Centre for Distance and Online Education

Punjabi University, Patiala

Class : BBA-Part-III **Semester : 5**

Paper : BBA-510(Stock Market Operations) Unit: I Medium : English

Lesson No. **(Updated on 26th June 2023)**

Department website : www.pbidde.org

BBA-510: STOCK MARKET OPERATIONS

Time Allowed: 3Hrs

Max. Marks	: 100
Theory	: 60
Internal Assessment	: 40

Note: The question paper covering the entire course shall be divided into three sections as follows:

SECTION-A

It will consist of 10 very short answer questions with answers to each question up to five lines in length. All questions shall be compulsory. Each question shall carry two marks; total weightage of the section shall be 20 marks.

SECTION-B

It will consist of essay type questions with answers to each question up to 7 pages in length. Four questions shall be set by the examiner from Part-I of the syllabus and the candidate shall be required to attempt two. Each question shall carry ten marks; total weightage of the section shall be 20 marks.

SECTION-C

It will consist of essay type questions with answers to each question up to 7 pages in length. Four questions shall be set by the examiner from Part-II of the syllabus and the candidate shall be required to attempt two. Each question shall carry ten marks : total weightage of the section shall be 20 marks. **Course Input :**

PART-I

Indian Stock Markets : Introduction, Evolution and Growth of Stock Markets in India. Functions of Stock Exchange, Intermediaries in the Secondary Market, Secondary Market Mechanism. an Overview of Major Stock Exchanges in India – N.s.E., B.S.E. and O.T.C.E.I.

Stock Market Indexes: Concept, Types, Brief Overview of BSE SENSEX and S&P CNX Nifty.

Legal Framework for Stock Exchanges : The Sceurities Exchange Board of India Act 1992-Definition, Powers and Functions of SEBI, SEBI (Stock Brokers and Sub Brokers) Rules and Regulations, 1992, NSE Rules, Regulations and Byclaws, NSCCL Rules, Regulations and Byelaws.

PART-II

Trading Mechanism at N.S.E. : Introduction, Market Types, Market Phases, Order Management, Trade Management.

Clearing and Settlement : Introduction-Transacion Cycle, Settlement Process, Settlement Agencies, Risks in Setlement, Settlement Cycle, Securities & Funds Settlement, Shortages Handling, Risk containment, Dematerialisation and Electronic Transfer of Securities, Investor Protection Fund.

Depository Operations: Introduction to Depository Systems, Definition of Depository and Depository Participant, Salient Features of Depository Act 1996, Benefits of Depository System.

Future Market Operations : Introduction to Futures (Stock Futures and Index Futures) and Options (Stock Options and Index Options).

Suggested Reading

1. Capital Market Dealers (Module) Workbook by National Stock Exchange of India Ltd.
2. Depository Operations (Module) Workbook by National Stock Exchange of India Ltd.
3. Financial Markets : A Beginners (Module) by National Stock Exchange of India Ltd.
4. Derivative Market Dealers (Module) Workbook by National Stock Exchange of India Ltd.
5. Outlines of Indian Capital Market by H.S. Sidhu (Ludhiana Stock Exchange).
6. The Working of Stock Exchanges in India by H.R. Machiraju (New Age).
7. Merchant Banking and Financial Services by Dr. S. Gurusamy (Thomson).

BBA PART-III **PAPER : BBA-510**

SEMESTER-V **STOCK MARKET OPERATIONS**

LESSON NO. 1.1 **AUTHOR : DR HARPREET KAUR**

STOCK EXCHANGES

Contents:

1.1.1Objectives

Main objectives of this chapter are :

- To explain the meaning and functions of stock exchanges.
- To highlight the role of SEBI in regulating stock exchanges
- To give advantages and limitations of stock exchanges

- To discuss the stock exchanges in India

1.1.2 Introduction

Stock markets in India play a predominant role in its efforts in industrialization. A fair and efficient securities market contributes to a large extent towards industrial development by its many fold operations. Stock exchanges are primarily responsible for mobilizing and channelizing savings of the household sector into productive enterprises. By effectively monitoring available resources, the securities market offered attractive returns and capital appreciation. Slowly and steadily a consciousness has been built up among the common savers on account of several investment opportunities made available in the securities market, though most of them have to rely on the advice of brokers, sub–brokers or specialized agents. When a common man invests his life long savings in securities for getting better returns it is necessary for him to protect his interest in receiving maximum return by avoiding malpractices prevalent in the stock exchange. The stock exchange acts as a mirror to the stock market. The share and stock brokers constitute a service sector which renders services for advising intending investors to make investments in various securities profitably. The Government of India has adopted a conscious policy of widespread share holding in accordance with their socio-economic goals of opening up markets for middle and low income groups. While some of the investors may be professionals, a large number comes from a class which does not have full knowledge of operation of stock exchanges or stock markets. It is necessary to know the working of stock exchanges and securities before placing surplus funds in the stock market. Here, we are going to know more about the meaning of stock exchange, the organization and role of stock exchange in the capital market, the functions and powers of SEBI (Securities and Exchange Board of India), the role of SEBI in monitoring the stock exchange.

1.1.3 Meaning of Stock Exchange

Stock Exchanges are the organized securities markets regulating the trading in shares, debentures and other securities in the interest of the investors. Stock Exchange (also called *Stock Market* or *Share Market*) is one important constituent of capital market. Stock Exchange is an organized market for the purchase and sale of industrial and financial security. It is convenient place where trading in securities is conducted in systematic manner i.e. as per certain rules and regulations.

It performs various functions and offers useful services to investors and borrowing companies. It is an investment intermediary and facilitates economic and industrial development of a country.

Stock exchange is an organized market for buying and selling corporate and other securities. Here, securities are purchased and sold out as per certain well-defined rules and regulations. It provides a convenient and secured mechanism or platform for transactions in different securities. Such securities include shares and debentures issued by public companies which are duly listed at the stock exchange, and bonds and debentures issued by government, public corporations and municipal and port trust bodies.

Stock exchanges are indispensable for the smooth and orderly functioning of corporate sector in a free market economy. A stock exchange need not be treated as a place for speculation or a gambling den. It should act as a place for safe and profitable investment, for this, effective control on the working of stock exchange is necessary.

This will avoid misuse of this platform for excessive speculation, scams and other undesirable and anti-social activities.

London stock exchange (**LSE**) is the oldest stock exchange in the world. While Bombay stock exchange (**BSE**) is the oldest in India. Similar Stock exchanges exist and operate in large majority of countries of the world.

1.1.4 Definitions of Stock Exchange

According to Husband and Dockerary,

"Stock exchanges are privately organized markets which are used to facilitate trading in securities

The Indian Securities Contracts (Regulation) Act of 1956, defines Stock Exchange as,

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

1.1.5 Features of Stock Exchange

Characteristics or features of stock exchange are:-

1. Market for securities : Stock exchange is a market, where securities of corporate bodies, government and semi-government bodies are bought and sold.

2. Deals in second hand securities : It deals with shares, debentures bonds and such securities already issued by the companies. In short it deals with existing or second hand securities and hence it is called secondary market.

3. Regulates trade in securities : Stock exchange does not buy or sell any securities on its own account. It merely provides the necessary infrastructure and facilities for trade in securities to its members and brokers who trade in securities. It regulates the trade activities so as to ensure free and fair trade

4. Allows dealings only in listed securities : In fact, stock exchanges maintain an official list of securities that could be purchased and sold on its floor. Securities which do not figure in the official list of stock exchange are called unlisted securities. Such unlisted securities cannot be traded in the stock exchange.

5. Transactions effected only through members : All the transactions in securities at the stock exchange are effected only through its authorised brokers and members. Outsiders or direct investors are not allowed to enter in the trading circles of the stock exchange. Investors have to buy or sell the securities at the stock exchange through the authorised brokers only.

6. Association of persons : A stock exchange is an association of persons or body of individuals which may be registered or unregistered.

7. Recognition from Central Government : Stock exchange is an organised market. It requires recognition from the Central Government.

8. Regulates trade in securities : Stock exchange does not buy or sell any securities on its own account. It merely provides the necessary infrastructure and facilities for

trade in securities to its members and brokers who trade in securities. It regulates the trade activities so as to ensure free and fair trade

9. Working as per rules : Buying and selling transactions in securities at the stock exchange are governed by the rules and regulations of stock exchange as well as SEBI Guidelines. No deviation from the rules and guidelines is allowed in any case.

10. Specific location : Stock exchange is a particular market place where authorised brokers come together daily (i.e. on working days) on the floor of market called trading circles and conduct trading activities. The prices of different securities traded are shown on electronic boards. After the working hours market is closed. All the working of stock exchanges is conducted and controlled through computers and electronic system.

11. Financial Barometers : Stock exchanges are the financial barometers and development indicators of national economy of the country. Industrial growth and stability is reflected in the index of stock exchange.

1.1.6 Functions of a Stock Exchange

The role of a stock exchange in a capital market is as follows:-

(1) Ready and Continuous Market: The stock exchange provides a ready and continuous market for the sale and purchase of securities.

(2) Bank Borrowing Facility: Securities listed on a stock exchange serve as a collateral security when an investor need funds from a bank.

(3) Promotes Capital Formation: Stock Exchanges promote capital formation as they encourage investors to invest need funds from a bank.

4) Safety and Fair Dealing: The Stock Exchange operates under rules and regulations framed by the Central Government. The rules and regulations framed by the Central Government are in the interest to ensure safety to the investors and whatever be their dealings, it should a fair one.

(5) Government Funding: Stock Exchanges help the government to raise funds by selling shares and debentures.

(6) Creation of Employment Opportunities: Stock Exchange creates a number of employment opportunities to a number of brokers, sub brokers as they are the intermediaries through which shares are being sold.

(7) Evaluation of Securities: Stock Exchanges helps to evaluate the worth of securities, as securities are traded at a certain price on the stock market. Investors are able to determine the real worth of their holdings in the form of shares and debentures which are listed on the stock exchange.

(8) Industrial Development: The capital collected through shares and debentures can be put to industrial use. With the capital, new industries can be started, existing ones can be expanded and modernized and thereby enhancing the industrial development of a country.

(9) Clearing House of Securities: The Stock Exchanges acts as a clearing house of securities. It facilitates easy and quick clearance of transactions of securities between the buyers and the sellers.

(10) Facilitates Flow of Capital: Stock Exchange facilitates the flow of capital to companies who have a high potential to raise substantial funds.

1.1.7 Role of SEBI in monitoring the Stock Exchange

SEBI stands for Securities and Exchange Board of India. It was set up in April, 1988, as a strong need was felt to protect the interest of the investors and to have a systematic and organized working of the securities market. It started actually functioning when the SEBI Act was passed in 1992. The Act empowered SEBI with necessary powers to regulate the activities connected with marketing of securities and investment of Stock Exchanges, Portfolio Management, Stock Brokers, and Merchant Banking etc.

1.1.7.1 Objectives of Securities & Exchange Board of India

There are three basic objectives of SEBI. They are as follows :-

(1) Towards Investors: To protect the interest of the investors.

(2) Towards Capital Issuers: It aims at creating a good market environment where capital issuers can raise necessary funds.

(3) Towards Intermediaries: It wants to bring about professionalism among the brokers, stokers and sub – brokers.

1.1.7.2 Powers and Functions of SEBI

(1) To protect investors' Interest: SEBI is formed to protect the interest of the investors. It monitors whether issuing companies, brokers, mutual funds are following the rules and regulations. It also gives a hearing to the investor's complaints and grievances, if any, against the issuing companies brokers etc.

(2) Regulating Working of Mutual Funds: SEBI regulates the working of mutual funds. It has laid down certain rules and regulations that are needed to be followed. Failure to follow the regulations may lead to cancellation of the registration of a mutual fund.

(3) Regulates Merchant Banking: SEBI has laid down certain regulations in respect of registration, submission of half yearly results, code of conduct in respect of merchant banking, etc.

(4) Take over and Mergers: SEBI has issued guidelines to protect the interest of the investors in case of take over and mergers.

(5) Restriction on Insider Trading: SEBI restricts insider trading activity. Its regulation states that, no insider shall either on his own behalf or on behalf of any other person may deal in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information.

(6) Regulates Stock Brokers Activities: SEBI has laid down the regulations in respect of brokers and sub-brokers. Without being a registered member of SEBI, no broker or sub-broker can buy, sell or deal in securities.

(7) Research and Publicity SEBI conducts survey and research in respect of investments and opportunities. It also undertakes to publish two monthly bulletins called SEBI market review and SEBI news letter.

(8) Guidelines on Capital Issues: SEBI has framed certain guidelines on capital issues which are applicable to first public issue of new companies, first public issue by existing private held companies, public issue by existing listed companies.

(9) Portfolio Management: SEBI has laid down certain regulations regarding portfolio management. Without proper registration with SEBI, no person or institution can work as a portfolio manager.

(10) Other functions: There are some other functions also which are as follows:- (i) It prevents unfair trade practices relating to the securities market.

(ii) It gives training to intermediaries in the securities market.

(iii) It promotes investor's education.

(iv) It conducts audits of the stock exchanges.

(v) It also conducts inquiries, and inspections.

1.1.8 The Role of Stock Exchanges

Stock exchanges have multiple roles in the economy. This may include the following:[3]

1. Raising capital for businesses

The Stock Exchange provide companies with the facility to raise capital for expansion through selling shares to the investing public.

2. Common forms of capital raising

Besides the borrowing capacity provided to an individual or firm by the banking system, in the form of credit or a loan, there are four common forms of capital raising used by companies and entrepreneurs. All of these available options, might be achieved, directly or indirectly, involving a stock exchange.

3. Going public

Capital intensive companies, particularly high tech companies, always need to raise high volumes of capital in their early stages. By this reason, the public market provided by the stock exchanges, has been one of the most important funding sources for many capital intensive startups. After the 1990s and early-2000s hi-tech listed companies' boom and burst in the world's major stock exchanges, it has been much more demanding for the high-tech entrepreneur to take his/her company public, unless either the company already has products in the market and is generating sales and earnings, or the company has completed advanced promising clinical trials, earned potentially profitable patents or conducted market research which demonstrated very positive outcomes. This is quite different from the situation of the 1990s to early-2000s period, when a number of companies (particularly Internet boom and biotechnology companies) went public in the most prominent stock exchanges around the world, in the total absence of sales, earnings and any well-documented promising outcome. Anyway, every year a number of companies, including unknown highly speculative and financially unpredictable hi-tech startups, are listed for the first time in all the major stock exchanges - there are even specialized entry markets for this kind of companies or stock indexes tracking their performance.

4. Limited partnerships

A number of companies have also raised significant amounts of capital through R&D limited partnerships. Tax law changes that were enacted in 1987 in the United States changed the tax deductibility of investments in R&D limited partnerships. In order for a partnership to be of interest to investors today, the cash-on-cash return must be high enough to entice investors. As a result, R&D limited partnerships are not a viable means of raising money for most companies, especially hi-tech start-ups.

5. Venture capital

A third usual source of capital for start-up companies has been venture capital. This source remains largely available today, but the maximum statistical amount that the venture company firms in aggregate will invest in any one company is not limitless (it was approximately $15 million in 2001 for a biotechnology company).At those level, venture capital firms typically become tapped-out because the financial risk to any one partnership becomes too great.

6. Corporate partners

A fourth alternative source of cash for a private company is a corporate partner, usually an established multinational company, which provides capital for the smaller company in return for marketing rights, patent rights, or equity. Corporate partnerships have been used successfully in a large number of cases.

7. Mobilizing savings for investment

When people draw their savings and invest in shares (through a IPO or the issuance of new company shares of an already listed company), it usually leads to rational allocation of resources because funds, which could have been consumed, or kept in idle deposits with banks, are mobilized and redirected to help companies' management boards finance their organizations. This may promote business activity with benefits for several economic sectors such as agriculture, commerce and industry, resulting in stronger economic growth and higher productivity levels of firms. Sometimes it is very difficult for the stock investor to determine whether or not the allocation of those funds is in good faith and will be able to generate long-term company growth, without examination of a company's internal auditing.

8. Facilitating company growth

Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase its market share, or acquire other necessary business assets. A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways for a company to grow by acquisition or fusion.

9. Profit sharing

Both casual and professional stock investors, as large as institutional investors or as small as an ordinary middle class family, through dividends and stock price increases that may result in capital gains, share in the wealth of profitable businesses.
Unprofitable and troubled businesses may result in capital losses for shareholders.

10. Corporate governance

By having a wide and varied scope of owners, companies generally tend to improve management standards and efficiency to satisfy the demands of these shareholders, and the more stringent rules for public corporations imposed by public stock exchanges and the government. Consequently, it is alleged that public companies (companies that are owned by shareholders who are members of the general public and trade shares on public exchanges) tend to have better management records than privately held companies (those companies where shares are not publicly traded, often owned by the company's founders and/or their families and heirs, or otherwise by a small group of investors).

11. Creating investment opportunities for small investors

As opposed to other businesses that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares they can afford. Therefore, the Stock Exchange provides the opportunity for small investors to own shares of the same companies as large investors.

12. Government capital-raising for development projects

Governments at various levels may decide to borrow money to finance infrastructure projects such as sewage and water treatment works or housing estates by selling another category of securities known as bonds. These bonds can be raised through the Stock Exchange whereby members of the public buy them, thus loaning money to the government. The issuance of such bonds can obviate the need, in the short term, to directly tax citizens to finance development—though by securing such bonds with the full faith and credit of the government instead of with collateral, the government must eventually tax citizens or otherwise raise additional funds to make any regular coupon payments and refund the principal when the bonds mature.

13. Barometer of the economy

At the stock exchange, share prices rise and fall depending, largely, on market forces. Share prices tend to rise or remain stable when companies and the economy in general show signs of stability and growth. An economic recession, depression, or financial crisis could eventually lead to a stock market crash. Therefore the movement of share prices and in general of the stock indexes can be an indicator of the general trend in the economy.

14. Speculation

The stock exchanges are also fashionable places for speculation. In a financial context, the terms "speculation" and "investment" are actually quite specific. For instance, although the word "investment" is typically used, in a general sense, to mean any act of placing money in a financial vehicle with the intent of producing returns over a period of time, most ventured money—including funds placed in the world's stock markets—is actually not investment but speculation.

1.1.8.1 Self-Check Exercise-I

Q.1 What is the role of stock exchanges in an economy?

1.1.9 Advantages Of Stock Exchanges

(a) To the Companies

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

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

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

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

(b) To the Investors:

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

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

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

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

(c) To the Society

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

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

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

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

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

1.1.10 Limitations of Stock Exchanges

Like any other institutions, stock exchanges too have their limitations. One of the common evils associated with stock exchange operations is excessive speculation.

Speculation implies buying or selling securities to take advantage of price differentials at different times. The speculators generally do not take or give delivery and pay or receive full payment. They settle their transactions just by paying the difference in prices. Normally, speculation is considered a healthy practice and is necessary for successful operation of stock exchange activity. But, when it becomes excessive, it leads to wide fluctuations in prices and various malpractices by the vested interests. In the process, genuine investors suffer and are driven out of the market. Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as on account of rumours spread by interested parties. This makes it difficult to assess the movement of prices in future and build appropriate strategies for investment in securities. However, these days, good amount of vigilance is exercised by stock exchange authorities and SEBI to control activities at the stock exchange and ensure their healthy functioning, about which you will study later.

1.1.11 Speculation on Stock Exchanges

The buyers and sellers at the stock exchange undertake two types of operations, o one for speculation and the other for investment. Those who buy securities, primarily aiming at earning a regular income from such investments and possibly making some long-term gains on account of price rises in future, are called investors. They take delivery of the securities and make full payment of the price. Such transactions are called investment transactions. But, when the securities are bought with the sole object of selling them in future at higher prices or these are sold now with the intention of buying at a lower price in future, are called speculation transactions. The main objective of such transactions is to take advantage of price differentials at different times. The stock exchange also provides for settlement of such transactions even by receiving or paying, as the case may be, just the difference in prices. For example, Rashmi bought 200 shares of Moser Baer Ltd. at Rs. 210 per share and sold them at Rs. 235 per share. He does not take and give delivery of the shares but settles the transactions by receiving the difference in prices amounting to Rs. 5,000 minus brokerage. In another case, Mohit bought 200 shares of Seshasayee Papers Ltd. at Rs. 87 per share and sold them at Rs. 69 per share. He settles these transactions by simply paying the difference amounting to Rs. 3600 plus brokerage. However, now-a-days stock exchanges have a system of rolling settlement. Such facility is limited only to transactions of purchase and sale made on the same day, as no carry forward is allowed.

1.1.12 Stock Exchanges in India

The first organised stock exchange in India was started in Mumbai known as
Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went upto 7 by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as kerb market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation

of Stock Exchanges in India. At present, we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is the National Stock Exchange (NSE). It is also based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage. Another stock exchange that needs special mention is Over The Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992, specially to cater to small and medium-sized companies with equity capital of more than Rs.30 lakh and less than Rs.25 crore. It helps entrepreneurs in raising finances for their new projects in a cost effective manner. It provides for nationwide online ring less trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalise it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

1.1.13 Regulations of Stock Exchanges

As indicated earlier, the stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, as early as 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the central Government. There is also the provision of framing of proper bylaws by every stock exchange for regulation and control of their functioning subject to the approval of the Government. All stock exchanges are required to submit information relating to its affairs as required by the government from time to time. The Government was given wide powers relating to listing of securities, make or amend bylaws, withdraw recognition to, or superseding the governing bodies of stock exchange in extraordinary/abnormal situations. Under the Act, the Government promulgated the Securities Regulations (Rules) 1957, which provided *inter alia* for the procedures to be followed for recognition of the stock exchanges, submission of periodical returns and annual returns by recognised stock exchanges, inquiry into the affairs of recognised stock exchanges and their members, and requirements for listing of securities.

1.1.14 Role of SEBI

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

(a) protecting the interest of investors in securities;

(b) promoting the development of the securities market;

(c) regulating the securities market; and

(d) matters connected there with or incidental thereto.

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

(i) regulating the business in stock exchanges and any other securities market;

(ii) registering and regulating the working of various intermediaries and mutual funds;

(iii) promoting and regulating self-regulatory organisations;

(iv) promoting investors education and training of intermediaries;

(v) prohibiting insider trading and unfair trade practices;

(vi) regulating substantial acquisition of shares and take over of companies;

(vii) calling for information, undertaking inspection, conducting inquiries and audits of stock exchanges, and intermediaries and self-regulation organisations in the stock market; and

(viii) performing such functions and exercising such powers under the provisions of the

Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government. As part of its efforts to protect investors' interests, SEBI has initiated many primary market reforms, which include improved disclosure standards in public issue documents, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and risk factors associated with their projects while making public issue. All issue documents are to be vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. Merchant bankers and all mutual funds including UTI have been brought under the regulatory framework of SEBI. A code of conduct has been issued specifying a high degree of responsibility towards investors in respect of pricing and premium fixation of issues. To reduce cost of issue, underwriting of issues has been made optional subject to the condition that the issue is not under-subscribed. In case the issue is under-subscribed i.e., it was not able to collect 90% of the amount offered to the public, the entire amount would be refunded to the investors. The practice of preferential allotment of shares to promoters at prices unrelated to the prevailing market prices has been stopped and private placements have been made more restrictive. All primary issues have now to be made through depository mode. The initial public offers (IPOs) can go for book building for which the price band and issue size have to be disclosed. Companies with dematerialised shares can alter the par value as and when they so desire. As for measures in the secondary market, it should be noted that all statutory powers to regulate stock exchanges under the Securities Contracts (Regulation) Act have now been vested with SEBI through the passage of securities law (Amendment) Act in 1995.

1.1.14.1 Self-Check Exercise-II

Q.1 Enlist the advantages of stock exchanges to the investors.

1.1.15 Summary

SEBI has duly notified rules and a code of conduct to regulate the activities of intermediaries in the securities market and then registration in the securities market and then registration with SEBI is made compulsory. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives. Corporate membership has also been introduced at the stock exchanges. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions. SEBI has constantly reviewed the traditional trading systems of Indian stock exchanges and tried to simplify the procedure, achieve transparency in transactions and reduce their costs. To prevent excessive speculations and volatility in the market, it has done away with badla system, and introduced rolling settlement and trading in derivatives. All stock exchanges have been advised to set-up Clearing Corporation /settlement guarantee fund to ensure timely settlements. SEBI organises training programmes for intermediaries in the securities market and conferences for investor education all over the country from time to time.

1.1.16 Glossary

Corporate Governance : The practice by companies to improve management standards and efficiency to satisfy the demands of these shareholders, and following the more stringent rules for public corporations imposed by public stock exchanges and the government.

Speculation : When the securities are bought with the sole object of selling them in future at higher prices or these are sold now with the intention of buying at a lower price in future, they are called speculation transactions.

1.1.17 Exercise Questions:

- Give the meaning of stock exchanges. Explain its functions in detail.
- Explain the role of SEBI in regulating stock exchanges.
- Define stock exchange. Give its advantages and limitations.
- Short notes:
    - Features of stock exchange
    - Stock exchanges in India
    - Speculation on stock exchanges
    - Role of stock exchanges
    - Limitations of stock exchanges

1.1.18 Suggested Readings:

Financial Institutions and Markets : L.M. Bhole

Financial Markets and Services :Gordon and Natrajan

1.1.19 Answers to Self-check Exercises

Self-check Exercise 1:Refer para 1.1.7

Self-check Exercise 2:Refer para 1.1.9

BBA Part-III **Paper : BBA-510**

Semester-V **Stock Market Operations**

Lesson No. 1.2 **Author : Dr Harpreet Kaur**

INTERMEDIARIES AND SECONDARY MARKET MECHANISM

Contents

1.2.1 Objectives of the lesson

After going through this lesson, students will be able to -

- understand the procedure for dealing at stock exchange
- know about the types of functionaries and speculators in the stock exchange - understand the working of BSE and OTCEI

1.2.2 Introduction

The market where existing securities are traded is referred to as the secondary market or stock market. In a stock market, purchases and sales of securities whether of Govt. or semi-govt. bodies or other public bodies and also shares and debentures of joint-stock companies are effected.

1.2.3 Procedure for dealing at Stock Exchanges –

The buying and selling at stock exchanges is not allowed to outsiders . They have to approach brokers who are members of the exchange and the dealings can only be through them. The following procedure is followed for dealings at exchanges:

1. Selection of a broker: The first thing to be done is to select a broker through whom the purchase or sale is to be made . The intending investor or seller may approach his bank for this purchase . The banks have appointed their own brokers at exchanges and they contact for dealings on behalf of their customers on a recommendation from their bank . The clients account is opened by the broker.The bank assures the financial condition of the client.

2. Placing an order: After selecting the broker, the client places an order for the purchase or sale of securities . The broker also guides the client about the type of securities to be purchased and the proper time for it . If a client is to sell the securities then the broker tells him about the favorable time for sale the broker is told to purchase shares, their number and price to be paid sometimes a definite price is given on which the purchase is to be made, sometimes the tentative price is told sometimes the maximum price to be paid is told etc the broker will try to make purchases as far as possible to the nearest price offered by the client the broker is given some choice for bargaining the same type of choice is given to the broker for selling the securities.

3. Making the contract : The trading floor of the stock exchange is divided into different parts known as trading posts . Different posts deal in different types of securities the authorised clerk of the broker goes to the concerned post and expresses his intention to buy and sell the securities a deal is struck when the other party also agrees the bargain is struck by an outery mentioning the price and number of securities contracted by both the clerks the bargain is noted by both the parties in their note books the slip giving brief details of the bargain is put in a box for making announcement in the official price list for publicity.

4. Contact note: The buying and selling brokers prepare notes after their mutual consent next day the seller is sent a selling note and the buyer is sent a buying note the details of securities traded are given mentioning their number price etc.

5. Settlement: The spot dealings are settled there in full the selling broker hands over the transfer form and share certificates to the buying broker after receiving the price the settlement for ready delivery and firward contracts is done with a different procedure.

(1) Settlement of ready delivery contracts: The settlement in different stock exchanges is done between 3 to 7 days of the transaction if the settlement is done by giving actual delivery of securities on receiving the price it is called liquidation in full in another method the dealings are squared by adjusting price differences only.

(2) Settlement of forward delivery contracts: The forward delivery contracts are done for speculative purposes only the active and broad market securities are traded in forward contracts the settlement of forward contracts can bedone in any of the three ways;

(a) Liquidation in full: The securities are delivered and payment is received or vice-versa after crossing all intermediate purchases and sales.

(b) **Liquidation by payment of differences:** The purchases and sale are offset at the ruling price by paying or receiving the difference amount the securities are not delivered, but only the difference of prices contracted and current prices are received or paid as the case may be.

(c) **Carry over to the next settlement:** When the buyer does not want to settle the contract but wants to carry it to a future date then it is called carry over. the buyer will have to pay a certain amount to the seller for this concession and the amount paid is known as 'Badla' or 'Contago charge'.

6. Electronic settlement of trade:

(a) Procedure for selling dematerialised securities

The procedure for selling dematerialised securities in stock exchanges is similar to the procedure for selling physical securities the only major difference is that instead of delivering physical securities to the broker,the investor instructs his depository participant (DP) to debit his demat account with the number of securities sold by him and credit the brokers clearing account the procedure for selling dematerialised securities is given below:

(1) Investor sells securities in any of the stock exchanges linked to depository through a broker.

(2) Investor instructs his dp to debit his demat account with the number of securities sold and credit the brokers clearing account.

(3) Before the pay-in day, broker of the investor transfers the securities to clearing corporation.

(4) The broker receives payment from the stock exchange.

(5) The investor receives payment from the broker for the sale of securities in the same manner as received in case of sale of physical securities.

(b) Procedure for purchasing dematerialised securities

The procedure for purchasing dematerialised securities is also similar to the procedure for buying physical securities.

(1) Investor instructs DP to receive credits into his account in the prescribed form there may be one time standing instruction or separate instruction each time to receive credits.

(2) Investor purchases securities in any of the stock exchanges linked to depository through a broker.

(3) Broker receives payment from investor and arranges payment to clearing corporation.

(4) Broker receives credit of securities in clearing account on the pay-out day.

(5) Broker gives instructions to DP to debit clearing account and credit clients account.

(6) Investor receives shares into his account by way of book entry

7. Rolling settlement

Rolling settlement is an important measure to enhance the efficiency and integrity of the security market the shift from the traditional account period settlement marks an important change in the market design and age old practices in January,1998,sebi had introduced rolling settlement on a voluntary basis on the stock exchanges for securities, which were eligible for dematerialised trading however, as there was hardly any response to the voluntary scheme, SEBI introduced compulsory rolling settlement initially for 10 scrips in January 2000 and then increased the number of scrips in a phased manner to 163 by may 2000 and further to 414 scrips from July 2, 2001 rolling settlement has been introduced in the form of T+5 settlement system where t is t is the trade date and 5 days are given for delivery of securities and cash payments.

In other words, T+5 means delivery and payment will be made five working days later. if trading takes place on Monday to buy 300 shares, it will be settled on Sunday, when payment will be made and delivery of shares received this cycle would be rolling and hence there would be number of set of transactions for delivery everyday as each days transactions are settled in full, rolling settlement helps in increasing the liquidity in the market w.e.f. January 2,2002, all scrips have been brought under compulsory rolling mode.

Advantages of rolling settlement

(1) Rolling settlement system eliminates any scope for speculation and arbitrage.

(2) Rolling settlement system is simple to understand as compared to Badla system it is more transparent and regulated the chances of fraud are very less the investors has to remember the day of purchase or sale.

(3) Rolling settlement reduces the period of settlement of transactions.

(4) There is no risk of fluctuations of transactions.

(5) Rolling settlement ensures standardized settlement (i.e.T+5) process, thus the participants can pay attention to other market factors.

(6) Retail investors are at more advantageous position because Rolling settlement shortens the delays for converting securities into cash.

The success of rolling system depends upon depository, margin trading, strong banking system with electronic fund transfer facility and continuous net settlement of transactions stock markets moved from T+5 to the T+2 system from April 1,2003 and further moved to T+1 system thus at present delivery and payments are made one day after the date of trading.

1.2.4 Screen Based Trading

Screen based trading has been a major development in the secondary market in India it has transformed the character of the entire Indian stock market under this system of trading the computer screen replaces the trading ring and distant participants distributed widely over the country, can trade simultaneously at high speeds this system permits the markets participants to have a full view of the market which increases their confidence and helps to establish greater transparency.

NSE and OTCEI have set up these computerized exchanges some of the benefits of screen based trading include:

(1) By using very small terminals of NSE the members can trade with each other with much more ease and comfort sitting at their door steps.

(2) It provides full information to the investors about the market.

(3) It enables members all over the country to trade with each other simultaneously.

(4) It has avoided the need of the people to assemble on the floor of the stock exchange for trading.

(5) It ensures greater transparency and has increased the confidence of the people.

1.2.5 Functionaries of Stock Exchanges

Functionaries of stock exchanges refer to those persons or individuals or institutions who perform the functions of a stock exchange and who are the registered members of the exchange the following are the various types of functionaries who function at the stock exchange:

(1) Jobbers: Jobbers are security merchants dealing in shares and debentures as independent operators they buy and sell securities on their own behalf and try to earn through price changes jobbers cannot deal on behalf of public and are barred from taking commission they directly deal with brokers who in turn make transactions on behalf of public jobber generally quotes two prices one at which he is prepared to purchase and the other at which he is prepared to sell a particular security the difference between the two prices is the jobbers profit which is technically known as jobbers turn.

(2) Brokers : Brokers are commission agents, who act intermediaries between buyers and sellers of securities they do not purchase or sell securities on their behalf they bring together buyers and sellers and help them in making a deal brokers charge commission from both the parties for their services brokers are the experts in estimating trends of prices and can effectively advise their client in reaching a fruitful gain brokers get orders from investing public and execute the orders through jobbers and they are entitled to a prescribed scale of brokerage the investors who do not know the technicalities of stock exchanges are greatly benefited by the expertise of brokers.

(3) Sub-broker: A sub-broker is an agent of the stock-broker or a person who helps the investors to deal with stock broker a sub-broker is required to submit along with the application for registration a letter of recommendation from a stock broker of a recognized stock exchange and two references one of which should be from his banker.

Eligibility criteria: An individual can act as a sub-broker provided

(1) He is not less than 21 years of age.

(2) He is not convicted of any offence involving fraud or dishonesty.

(3) He has passed 12^{th} standard from a recognised institute.

(4) He is a fit and proper person.

For a firm or a body corporate, the partners or directors should fulfill above first three Conditions. A sub-broker is granted a certificate of registration after the board is satisfied that he fulfills the above said criteria.

(4) Tarawaniwalas: The members of Bombay stock exchange have unofficially divided themselves into two categories: Brokers and Tarawaniwalas.

The latter act both as jobbers and brokers a tarawaniwala makes transactions on his own behalf like a jobber but he may also act as a broker on behalf of the public they indulge in malpractices to earn profits they may sell their own securities to their clients when prices are higher and vice-versa.

The distinction between jobbers of London exchange and tarawaniwalas of Bombay stock exchange is that the former are not brokers whereas the latter may act both as brokers and jobbers section 15 of the securities contract (Regulation)act prohibits such practices it states that no member of a recognised stock exchange shall, in respect of any securities, enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the memorandum or agreement of sale or purchase that he is acting as principal.

(5) Portfolio consultants : Portfolio construction, formulation of investment strategy, evaluation and regular monitoring of portfolio is an art and requires skill and high degree of expertise portfolio consultants possess the requisite skill and experience they advise their clients or direct them or undertake investments on behalf of their clients and manage the same a person is allowed to act as portfolio consultant only if he possesses a certificate granted by SEBI every portfolio consultant has to deposit a fee of Rs.5 lakh as registration fees at the time of the grant of certificate by the board after three years he has to pay a renewal fee of Rs.2.5 lakhs the certificate of registration or its renewal is valid for a period of three years from the date of its issue to the portfolio manager failure to pay fees in the prescribed time will lead to suspension of certificate.

1.2.5.1 Self-Check Exercise-I

Q.1 Enlist the functionaries of stock exchange.

1.2.6 Types of Speculators

There are four types of speculators who are active on stock exchanges in India they are known as bull bear stag and lame duck these names have been derived from the animal world to bring out the nature and working of speculators.

(1) Bull: A bull or tejiwala is an operator who expects a rise in prices of securitieis in the future in anticipation of price rise he makes purchases of shares and other securities with the intention to sell at higher prices in future he being a speculator has no intention of taking delivery of securities but deals only in differences of prices such a speculator is called a bull because of resemblance of his behaviour with the bull a bull tends to throw his victims up in the air similarly a bull speculator tries to raise the prices of securities by placing big purchase orders.

(2) Bear: A bear or Mandiwala speculator expects prices to fall in future and sells securities at present with a view to purchase them at lower prices in future a bear does not have securities at present but sells them at prices in anticipation that he will supply them by purchasing at lower prices in future if the prices move down as per the expectations of the bear he will earn profits out of these transactions just as a bear presses its victims down to the ground the bear speculator tends to force down the prices of different securities when the bear operator starts selling the securities, the bearish pressure gradually forces down the prices.

A bear does not take delivery of securities but takes the difference if prices fall down in case prices rise then he will have to pay the difference between the prices at which he purchased the securities and the prevailing price on the date of delivery a market is said to be bearish when it is dominated by the bear speculators on the other hand there is a strong expectation of fall in prices pessimism prevails in a bearish market in case the prices are not falling as expected by the bears then they may start speculator rumors to pressurise price downwards it is known as bear raid.

(3) Stag: A stag is a cautious speculator in the stock exchange he applies for shares in new companies and expects to sell them at a premium if he gets an allotment he selects those companies whose shares are in more demand and are likely to carry a premium he sells the shares before being called to pay the allotment money.

A stag does not indulge in purchase and sale of shares in the market like a bull and bear he relies only on the allotment of securities to him he applies for large number of shares so that he gets some allotment even if there is heavy over subscription.

(4) Lame duck: When a bear finds it difficult to fulfill his commitment he is called struggling like a lame duck.

A bear speculator contracts to sell securities at a later date on the appointed time he is not able to get the securities as the holders are not willing to part with them in such situations he feels cornered, moreover, the buyer is not willing to carry over the transactions.

1.2.7 Stock exchanges in India:

Despite the fact that unorganized stock market existed in Calcutta since 1830,the first organised stock exchange was set up at Bombay in 1877 under the name of native stock and share brokers association the next stock exchange which emerged in the country was Ahmadabad Share And Stock Brokers Association which was founded in 1894 the third stock exchange was set up at Calcutta in the year 1908 though some more stock exchanges were set up before independence but there was no all India legislation to regulate their working every stock exchange followed its own method of working to rectify this situation and to regulate the working of stock exchanges in the country,the securities contract (Regulation) act was passed in 1956 there were only nine recognised stock exchanges in the country uptil 1981-82.

At present, there are 24 recognised stock exchanges in the country further, over the counter exchange and national stock exchange have also started functioning in our country we have discussed below the important provisions of the securities contracts (Regulation) act,1956, the organisation and growth of stock exchanges, the major stock exchanges in India, the weaknesses of stock exchanges, the role of the newly formed

Securities and exchange board of India (SEBI) in a stock exchange.

1.2.8 Organisation and growth of stock exchanges:

Stock exchanges in India are organised in any of the following forms:

(a) Voluntary, non-profit making associations e.g. Bombay, Ahmadabad and Indore;

(b) Public limited companies such as Calcutta, Delhi and Bangalore stock exchanges; and

(c) Company limited by guarantee e.g. Hyderabad and madras stock.

Only the securities which are listed are traded on the stock exchanges in India a company can list, delist and relist its securities in the stock exchange by paying the stipulated fees transactions on stock exchanges have been carried either on cash basis some exchanges like Ahmadabad and madras have their own clearing houses. The growth of stock exchanges in India has been linked with the growth of corporate sector.

1.2.9 Major stock exchanges in India:

Bombay Stock Exchange (BSE)

Bombay stock exchange was established in 1875 as a voluntary non-profit making association at Mumbai it is Asia's oldest stock exchange and is a major stock exchange in India the exchange has mechanism to redress grievances of investors as well as members it provides informative inputs to the investing public.

(1) Management: A governing board comprising of 9 elected directors (one third to retire every year by rotation) an executive director, three government nominees, a reserve bank of India nominee and five public nominees regulate the working of the exchange however, as per SEBI orders issued in march,2001,the elected directors have been restrained from acting and governing board presently comprises of only 10 directors the executive director acts as the chief executive officer and is responsible for the day to day administration of the exchange.

(2) Working: The members of the stock exchange can trade in the exchange the members can trade on behalf of outsiders if a member trades on his own account then transactions can be only among stock exchange members the shares of listed companies only can be traded at the exchange Bombay stock exchange allows following category of persons for trading:

(1) The commission broker.

(2) The floor broker.

(3) The tarawaniwala, akin to a jobber or specialist.

(4) The dealer in non-cleared securities.

(5) The odd-lot dealer.

(6) The dealer in foreign securities or arbitrageur.

(7) The security dealer or dealer in government securities.

On striking a deal, traders enter appropriate details in small books called souda books at the end of the trading period, all deal details are transferred to a souda sheet which is handed over to the BSE computer department for processing a display board within the ring is used to show the current price of the important shares from time to time SEBI has allowed BSE to extend its trading terminals to outside centres and the Bombay online trading system (Bolt)has enabled it to open trade working stations all over the country.

National stock exchange (NSE):

National stock exchange was incorporated in November,1992 with an equity capital of Rs.25 crores it is not an exchange in the traditional sense where brokers own and manage the exchange NSE is a professionally managed national market for shares, PSU bonds, debentures and government securities with all the necessary infrastructure and trading facilities nse is an electronic screen based system where members have equal access and equal opportunity of trade irrespective of their location in different parts of the country as they are connected though a satellite network the system helps to integrate the national market and provide a modern system with a complete audit trial of all transactions.

Objectives of NSE: The following are the objectives of NSE.

(1) Providing a nationwide trading facility for equities, debt instruments etc.

(2) Ensure equal access to investors all over the country through an appropriate communication network.

(3) Provide fair, efficient and transparent securities market to investors using electronic trading system.

(4) Enable shorter settlement cycles and book entry settlement system.

(5) Attain current international standards of securities market.

Working: The settlement cycle is completed within eight days from the last day of the trading cycle the trading period is a week (Wednesday to Tuesday) and settlement of trade takes place in the ensuing week NSEs clearing corporation stands guarantee to all trades done in the cash market on the exchange and the counter, guarantee of the clearing corporation insures that no default, either of payment or delivery takes place for trade done or NSE.

Over the counter exchange of India (OTCEI)

In India certain stock exchanges have monopolized the capital market there are a large number of small companies which do not get listing at stock exchanges over the counter exchange of India (OTCEI) was established in October,1990 with an objective to provide an alternate market for the securities of smaller companies the government of India has conferred it the status of a recognised stock exchange this exchange has been jointly promoted by UTI,ICICI,IDBI,SBI capital markets ltd IFCI,GIC and Canbank Financial services Ltd. OTCEL promoters have been designated as sponsor members and they alone are entitled to sponsor a company for listing at this exchange before recommending a company for enlistment, such members have to carry out the appraisal of the project to ensure its technological and financial viability they also ensure that all government rules and regulations have been complied with the following are the main features of OTCEI:

(1) It is a ring less and electronic national stock exchange it is an exchange without a specified trading floor.

(2) It caters to the needs of the small business which have so far not met the requirements for listing on the stock exchange.

(3) This exchange has a nation wide reach the market is spread across the country through numerous countries of the operators of the exchange.

(4) Small and medium sized companies with a paid up capital between Rs.30 lakhs and Rs.25 crores can be enlisted.

(5) OTCEI deals in equity shares, preference shares, bonds, debentures, warrants.

(6) The trading is by way of negotiated bidding.

(7) As opposed to traditional ring in the stock exchange the trading here is screen based transactions take place though satellite communication telephone lines.

(8) A company which is listed on any other recognised stock exchange in India will not simultaneously be eligible for listing on the OTCEI.

Advantages of OTCEI: This exchange has the following advantages:

(1) There is transparency in transaction. The bids for purchase and sale are accepted on the screen of the computer, so the clients can see it themselves in other exchanges the deals are done in a ring where clients cannot go.

(2) The liquidity is ensured and a transaction is normally completed in 7 days.

(3) A proper scrutiny is done of the scrips by the sponsors so the securities traded will be good.

(4) A company needing immediate funds can pledge its equity with the sponsor and thereby reduce interest cost.

(5) A company at one gets nationwide listing.

(6) Small and growth-oriented companies would be able to grow faster as they would raise required capital through OTCEI market at a low cost.

(7) The companies listed on OTCEI are subjected to low income tax.

1.2.9.1 Self-Check Exercise-II

Q.1 How is screen based trading different from conventional trading ?

1.2.10 Summary

Stock exchangs are platforms for public debt. They help in mobilising resources from the public for Government and corporates. The advent of technology has revolutionised the trading system in stock exchanges leading to denoteriolisation of securities and online trading. The establishment of NSE and OTCE, have been a step is this direction, which have increased the transparency and speed in settlement of trading.

1.2.11 Glossary

Contact Note : The buying and selling brokers prepare notes after their mutual consent next day the seller is sent a selling note and the buyer is sent a buying note the details of securities traded are given mentioning their number price etc.

Rolling Settlement : A system of settlement which eleminates any scope speculation as net settlement of transactions at stock markets is done at T+1 days i.e. at present delivery and payments are made one day after the date of timing.

Jobbers : Jobbers are security merchants dealing is share and debentures as independent oprators and buy and sell securities on their behalf.

Brokers : They are commission agents, who art as intermediaries between buyers and sellers of securities and do not buy/sell their behalf.

Tarawani Wallahs : They cut as both jobbers and brokers.

Bull : An operator who expects a rise in prices of securities and makes purchase of securities.

Bear : An operator who expects a fall in future and sells securities at present with a view to purchase them at lower prices in future.

Lame Duck : When a bear finds it difficult to fulfill his commitment, he is called struggling like a lame duck.

1.2.12 Exercise Questions :

1. Write a detailed note on the procedure of dealings in stock exchange.
2. Discuss various functionaries of stock exchanges.
3. Discuss major stock exchanges of India.
4. Write notes :
   (i) Rolling Settlement (ii) OTCEI
5. Explain the working of NSE.
6. Enlist the advantages of trading in OTLEI.
7. Write short notes on :
   (a) Bull (b) Bear (c) Lame Duck (d) Contract Note
   (e) Tarawani Wallah (f) Jobbers

(g) Forward Delivery Contract

1.2.13 Suggested Readings:

Financial Institutions and Markets : L.M. Bhole

Financial Markets and Services :Gordon and Natrajan

1.2.14 Answers to Self-check Exercises

Self-check Exercise 1:Refer para 1.2.5

Self-check Exercise 2:Refer para 1.2.4 and 1.2.9

BBA PART-III **PAPER : BBA-510**

SEMESTER-V **STOCK MARKET OPERATIONS**

LESSON NO. 1.3 **AUTHOR : DR. HARPREET KAUR**

NRIPINDER KAUR

STOCK MARKET INDEXES

1.3.1 OBJECTIVES OF THE LESSON

After reading this lesson, students will be able to

- comprehend the methods of computing the stock indices
- understand the construction of stock indices

1.3.2 INTRODUCTION

Market indexes have always been of great importance in the world of security analysis. Investors, both individual and institutional, use the market index as a benchmark against which they evaluate the performance of their own or institutional portfolio. The experts or technicians often base their decisions to buy and sell on the patterns emerging out of the time series data of market indexes. Even economists also use stock market indexes to study the trend of growth patterns in the economy.

An index is a number used to represent the changes in a set of values between a base time period and another time period. A stock index is a number that helps measure the levels of the market. Returns on the Index thus are supposed to represent returns on the market i.e. the returns that an investor can get if he has the portfolio representing the entire market.

1.3.3 METHODS OF COMPUTING THE STOCK INDEXES

Different indexes are computed and compiled for use by the investors. While some indexes employ an equal weighting approach which means equal amounts assumed to be invested in each component and others are either price weighted or value weighted. Both these methods are employed in the compilation of stock and consumer price (cost) indexes. Stock indexes are directly used in security analysis and portfolio management and consumer price (cost) indexes are used in measuring the change of purchasing power but are also useful in security analysis and portfolio management.

1.3.3.1 PRICE-WEIGHTED AND QUANTITY WEIGHTED INDEXES

In price-weighted index, the basic approach is to sum the prices of the component securities used in the index and divide this sum by the number of components. In other words, we compute a simple arithmetic average. To allow for the impact of stock splits and stock dividends, which could destroy the consistency and comparability of price-weighted index data over time, an adjustment of either the reported price data or the advisor itself is required.

Two classical forms of indexes are the Paasche Index and Laspeyres Index. Both of these are used as methods for determining the consumer price index.

$$\text{Paasche Price Index} = \frac{\sum P_{jt}\ Q_{jt}}{\sum P_{jo}\ Q_{jo}} \qquad -----1$$

$$\text{Laspeyers Price Index} = \frac{\sum P_{jt}\ Q_{jo}}{\sum P_{jo}\ Q_{jo}} \qquad -----2$$

Where : P_{jt} price per unit for jth commodity in period t

Pjo = Price per unit of jth commodity in period 0

Qjt = Quantity of jth commodity in period t and

Qjo = the quantity of jth commodity in period 0.

Equations 1 & 2 can be used to construct Fisher's ideal price index :

Fisher's Ideal Price Index :

Fisher's Ideal Price Index = $\left(\dfrac{\sqrt{\sum P_{jt}Q_{jt}}}{\sum P_{jo}}\right)\left(\dfrac{\sqrt{\sum P_{jt}Q_{jo}}}{\sum P_{jo}Q_{jo}}\right)$

Similarly, quantity-weighted indexes can be defined :

Laspeyers quantity index = $\dfrac{\sum Q_{jt}\ P_{jo}}{\sum Q_{jo}\ Q_{jo}}$

Paasche quantity index = $\dfrac{\sum Q_{jt}\ P_{jt}}{\sum Q_{jo}\ Q_{jt}}$

Fisher's ideal quantity index = $\left(\dfrac{\sqrt{\sum Q_{jt}P_{jo}}}{\sum Q_{jo}P_{jo}}\right)\left(\dfrac{\sqrt{\sum Q_{jt}P_{jt}}}{\sum Q_{jo}P_{jt}}\right)$

1.3.3.2 VALUE-WEIGHTED INDEXES :

After discussing the indexes of quantity as well as price, it would be appropriate to define total cost of consumer's purchases in terms of cost Index :

Cost Index = $\dfrac{\sum P_{jt}\,Q_{jt}}{\sum P_{jo}Q_{jo}}$

The cost index is the basic form used for compiling the value-weighted stock index. The standard form of value weighted stock indexes is expressed

Stock index = $\dfrac{\sum P_{jt}\,Q_{jt}}{\sum P_{jo}Q_{jo}}$

Therefore, changes in the index level could be result of either price changes or volume changes.

1.3.4 IMPORTANCE/USES OF STOCK MARKET INDEX :

1. It acts as barometer for market behaviour.
2. It is used to benchmark portfolio performance.
3. It helps to allocate scarce resources to the best performed companies reflect through best performed scrips.
4. It is used as a forecasting tool to predict the future movement of stock indices and also the business cycles.
5. It is used in derivative instruments like index futures and index options.
6. It can be used for passive fund management as in the case of index funds.

1.3.5 STOCK INDICES OF BSE AND NSE

1.3.5.1 INDICES OF BSE

(i) **Sensex :** The stock index which is very popular in BSE is sensex. It is otherwise called BSE sensitive index. The base year for this index is April 79. It is index of 30 stocks including a sample of large, well established and financially sound companies. It is also the oldest index of Indian stock market, it provides time series data over a fairly long period of time (since 1978-1999).

(ii) **BSE National Index :** Base year of this index is 1982-84. This index is made up of 100 scrips. The special feature of this index is that it includes prices of scrips on other stock exchanges of Delhi, Calcutta, Ahmedabad and Madras and the average of these prices is selected as price of scrips for compilation of the index.

(iii) **BSE 200 :** This index was introduced in May 1994. The base year of this index is 1989-90. 200 companies selected on the basis of market capitalisation, volume of turnover and strength of the companies' fundamentals for this index.

(iv) **Dolex :** It is form of BSE 200. In this index the rupee value is converted into Dollar value so that it may be useful to foreign investors. In Dollex, the BSE-200 is modified by dividing the current rupee market value by the Rupee-Dollar Conversion Rate.

(v) **BSE-500 :** It was introduced in 1999 with the base year 1999 itself. It is considered to be a standard index covering all sections of the economy as well as the major part of capitalisation.

(vi) **IPO Index :** The BSE has launched IPO index, the first of its kind in India recently. Main aim of this index is to track the value of companies for two years from the date of their listing after their initial Public offers. According to BSE, IPOs of companies with a free float market capitalization of INR 100 crore and above on its first day of listing would be included in the index and Follow-on Public offers would be excluded. Some international IPO's indices are Dow Jones STOxx IPO Index, FISE Renaissance IPO index, NYSE IPO composite index and Bloomberg IPO index.

(vii) **Green Index - BSE Green X :** This is the first index of this type which is based on actual performance in the energy efficiency front. It has been co-developed with g Trade, a domestic sustainability firm working on financial innovations in energy efficiency. It gives weightage to both energy efficiency and profitability. It includes 20 stocks taken from BSE 100. This index mainly targets the retail as well as institutional investors who looks for investment in stocks with strong long term prospects and develop green financial products. In fact, companies which are able to balance energy efficiency and profitability give better returns for investors.

1.3.5.2 INDICES OF NSE :

NSE index is popularly known as CNX index. All MSC indices are prepared by the India Index Services and Products Ltd. (IISL). It is joint venture between NSE, CRISIL and Standard & Poors. The CNX stands for the following :

C stands for CRISIL

N stands for NSE

X stands for Index

S & P with any index indicates that it is supported by Standard &Poors also.

1.3.5.3 Self-Check Exercise-I Q.1

What is price-weighted index ?

1.3.6 MAJOR CNX INDICES :

(i) S & P CNX Nifty : It is a very popular index of NSE. It was introduced in April 96 with 96 as the base year. It is a well-diversified 50 stock index accounting for 23 sectors of economy. The main purposes of index are benchmarking fund portfolios, index based derivatives and index funds. Total traded value of all nifty stock is 70% of value of all the stocks traded on NSE. Nifty stocks represent about 59% of the total market capitalisation. S&P CNX index is professionally maintained and is ideal for derivatives trading.

(ii) S&P CNX Diety : It is nothing but S&P CNX Nifty expressed in dollars and hence, it is basically a dollar dominated index. This is mainly intended for foreign investors. It is computed at an online - Rupee-Dollar exchange rate.

(iii) S&P CNX 500 Equity Index : It is purely a market capitalisation weighted index. It comprises of 500 stocks covering 79 industries. It covers 97 percent of the total turnover in BSE and 73% of total market capitalisation.

(iv) CNX Midcap 200 Index : This index covers the stocks of Midcap companies whoses market capitalisation between Rs. 150 crore to Rs. 1000 crore.

(v) NSE Govt. Security Index : This index is meant for all Govt. of India Bonds issued after April 1992 but redeemed after 1997. The base date of this index is Ist January, 1997. New issues are added to the index while the old ones can be removed as soon as they are redeemed.

(vi) CNX Segment Indices : This index reflects the stock market performance of various segments of the Indian Corporate Sector like multinationals, PSUs etc.

1.3.7 CONSTRUCTION OF STOCK MARKET INDEX

Each Stock Market Index has a base which is the starting of Index. It is not necessary to have only one year as base year, but we can take an average of the past few years as base e.g. S&P 500 Index of NYSE takes average market value of 1941, 1942 & 1943 as base period. The base period is taken to be 1, 10 or 100.

1.3.7.1 PRINCIPLES TO BE FOLLOWED WHILE CONSTRUCTING A STOCK INDEX :

There are some principles to follow while constructing a stock market index and these principles are meant to be followed in all types of indices, like wholesale price index, consumer index etc. These principles are :

1. **Sample Size :** Size of the sample should be large. It should statistically significant with respect to its representation of the population. It should also be the representative of various interests or major sectors. Representativeness has nothing to do with the number of securities in the sample as a sample of one

stock can be highly representative if the population is made up of highly homogeneous securities. In India, BSE sensex is the most popular index but include only 30 stock.

2. Weighting : For constructing an Index one must be clear about the choice of weighting. On one hand there is equal weighted index which gives equal weight to each & every stock in the index, on the other hand there is market value weighted index which uses the market capitalisation of the companies to determine the security's weight in the index e.g. NSE Nifty.

3. Uniform Definition : Uniformity or standardisation helps in meaningful comparison over different periods of time e.g. the term 'total return' means not only the difference between the share prices of two periods but also the cash flows on account of dividend. It would not be appropriate to use the term "total return" for a mere change in stock prices over the period. It is better to use any other term like "percentage price change" or "returns from price change".

4. Continuous purchase in sale of stocks :

All the stock, included in index, should be bought and/or sold on continuous basis.

1.3.8 CLASSIFICATION OF SECURITIES TO BE INCLUDED IN THE INDEX :

Three factors to be considered before including securities in index.

(i) The security should be regularly traded and should also have consistant record of profitability over the years.

(ii) The stock should have market capitalisation.

(iii) The index should perferably include scrips from all major sectors like Banking, IT, Infrastructure, Pharmaceuticals etc.

(iv) The Index should be representative of all the stocks.

The following table gives the composition of the BSE Sensex and the Nifty.

Stock Market Index Composition (2002)

	BSe Sensex % Weights in Index		**NSE Nifty % Weights in Index**
* FMCG	23.5	FMCG	20.2
Pharmaceuticals	11.4	Pharmaceuticals	8.5
Oil & Gas	18.7	Oil & Gas	4.2
Finance	15.9	Finance	11.1
IT **	18.7	IT	23.2
Transport	9.3	Transport	12.6

Metal	5.8	Metal	20.2

* Fast moving consumer goods ** Information Technology

1.3.9 BSE CLASSIFICATION

Group A : Stocks belonging to BSE National Index & Sensex.

Group B1 : Stocks with good market capitalisation

Group B2 : Stocks with low Market Capitalisation

Group Z : Stocks which have violated the listing requirement due to any reason e.g. non-payment of listing fee, non-declaration of results and so on.

Group T : Includes only theses stocks which can do "trade for trade" trading & these stocks are under constant surveillance.

1.3.10 How are Stocks Selected by Indices

We have understood that indices are ways and means to group the best of the stocks as they impact the economy the most and are the best gauge to understand the markets in general. However, we also need to know how a stock market index in India selects stocks.

How do indices arrive at a value : When an entire index, for e.g. like a sensex or a nifty goes up or down, it means that stocks comprising those indices have performed better or worse. This does not mean that if a company, say Reliance Industires Ltd. (RIL) which is listed in both, Nifty and Sensex, goes up by say 4% during a trading session, the index will not corresondingly go up by 4% because there are other stocks in the index as well which may have gone up or down and influenced the movement of the index. On any given day, not all sectors in the economy are doing well. An index's total value cannot be a simple addition of all m-cap values because not all stocks carry the same weightage in the index. How will the weights be assigned depends on the stock selection strategy put in place?

The are primarily two factors by which stocks are picked :

a) Market-Capitalization : Companies with the largest market-cap are picked and groupted together in an index when the M-cap is the premise of the stock selection strategy. Companies with the largest m-cap have a bigger weightage on the index's value while stocks with a small m-cap do not influence the index as much. Indian indices mostly use free-float market capitalization for assigning weights to their stocks.

How is free float m-cap different from full m-cap : M-cap is the total value of the company measured in the outstanding shares it has issued. Free float m-cap, which the indices use to weigh stocks, excludes shares held by promoters.

For example, Reliance Industries Ltd. (RIL) has the highest free float m-cap as on April 20 closing data so it has the highest weightage among other stocks that from sensex. So a movement in RIL, positive or negative, will have a higher impact than a positive or negative movement in other stocks.

b) Price : There are also some indices in the world that use price to give weightage to stocks in an index. An example of this would be Japan's Nikkei 225. Companies with a higher stock price have a higher weightage and impact the index more than the lower valued stocks.

1.3.11 Need of Indices

The basic premise of having indices is to make trading easy for investors. Imagine a stock market where one does not have such categories. It is just an open marketplace where all the stocks listed on the exchange are available for purchase, One does not know which stocks listed on the exchanges are available for purchase, one does not know which stock has a higher m-cap, you do not know which stocks have lower value and which are the 'better' stocks. All investors will be roaming around like headless hunters. This is where the importance of stock market indices is realized. They make it easy for you to trade by grouping them and making their visibility stronger.

Here are a few reasons why having indices is an essential component of stock market investments :

Grouping /Sorting : As mentioned above, having all the stocks grouped together in an organised fashion and selected by a certain strategy, such as free float m-cap in this case, makes it easier to see the best of the stocks in one place. Let's consider sensex as an example. S&P BSE sensex is a collection of 30 stocks, S&P BSE 100 is a collection of 100 stocks and S&P BSE 500 is a collection of 500 stocks. These indices help you to see the top stocks by way of m-cap in one place.

Sometimes you may just want to see how a certain sector is doing. For example, in current times where a pandemic has gripped the entire world and stock markets are down, you may be curious about how the health sector is doing. In the absence of indices, you would have to individually hunt for all pharmaceutical companies, collate them together and do your own math. However, grouped indices like Nifty Pharma and S&P BSE Healthcare do that job for you.

Assessing Stock and Market Performance : Not ony does sorting help you to pick your stocks but also guides you in the process thereafter. Having organized indices help you to find answers to if a stock is performing better than the benchmark stock market index, if a certain stock is riskier than the others, if it is performing better or worse than the others listed along with it in the index, has the stock performed better or worse than the others belonging to its sector and many such questions. Indices are a great way to have a record of how the stock performs individually and comparatively.

Indices have a plethora of information on stocks. Price history, volume changes, peer to peer comparison, sector performance, volatility, and a sense of where the market is moving. If a collection of the 30 or 50 best companies is showing an uptrend or a downtrend it speaks volumes on how the stock market is doing in general.

Reflects Investor Sentiment :

Index	YTD Performance (year to date)*
Nifty 50	-26.59%
S&P BSE Sensex	-26.07%

* As on April 20 closing session

If we refer to the table above, we can see that in the calendar year 2020, Nifty 50 has dropped 26.59% and Sensex by 26.07% in the last 4.5 months. This speaks a lot about

investor sentiment. Coronavirus has shaken investor confidence and global economics. With job loss, industry shutdowns and the lockdown imposed, people have lower confidence in the markets and do not consider them as safe havens anymore.
Currently, the market is indicating a negative investor sentiment.

In the absence of indices, you would not be able to get this figure in a jiffy and would have to do your own calculation, siphon off the best and worst-performing companies from a list of 1,000 companies.

1.3.11.1 Self-Check Exercise-II

Q.1 Which factors are considered before including securities in index ?

1.3.12 Summary

Stock market indices are the bread and butter of the investment milleu. It is not just an added advantage but a necessity. In its absence, the investment world would have been mayhem of investors flocking around for good stocks to invest in. The importance of stock market indices rests in making investment easy.

1.3.13 Glossary

BSE Sensex : The stock index which is most popular and consists of 30 stocks of financially sound companies.

Green Index : This is the index which is based on actual performance is the energy efficiency front.

Market Capitalisation : It is the total value of the company measured is the outstanding shares it has issued.

IPO Index : This index tracks the value of companies for 2 years from the date of their listing after their initial public offers.

1.3.14 Questions for exercise

1. Write short note on:

I. Sensex

II. Dolex

III. Market-Capitalization

IV. IPO Index

2. What are the functionaries of Stock Exchange?

3. Explain the procedure for dealings at stock exchange.

4. Explain the growth of Stock Exchanges

5. What are the Major CNX Indices?

1.3.15 Suggested Readings:

Financial Institutions and Markets : L.M. Bhole

Financial Markets and Services :Gordon and Natrajan

1.3.16Answers to Self-check Exercises

Self-check Exercise1:Refer para 1.3.3.1

Self-check Exercise:Refer para 1.3.10

BBA Part - III | Paper : BBA-510
Semester-V | Stock Market Operations
LESSON NO. 1.4

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

1.4.1 Objectives of the Lessson

* To understand the need for SEBI
* To explain the fuctions and powers of SEBI
* To analyse the role of SEBI in regulating stock markets of India.

1.4.1 Introduction

The Securities and Exchange Board of India (SEBI) was established in 1988 to regulate and develop the growth of the capital market. SEBI regulates the working of stock exchanges and intermediaries such as stock brokers and merchant bankers, accords approval for mutual funds, and registers Foreign

'Courtesy : School of Management Studies', Punjabi University, Patiala.

Institutional Investors who wish to trade in Indian scrips. Section 11(1) of the SEBI Act propounds that it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

SEBI regulates the business in stock exchanges and any other securities markets and the working of collective investment, schemes, including mutual funds, registered by it. SEBI promotes investor's education and training of intermediaries of securities markets. It prohibits fraudulent and unfair trade practices relating to securities markets and insider trading in securities, with the imposition of monetary penalties, on erring market intermediaries. It also regulates substantial acquisition of shares and takeover of companies and calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self-regulatory organizations in the securities market.

SEBI has introduced a few reforms, but the stock brokers have been slow to accept the need for reforms. Reform measures include improved transparency, computerisation, enactment against insider trading, improved capital adequacy, restrictions on forward trading and provisions to encourage corporate membership in the stock exchanges. The restriction on forward or Contango trading, referred to in India as 'Badla' has been met with cynicism. New measures include provision for cash margin and need for physical transfer on settlement date.

1.4.3. Management of the Board

As per Section 4 of the SEBI Act, 1992 as amended by the Securities and Exchange Board of India (Amendment) Act, 2002, the Board shall consist of the following members viz.

(a) A chairman;

(b) 2 members from amongst the officials of the Ministry of the Central Govt. dealing with finance and administration of the Companies Act, 1956;

(c) 1 member from amongst the officials of RBI.

(d) 5 other members of whom atleast 3 shall be the whole time members to be appointed by the Central Govt.

The Chairman and members referred to clauses (a) and (d) shall be appointed by the Central Govt. and the members referred to in clause (b) and (c) shall be nominated by the Central Govt. and RBI respectively. The chairman and other members shall be persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration, which in the opinion of the Central Govt., shall be useful to the Board.

Term of Office and Conditions of Service

The term of office and other conditions of service of the Chairman and members appointed by the Central Govt. shall be such as may be prescribed. Removal of Member of Office

The Central Govt. shall remove a member from office if he

(a) is or has any time been adjudicated as an insolvent.

(b) is of unsound mind as declared by a competent court.

(c) has been convicted of an offence involving moral turpitude.

(d) has so abused his position as to render his continuation in office detrimental to the public interest (Section 6).

Meetings

The Board shall meet at such places and times and shall observe such rules of procedure in regard to the transaction of business at its meetings as may be prescribed by regulations. Decisions at the meeting are to be made by a majority vote of the members present and voting, and in the event of any equality of votes, the chairman or a presiding member has a second or casting vote. (Section 7)

1.4.4. Functions of SEBI

U/s Section 11 of the SEBI Act, the basic duty of SEBI is :

(a) to protect the interests of investors in securities.

(b) to promote the development of, and to regulate the securities market. The following functions are performed by SEBI :

(i) regulating the business in stock exchanges and any other securities markets;

(ii) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers etc.;

(iii) registering and regulating the working of depositories, participants, custodians of securities, FIIs, credit rating agencies and such other intermediaries as the Board may, by notification specify;

(iv) registering and regulating the working of the venture capital funds and collective investment schemes including mutual funds;

(v) promoting and regulating self regulatory organisations;

(vi) prohibiting fraudulent and unfair trade practices relating to securities markets;

(vii) promoting investor's education and training of intermediaries of securities markets.

(viii) prohibiting insider trading in securities;

(ix) regulating substantial acquisition of shares and take-over of companies;

(x) call for information from undertaking inspection, conducting inquiries and audits of stock exchanges, mutual funds, other persons associated with the securities markets, intermediaries and self regulatory organisations in the securities markets;

(xi) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Govt.;

(xii) levying fees or other charges for carrying out the purposes of this section;

(xiii) conducting research for the above purposes;

(xiv) performing such other functions as may be prescribed.

1.4.5. Role of SEBI

Up to 1992, the capital primary market was controlled by the Controller of Capital Issue (CCI) formed under the Capital Issues Control Act. During that period, the pricing of capital issues was controlled by CCI. The premium on issue of equity shares issued through the primary markets was done in accordance with the Capital Issues Control Act.

The CCI guidelines were abolished with the introduction of Securities and Exchange Board of India (SEBI) formed under the SEBI Act, 1992 with the prime objective of protecting the interests of investors in securities, promoting the development of, and regulating, the securities market and for matters connected therewith or incidental thereto.

SEBI was formed to promote fair dealing in issue of securities and to ensure that the capital markets function efficiently, transparently and economically in the better interests of both the issuers and investors.

The promoters should be able to raise funds at a relatively low cost. At the same time, investors must be protected from unethical practices and their rights must be safeguarded so that there is a steady flow of savings into the market. There must be proper regulation and code of conduct and fair practice by intermediaries to make them competitive and professional.

Since its formation, SEBI has been instrumental in bringing greater transparency in capital issues. Under the umbrella of SEBI, companies issuing shares are free to fix the premium provided adequate disclosure is made in the offer documents.

1.4.5.1 Self Check Exercise

1. Discuss the functions of SEBI.

1.4.6. Role of Intermediaries

Many intermediaries are involved in connection with the public issue. Following are the intermediaries who have to be registered with SEBI and must have valid certificate from SEBI to act as intermediaries :

- Merchant Bankers
- Registrar and Share Transfer Agents
- Bankers to the Issue
- Underwriters
- Stock Brokers and Sub-Brokers
- Depositories.

Merchant Bankers play the most vital role amongst all intermediaries. They assist the company's right from preparing prospectus to the listing of securities at the stock exchanges. Merchant Bankers have to satisfy themselves about the correctness and propriety of all the information provided in the prospectus. It is mandatory for them to carry due diligence for all the information provided in the prospectus and they must issue a certificate to this effect to SEBI. A Company may appoint more than one Merchant Banker provided inter- se allocation of responsibilities between the Merchant Bankers are properly structured.

Underwriters are those intermediaries who underwrite the securities offered to the public. In case there is undersubscription (in short, the company does not receive good response from public and amount received from public is less than the issue size), underwriters subscribe to the unsubscribed amount so that the issue is successful.

Registrar & Share Transfer Agent processes all applications received from the public and prepare the basis of allotment. The despatch of share certificates/refund orders are handled by them.

Bankers to the Issue are banks which accept applications from the public on behalf of the company. These applications are then forwarded to Registrar and Share Transfer Agent for further processing.

Stock Brokers and Sub-Brokers are those intermediaries who through their contacts/sources invite the public for subscribing shares for which they get commission.

Depositories are the intermediaries who hold securities in dematerialised form on behalf of the shareholders. Regulation of Stock Exchange Securities Securities :

Several public sector undertakings have issued "debt instruments" commonly known as PSU bonds. These bonds are securities as defined under the SCR Act. Interest earned on some of these PSU bonds are not liable to income tax.

Euro-Issues :

A larger number of Indian companies are considering the issue of Euro- issues in order to finance their foreign exchange requirements. Blue chip companies initially allowed to enter the market included Grasim Industries and Tata Iron. Several international bankers and other organisations have approached the above companies indicating their keenness to price and underwrite the issues. Securities :

Several public sector undertakings have issued "debt instruments" commonly known as PSU bonds. These bonds are securities as defined under the SCR Act. Interest earned on some of these PSU bonds are not liable to income tax.

1.4.7. Powers of SEBI

- Regulating the business in stock exchanges and any other securities markets.
- Registering and regulating the working of collective investment schemes, including mutual funds.
- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Promoting investor's education and training of intermediaries of securities markets.
- Prohibiting insider trading in securities, with the imposition of monetary penalties on guilty market intermediaries.
- Regulating substantial acquisition of shares and takeover of companies.
- Calling for information from, carrying out inspection, conducting inquiries and audits of the stock exchanges and intermediaries and self-regulatory organizations in the securities market.

- Carry forward deals permitted only on stock exchanges, which have screen based trading system.
- Transactions carried forward cannot exceed 25% of a broker's total transactions on any one day.
- 90-day limit for carry forward and squaring off allowed only till the 75th day (or the end of the fifth settlement).
- Daily margins to rise progressively from 20% in the first settlement to 50% in the fifth.

1.4.8. Penalties And Adjudication Under SEBI :

1. Penalty for failure to furnish information, return etc

If any person, who is required under this Act to furnish any document, return or report to the Board or fails to maintain books of accounts or records then he shall be liable to a penalty of one lakh rupes for each day during which such failure continues or one crore rupees, whichever is less.

2. Penalty for failure to redress investor's grievances :

If any listed company or any person who is registered as an intermediary, after having being called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees w.e. is less.

3. Penalty for default in case of stock brokers under this Act :

(a)fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker

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1. The words "by prohibiting options and" omitted by the Securities Laws (Amendment) Act, 1995, w.e.f. 25-03-1995.
2. The Act came into force on 20th February, 1957 vide Notification No.SRO 528, dated 6 February, 1957 published in Gazette of India, Extraordinary, Part II, Section 3, Page 549, dated 16 February, 1957.
3. Inserted by Securities Laws (Second Amendment) Act, 1999 vide Gazette notification dated December 16, 1999.

(b) charges as amount of brokerage, which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charge in excess of the specified brokerage, whichever is higher.

4. Penalty for Insider Trading :

If any insider who -

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information or

(ii) communicates as unpublished price sensitive information to any person, with or without his request for such information, except as required in the ordinary course of business or under any law, shall be liable to a penalty of Rs. 25 crores or three times the amount of profits made out of insider trading whichever is higher.

5. Penalty for non-disclosure of aquisiton of shares and takeovers :

If any person, who is required under this Act, or any rules, fails to -

(i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate;

(ii) make a public announcement to acquire shares at a minimum price, he shall be liable to a penalty of Rs 25 crores or three times the amount of profits made out of such failure, whichever is higher.

6. Penalty for fraudulent and unfair trade practices :

If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of Rs 25 crore rupees or three times the amount of profits made out of such penalties, w.e. is higher.

1.4.9. The Securities Contracts (Regulation) Act, 1956

An Act to prevent undesirable transactions in securities by regulating the business of dealing therein, (***)[1] by providing for certain other matters connected therewith. Be it enacted by Parliament in the Seventh Year of the Republic of India as follows :

4. Ibid.
5. Ibid.
6. Substituted for "(ii) Government Securities; and" by the Securities and Exchange Board of India Act, 1992, w.e.f. 30-01-1992.
7. Substituted for the following :
 (i) "Spot delivery contract" means a contract which provides for the actual delivery of securities (Contd.)

Preliminary

Short title, extent and commencement

1. (1) This Act may be called the Securities Contracts (Regulation) Act, 1956.
 (2) It extends to the whole of India.
 (3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette appoint.[2]

Definitions

2. In this Act, unless the context otherwise requires :
 (a) "contract" means a contract for or relating to the purchase or sale of securities;
 (aa) "derivative" includes :

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

B. a contract which derives its value from the prices, or index or prices, of underlying securities;[3]

(b) "Government security" means a security created and issued, whether before or after the commencement of this Act, by the Central Government or a State Government for the purpose of raising a public loan and having one of the forms specified in clause (2) of section 2 of the Public Debt Act, 1944 (18 of 1944);

(c) "member" means a member of a recognised stock exchange;

(d) "option in securities" means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call in securities;

(e) "prescribed" means prescribed by rules made under this Act;

(f) "recognised stock exchange" means a stock exchange which is for the time being recognised by the Central Government under section 4;

(Contd. From Page 9) and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;" by the Depositories Act, 1996 (22 of 1996), w.e.f. 12-08-1996.

8. Supra n.3.

(g) "rules", with reference to the rules relating in general to the constitution and management of a stock exchange, includes, in the case of a stock exchange which is an incorporated association, its memorandum and articles of association;

(ga) "Securities Appellate Tribunal" means a Securities Appellate Tribunal established under sub-section (1) of Section 15K of the Securities and Exchange Board of India Act, 1992.[4] (h) "Securities" include :

(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instruments issued by any collective[5] investment scheme to the investors in such schemes;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and[6]

(iii) rights or interests in securities;

[(i) spot delivery contract means a contract which provides for, –

(a) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;

(b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository;][7]

(j) "stock exchange" means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

2A. Words and expressions used herein and not defined in this Act but defined in the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 shall have the same meanings respectively assigned to them in those Acts.[8]

1.4.9.1 Self Check Exercise

1. What are the penalties under SEBI?

1.4.10. Capital Issue Guidelines

In the case of new companies with foreign equity participation, the public offer should not be less than 20% of the issued capital, and the Indian promoter's share should not be more than 40% of the issued capital. For new companies without any foreign equity participation, the public offer is required to be at least 60% of the issued capital.

Finance Companies would be eligible to make an issue only if they have a minimum track record of 2 years operations or they have been granted registration as a non-banking financial company by RBI or as an intermediary by SEBI. Stock exchanges are required to ensure that the companies concerned, have a valid acknowledgement card issued by SEBI. SEBI vets the offer document, to ensure that all disclosures have been made by the company, in the offer document, at the time the Company applies for listing of its securities to the stock exchange.

Following the abolition of the office of Controller of Capital Issues and the consequent removal of administrative control over the pricing of new issues, the capital markets now enjoy a considerable degree of freedom. New companies, being set up by existing companies, with a five year track record of profitability, are free to price issues, provided the participation of the promoters is not less than 25% of the equity of the new company and the pricing is made applicable to all new investors symmetrically.

Where a new company is set up, existing private sector companies along with a state level agency, or a government company, or a foreign collaborator, it will be sufficient if the private sector companies alone satisfy the requirements of five year track record of profitability. Existing profitable companies issuing capital for augmenting their own capital base are free to price their issue. At the same time, the practice of making preferential allotment of shares, unrelated to the prevailing market prices was stopped by SEBI. In any capital issue to the public, there is a specified minimum capital contribution to be made by the promoters.

To reduce the cost of the issue, underwriting by issues has been made optional, subject to the condition that if an issue is not underwritten, and is not able to collect 90% of the amount offered to the public, the entire amount collected would be refunded to the investors.

Where fully convertible debentures (FCDs) are to be issued, the interest rate can be freely determined by the issuer. Companies are required to create a Debenture Redemption Reserve (DRR) equivalent to 50% of the amount of debenture issue before debenture redemption commences.

SEBI's intention of passing on some part of its responsibility to the lead managers is reflected in the new guidelines announced in May 1995. The major decisions were :

SEBI has decided to stop vetting of rights issues all together. The onus of this responsibility will now rest with the lead managers. The procedure for clearance would be that the merchant banker would have to file the offer document with SEBI six weeks prior to the proposed date of offer of rights issue. If SEBI does not ask for clarifications within 21 days from the date of filing, the company and the lead manager can proceed with the issue.

SEBI revised the guidelines for reservation in public issues. As per the new guidelines which took effect from 1 June 1995, half of the net public offer should be reserved for small applicants, i.e. those applying for less than 1,000 shares/securities. The other half would be reserved for the corporate applicants.

A committee comprising chiefs of senior executive directors of the five divisions of SEBI has been formed which will clear all public issues which are more than Rs.1 billion. Formerly, all the issues were cleared by the primary markets division. Issues less than Rs.200 million would be cleared by the division chiefs, those between Rs.200 million and Rs.500 million by the executive directors and those between Rs.500 million and Rs.1 billion by the senior executive director.

1.4.11. Book-Building

SEBI guidelines define book-building as a process undertaken by which a demand for securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for determination of the quantum of such securities to be issued by means of a notice circular, advertisement, document or information memoranda or offer document. Book building is a process used in Initial Public Offer (IPO) or efficient price discovery.

1.4.12. Stock Exchange Market in India - An Introspection

After the collapse of US markets and the global technology sector, many were skeptical of the future of software exporters. However, Indian firms (especially the better run ones) are now benefiting from an increased focus on outsourcing, driven by the cost-cutting imperatives of multinationals.

More importantly, the depth and breadth of outsourced jobs is increasing, as companies move up towards consulting and R&D, and sideways towards BPO. The business is no longer about sending programmers abroad, but managing mission-critical services for clients.

1.4.13. Summary

We all have our own views on the ideal reform agenda. While some argue that agriculture should be the first priority, others push for labour flexibility. Yet others criticise the opening up external trade, before we have achieved free trade within our own borders. Regardless of this healthy difference of opinion, few will question the basic need for reform. Our economy is inefficient, our social and physical infrastructure is dismal, our people are poor, uneducated and lack healthcare, housing and nutrition. To change this, massive reform is required.

The stock markets recognise and reflect this reality. Barring the IT sector, which is independent of the domestic economy, the rest of the market is more in tune with policy change than individual company performances. Though the latter are reflected in share prices, gains are invariably capped by an overall ceiling, which depends more on macro-perceptions than current sector or company performance. This is why broad market valuations remain at lows, despite improving performance in a large number of sectors. Just look at the recent surge in banking stocks. Though only a fraction of the bad debt is recoverable and may take years to encash, the mere passage of the Securitisation bill led to a bull run in bank stocks, especially PSUs.

Given existing political realities, it makes sense to focus on other important reforms, like VAT, rationalisation of the power sector, reduction of subsidies, removal of internal trade bottlenecks, especially in agriculture, and so on. Government ownership of corporates, while a big drag on the economy, is only one of the ills of our system. Even as politicians milk the issue to prop up media coverage, it might serve as a good screen and allow other vital reforms to continue in the background. If this happens, it might well provide the trigger for the Sensex in 2019.

1.4.14. Answers to Self Check Exercises

Self Check Exercise 1 : Refer Para 1. 4.4

Self Check Exercise 2 : Refer Para 1.4.8

1.4.15. Glossary

- Insider Trading: A person who has access to unpublished price sensitive information and makes profit on the basis of this information is insider and trading is called insider trading.
- Book-Building: Book building is a process used in Initial Public Offer (IPO) or efficient price discovery.
- Depositories: Depositories are the intermediaries who hold securities in dematerialised form on behalf of the shareholders.
- Stock Brokers and Sub-Brokers: Stock Brokers and Sub-Brokers are those intermediaries who through their contacts/sources invite the public for subscribing shares for which they get commission.

- Underwriters: Underwriters are those intermediaries who underwrite the securities offered to the public. In case there is undersubscription (in short, the company does not receive good response from public and amount received from public is less than the issue size), underwriters subscribe to the unsubscribed amount so that the issue is successful.
- Registrar & Share Transfer Agent: They processes all applications received from the public and prepare the basis of allotment. The despatch of share certificates/refund orders are handled by them.

1.4.16. Questions for Exercise

1. What was the need for the setting up of SEBI?
2. Discuss the various powers and functions of SEBI.
3. Enlist the penalties that can be imposed for offences under SEBI.
4. Discuss the role of intermediaries under SEBI.
5. How does SEBI regulate capital market?
6. Write short note on:
    a. Insider trading
    b. Depositories
    c. Underwriters
    d. Merchant Bankers
    e. Registrars
    f. Book Building

1.4.17. Suggested Readings

Financial Institutions and Markets : By L.M Bhole

Financial Markets and Services : By Gordon and Natrajan

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Note: Students, kindly click this google form link, and fill this feedback form once.