlement time of trades

    d) By complicating the process of monitoring investments

4. **Which feature of a Demat account allows shares to be used as collateral for loans?**

    a) Automatic updates

    b) Reduced costs

    c) Loan collateral flexibility

    d) Efficient settlement

5. **Which type of Demat account is designed for resident Indian investors?**

    a) Repatriable Demat Account

b) Non-Repatriable Demat Account

c) Regular Demat Account

d) Non-Resident External (NRE) Account

6. **Which Demat account allows NRIs to transfer funds abroad?**

a) Regular Demat Account

b) Non-Repatriable Demat Account

c) Non-Resident Ordinary (NRO) Account

d) Repatriable Demat Account

5.6 CDSL and NSDL

5.6.1 Role of CDSL and NSDL

The National Securities Depository Limited (NSDL), established in 1996, is India's first and largest depository, created to modernize the securities market by eliminating the need for physical certificates. NSDL facilitates the dematerialization of securities, thereby reducing risks associated with paper-based certificates, such as loss, theft, and delays. It offers a range of services, including the dematerialization and dematerialization of securities, account maintenance, trade settlement, corporate actions management, and e-voting. NSDL has played a crucial role in improving the efficiency, security, and transparency of the Indian securities market, significantly contributing to its growth and development. Regulated by the Securities and Exchange Board of India (SEBI), NSDL continues to innovate and expand its services, ensuring a safer and more efficient environment for investors and issuers alike.

Central Depository Services Limited (CDSL), established in 1999, is one of the primary depositories in India, providing electronic depository services to facilitate the holding and trading of securities in dematerialized form. By offering services such as dematerialization, account maintenance, trade settlement, corporate actions management, and e-voting, CDSL has significantly enhanced the efficiency, security, and transparency of the Indian securities market. It offers investors a reliable and secure platform to manage their securities without the risks associated with physical certificates, such as loss, theft, and delays. Regulated by the Securities and Exchange Board of India (SEBI), CDSL continues to expand its reach and innovate its offerings, playing a vital role in the modernization and growth of India's financial market infrastructure.

The main difference between NSDL and CDSL is that NDSL has the National Stock Exchange as the primary operating market, and CDSL has the Bombay Stock Exchange as the primary operating market.

Central Depository Services Limited (CDSL) and National Securities Depository

Limited (NSDL) are the two depositories in India. Depositories are entities that hold financial securities such as stocks in dematerialised form. It is similar to bank accounts where you store your money. However, instead of money, shares are stored in the depository in electronic form.

Depositories eliminate the risk of holding physical securities. For instance, share buyers had to ensure that shares were transferred safely to their accounts before depositories. However, depositories eliminated these problems and shares were transferred in electronic form.

Depositories hasten the share trading process and minimise the paperwork. Moreover, depositories facilitate huge share trading volumes, eliminating forgery and unscrupulous share transfers.

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Difference Between NSDL and CSDL

Features	**NSDL**	**CDSL**
Meaning	NSDL is an abbreviation for National Securities Depository Limited. It is an Indian central securities repository that permits the electronic storing and trading of securities.	CDSL is an abbreviation for Central Depository Services Limited. It is an Indian central securities depository that offers depository services to the Indian securities market.
Year of Establishment	1996	1999
Market Share	Greater market share in terms of the number of DEMAT accounts.	Lower market share in terms of the number of DEMAT accounts.

Depository Participants (DPs)	More DPs than CDSL.	Fewer DPs than NSDL.
Operating Markets	The principal functioning market for NSDL is the National Stock Exchange (NSE).	The principal functioning market for CDSL is the Bombay Stock Exchange (BSE).
DEMAT Account Number Format	The NSDL code is a 14-character numeric code that begins with IN.	The CDSL DEMAT account number is a numeric code of 16 digits.

5.6.2 Online Stock Trading

Online stock trading refers to the process of buying and selling stocks through internet-based platforms provided by brokerage firms. This method allows investors to manage their investments and execute trades electronically, without the need for physical interaction or paperwork typically associated with traditional stock exchanges.

Definition

Online stock trading leverages technology to facilitate the seamless execution of trades in the financial markets. Investors can access their trading accounts via desktop computers or mobile devices, enabling them to monitor market movements, analyze stock performance, and execute transactions in real-time. This method provides greater flexibility, accessibility, and efficiency compared to traditional methods, empowering individual investors and institutions alike to participate actively in the stock market.

Evolution and Growth of Online Trading Platforms:

The evolution of online trading platforms can be traced back to the late 1990s, when advancements in internet technology and electronic communication networks (ECNs) revolutionized financial markets. Initially, these platforms offered basic functionalities such as real-time stock quotes and order placement. Over time, they have evolved to include sophisticated tools for technical and fundamental analysis, customizable trading strategies, and integrated educational resources.

The growth of online trading platforms has been driven by several factors:

1. **Technological Advancements:** Continuous innovation in computing power, internet speed, and mobile technology has enhanced the capabilities of online trading platforms, making them faster, more reliable, and accessible from various devices.
2. **Regulatory Changes:** Regulatory reforms aimed at promoting market transparency and investor protection have encouraged the adoption of electronic trading platforms, facilitating a more efficient and competitive marketplace.
3. **Democratization of Investing:** Online trading has democratized access to financial markets, allowing individual investors, regardless of their location or financial background, to participate in stock trading with reduced barriers to entry.
4. **Globalization:** Online trading platforms have facilitated access to global markets, enabling investors to trade stocks listed on exchanges worldwide and diversify their portfolios across different asset classes and geographical regions.
5. **Educational Resources:** Brokerage firms and online platforms provide educational resources, tutorials, webinars, and research tools to empower investors with knowledge and skills necessary for informed decision-making.

Major advantages of online stock trading:

1. **Real-Time Trading**

   One of the biggest advantages of online stock trading is the ability to place trades in real time. Instead of contacting your broker for stock quotes, you can easily check the stock's current price on the online trading platform. You can check stock prices, place the order and execute the trade within a few seconds.

2. **Cost-Effective**

   Online trading is quite inexpensive as you pay less in brokerage and other charges, which is not the case with traditional investing. You can also opt for a broker like m.Stock, which offers zero brokerage plans, which will cut your brokerage costs to zero for life.

3. **Instant Access To Market Data**

   Online trading platforms such as m.Stock provide access to technical charts and investing tools that offer comprehensive research insights and statistics to traders. This helps traders make well-informed investment decisions to maximise their returns. Moreover, it also saves time and substantially reduces the risk.

4. **Flexibility**

   Traders can access their accounts from their mobile phones, laptops, and other devices. This allows them to keep tracking their investments from any location at any time. And in case your device is not working, you can easily shift to another medium without much hassle, unlike offline trading.

5. **Prompt Customer Support**

   With years of experience and extensive training, customer support executives at online trading platforms provide individual assistance and technical support. In addition, traders can opt for email and text alerts to get notified when their buy and sell price targets are hit.

6. **Round-The-Clock Access**

   Online trading allows instantaneous access to your funds and stocks anytime. It further enables you to track and evaluate stock performance efficiently, ensuring you make decisions without wasting any time.

7. **Transparency**

   Online trading platforms give clear information about all the fees and other charges associated with the trading account. These include brokerage fees, taxes, and other administrative costs. Thus, traders can accurately calculate the brokerage charges involved in the transactions.

8. **Receive Real-Time Notifications**

   As a trader, you can get real-time notifications about their stocks from the online trading platform. Moreover, you can follow live updates of stock prices, their performance, and market analysis. Online platforms like m. Stock also allow you to customise your notifications and updates about the stocks in your watchlists.

Let's Sum Up

CDSL and NSDL, as depositories, are integral to the efficient functioning of the Indian securities market, providing secure and transparent mechanisms for holding and trading securities. Online stock trading, facilitated by these depositories and supported by advanced trading platforms, has democratized access to financial markets, empowering investors with tools and resources to manage their investments effectively and participate actively in stock trading activities.

Check Ur Progress – QUIZ 6

1. **Which of the following is true about NSDL and CDSL?**

   A) They are banks.

   B) They are depositories facilitating dematerialization of securities.

C) They primarily issue physical share certificates.

D) They regulate stock exchanges.

2. **What is the primary function of NSDL and CDSL?**

A) Managing mutual funds.

B) Providing insurance services.

C) Facilitating dematerialization of securities.

D) Offering commodity trading platforms.

3. **Which service is NOT typically provided by NSDL and CDSL?**

A) Dematerialization of securities.

B) Real-time market data.

C) Settlement of trades.

D) Insurance brokerage.

4. **What benefit does online stock trading provide compared to traditional methods?**

A) Higher brokerage fees.

B) Delayed execution of trades.

C) Accessibility and convenience.

D) Limited market information.

5. **Which aspect of online stock trading is NOT true?**

A) It allows trading from anywhere with internet access.

B) It involves real-time access to market data.

C) It typically incurs higher brokerage fees than traditional trading.

D) It provides tools for technical and fundamental analysis.

5.7 Unit Summary

Underwriting involves an agreement where a financial institution guarantees to buy unsold shares in a new issue, mitigating issuer risk. Types include firm commitment and best efforts, differing in risk assumption and guarantee levels. Mechanics of underwriting entail due diligence, pricing, and distribution to investors. Benefits include assured capital for issuers and risk management for underwriters. Book building allows price discovery through investor demand, crucial in initial public offerings (IPOs). Characteristics include flexibility in pricing and efficient allocation of shares. e-IPO facilitates online bidding and subscription, enhancing investor participation and transparency. Reverse book-building determines price by investor bidding, used in delisting scenarios. Depository services like CDSL and NSDL offer dematerialization of securities into electronic form, enabling easy trading and settlement via demat accounts. Electronic settlement of trades ensures faster, secure transaction processing, transforming stock trading into a streamlined, online process.

5.7.1 Glossary

Underwriting	Firm commitment (guaranteed purchase) and best efforts (no guarantee), differing in risk and commitment levels.
Mechanics of Underwriting	Involves due diligence, pricing determination, and distribution of securities to investors.
Benefits of Underwriting	Provides assurance of capital for issuers and risk management for underwriters.
Book Building	Method for price discovery in IPOs based on investor demand, enhancing transparency and efficient allocation.
Concept of Book Building	Allows for flexibility in pricing and allocation of shares, crucial in determining market demand.
Characteristics of Book Building	Includes price sensitivity to demand, investor participation, and strategic pricing.

5.7.2 Self-Assessment Question

Short Answers Questions:

Sl.No	Questions	Level
1	How does underwriting mitigate risk for companies issuing new stocks?	K3
2	Explain the concept of book building in the context of initial public offerings (IPOs), and how it helps in determining the IPO price.	K3
3	What are the types of underwriting, and how do they differ in terms of risk and commitment levels?	K3
4	Describe the role of depository services like CDSL and NSDL in the securities market, focusing on their functions in dematerialization.	K4
5	Compare and contrast firm commitment and best efforts underwriting, highlighting their implications for both issuers and underwriters.	K4

Long Answer Questions

Sl.No	Questions	Level
1	Analyze the benefits of e-IPOs over traditional IPO processes, considering factors like accessibility, transparency, and investor participation.	K5
2	Evaluate the impact of electronic settlement on the efficiency and security of stock trading, citing specific advantages for investors and market operations.	K5
3	Discuss the characteristics of reverse book-building and its application in determining exit prices during delisting processes, with examples.	K6

5.7.3 Reference Book

1. "Investment Banking: Valuation, Leveraged Buyouts, and Mergers & Acquisitions" by Joshua Pearl and Joshua Rosenbaum - Wiley Finance
2. "Investments" by Zvi Bodie, Alex Kane, Alan Marcus - McGraw-Hill Education
3. "Initial Public Offerings (IPOs): A Practical Guide to Going Public" by Steven Dresner - Bloomberg Press