

- 2 i) Controller of Capital Issues
 ii) Short-term, long-term
 iii) seven
 iv) convertible debentures
 v) private placement
 vi) incorporation
- 3 i) iii ii) vi iii) i iv) v
 v) ii vi) iv
- C 1 i) development ii) 25 iii) 15 iv) refinances v) 10, 10, SFC
 2 i) False ii) True iii) False iv) False
 v) True vi) True vii) False viii) True
 3 i) True ii) False iii) False iv) False
 v) False vi) False vii) False
- D a) iv b) iv c) iii d) ii

6.9 TERMINAL QUESTIONS

- 1 Briefly explain the meaning of: (a) Money Market, (b) Capital Market, and (c) New Issue Market.
- 2 Mention the sources from which companies may raise long-term finance. Distinguish between investment companies and investment trusts as sources of long-term finance.
- 3 What is meant by private placement of shares? Is private placement possible for debentures also?
- 4 Is it compulsory to seek the consent of the Controller of Capital Issues before offering shares and debentures to the public? What are the conditions to be fulfilled if a company wants to issue debentures to the public?
- 5 What do you understand by the term development bank? State the functions of two all-India development banks.
- 6 State briefly the functions of the Unit Trust of India.
- 7 What is a leasing company? How can a company secure long-term finance through a leasing company? What do you understand by 'sale and lease back'?
- 8 Write explanatory notes on the following:
 - a) Retained profits as a source of long-term finance.
 - b) Foreign sources of long-term finance.
 - c) Restrictions on investment in shares by non-resident Indians.
- 9 What is meant by 'Underwriting' of shares and debentures? How does it help companies in raising long-term finance? Discuss briefly the terms and conditions relating to underwriting of shares and debentures.
- 10 A public company issuing debentures and shares has entered into an underwriting agreement with IFCI. The agreement covers the issue of 1,00,000 equity shares of Rs. 10 each and 50,000 debentures of Rs. 100 each. Underwriting commission is payable at the maximum rate allowed under the Companies Act. Public Subscription has been secured for 70,000 shares and 40,000 debentures. The balance of shares and debentures are taken up by the underwriters. Calculate the amount of underwriting commission to be paid.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not send your answers to the university. These are for your practice.

UNIT 7 STOCK EXCHANGES

Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 What is a Stock Exchange?
- 7.3 Functions of Stock Exchanges
- 7.4 Method of Trading on a Stock Exchange
- 7.5 Types of Dealings in a Stock Exchange
- 7.6 Some Important Terms
- 7.7 Listing of Securities on a Stock Exchange
- 7.8 Speculation and Stock Exchange
- 7.9 Factors Affecting Prices in a Stock Exchange
- 7.10 Advantages and Shortcomings
 - 7.10.1 Advantages
 - 7.10.2 Shortcomings
- 7.11 Regulation and Control of Stock Exchanges
- 7.12 Let Us Sum Up
- 7.13 Key Words
- 7.14 Some Useful Books
- 7.15, Answers to Check Your Progress
- 7.16 Terminal Questions

7.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning and importance of stock exchange
- state the economic functions of stock exchanges
- explain the method of trading on a stock exchange
- describe the terms used and types of dealings conducted at the stock exchanges
- describe the importance of listing
- explain the meaning of speculation
- identify the factors responsible for fluctuations in the prices of securities at the stock exchanges
- enumerate the advantages and shortcomings of stock exchanges
- appreciate the need to regulate and control stock exchanges
- explain the provisions of the Securities Contracts (Regulation) Act, 1956.

7.1 INTRODUCTION

In Units 5 and 6 you have learnt about the need for capital and the sources of short-term and long-term finance. You also know that companies raise capital by issuing shares or debentures known as **corporate securities**. Like companies, the central and state governments also issue bonds or instruments known as **government securities** to raise funds from the public. So do various other authorities like Port Trusts, Municipalities and public undertakings. Most investors hold securities to earn income by way of interest or dividend. But many of them might decide to sell them either to meet their urgent financial needs or to reinvest those funds in some other securities with a promise of better income. Similarly, people with accumulated savings or the institutions having surplus funds may also like to invest their funds in various securities.

If some investor wants to sell securities, he has to find another person who is interested to buy. But it is not easy to find ready buyers. Even if he finds one, the buyer may take advantage of the seller's urgency to sell and offer a lower price. A similar problem may be faced by a buyer also. Buyer may not be able to find a ready seller. Even if he finds, the seller may quote a high price knowing the buyer's eagerness to invest. Thus, both buyers and sellers have problems of identifying each

other and arriving at a mutually satisfactory price. It would be very convenient if buyers and sellers could meet at one place to solve their problem. The stock exchange is such a place. Stock exchange is an organisation which provides facilities for the purchase and sale of existing securities.

In this unit you will learn about the meaning of the stock exchange, its importance, the procedure of dealing at stock exchange, and regulation of stock exchanges in India.

7.2 WHAT IS A STOCK EXCHANGE ?

If you break up the expression 'Stock Exchange', you get two words: one is 'Stock' which means a part or fraction of the capital of a company, and the other is 'Exchange' which means a market for purchasing and selling. Thus, we can describe the stock exchange as a market or a place where different types of securities are bought and sold. It not only deals in shares and debentures but also in various other types of securities issued by central, state and local governments as well as institutions like Unit Trust of India, Steel Authority of India, National Thermal Power Corporation, etc. Therefore, it is also called 'securities market' or 'securities exchange'. It is a secondary market of securities because only the securities already issued are allowed to be dealt with on the floor of a stock exchange.

This market is open only to members, most of whom are brokers acting as agents of the buyers and sellers of shares, debentures and bonds. A stock exchange is generally organised as an association or a society or a company. The membership of the stock exchange is restricted to a certain number, and new members are admitted only when there are vacancies. Every member has to pay the prescribed membership fee.

The Securities Contracts (Regulation) Act, 1956 has defined stock exchange as an 'association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in Securities'.

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

K.L. Garg has described the stock exchange as 'an association of persons engaged in the buying and selling of stocks, bonds and shares for the public on commission and guided by certain rules and usages'.

Based on the above discussion and definitions, we can identify the characteristics of stock exchange as follows:

- 1 Stock exchange is an organised market.
- 2 Securities (shares, debentures, bonds, etc.) issued by central, state and local governments, municipalities, port trusts, public utility concerns, joint stock companies and public corporations are bought and sold on the floor of a stock exchange.
- 3 In a stock exchange, transactions take place between members or their authorised agents on behalf of the investors.
- 4 In a stock exchange all transactions are regulated by the rules and bye-laws of the concerned stock exchange.

There are fourteen stock exchanges in India in different cities and towns viz., Bombay, Calcutta, Madras, Delhi, Ahmedabad, Hyderabad, Indore, Bangalore, Cochin, Kanpur, Pune, Ludhiana, Gauhati and Jaipur. They all function in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956.

Check Your progress A

1 Tick mark the correct answers.

- a) Stock Exchange is a market where there is buying and selling of
- i) gold, silver and bullion. ()
 - ii) commodities. ()

- iii) securities. ()
- iv) all the above. ()
- b) Securities traded in the stock exchanges are issued by
 - i) joint stock companies. ()
 - ii) central government. ()
 - iii) public trusts. ()
 - iv) all the above. ()
- c) The buyers on a stock exchange are
 - i) government. ()
 - ii) companies. ()
 - iii) investors. ()
 - iv) none of the above. ()

2 Explain the meaning of a stock exchange.

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7.3 FUNCTIONS OF STOCK EXCHANGES

Stock exchange, being a part of financial market, plays a very important role in the economic development of the country. Let us now examine the functions of stock exchanges from the economic point of view. These functions may be enumerated as (a) primary functions, and (b) secondary functions,

Primary functions

- 1 Marketability and price continuity:** The stock exchange provides for easy marketability of securities as securities can be bought and sold conveniently on the floor of the stock exchange. Since transactions take place regularly, there is continuity in the dealings. Prices quoted are duly recorded and reported in the newspapers for the benefit of investing public. Besides, price fluctuations are also moderated because of the continuity of buying and selling.
- 2 Mobilising surplus savings:** Stock exchange is an integral part of the capital market of a country. It is because through stock exchanges the savings from all parts of the country are made available to the industrial and commercial undertakings for meeting their financial requirements.
- 3 Barometer of economic and business conditions:** The intensity of buying and selling of securities and the corresponding rise or fall in the prices of securities reflect the investors' assessment of the economic and business conditions. Thus, during periods of economic and business prosperity prices of securities tend to rise. Conversely, prices tend to fall when there is economic stagnation or when business activities slow down as a result of depression in the markets. Indeed, change in security prices are known to be highly sensitive to changing economic, social and political conditions. In the words of Alfred Marshall, the well known economist. stock exchanges are not merely the chief theatres of business transactions, they are also barometers which indicate the general conditions of the atmosphere of business.
- 4 Mobility of capital:** Stock exchanges furnish an open and continuous market for securities. Savings invested in securities are converted into cash for reinvestment in other securities. Thus, stock exchanges provide mobility to capital and facilitate sound investment.
- 5 Contribution to capital formation:** Savings are encouraged when people come to

know about the avenues of investment. Stock markets educate investors as regards where and how to invest their savings for a fair return.

- 6 Shock absorber: Stock exchanges bring about equilibrium in the prices of securities which are bought and sold by speculators. Speculators generally buy securities in anticipation of rise in the prices. As a result of their buying, prices do not decline as low as might have been the case without their buying. Again when prices are high, speculators sell securities in anticipation of decline in the prices. Their selling prevents price rising too high. Thus, speculative activities regulate excessive price fluctuations.
- 7 Sifting process: Investors generally prefer to invest their savings after proper assessment of the relative risks and returns associated with different securities. The comparative advantages and disadvantages of investment in various types of securities may be grasped by investors from the dealings which take place on the stock exchanges. Hence they can pick and choose from among different securities and make investment decisions on a sound basis.
- 8 Facilitates resource allocation: As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises. Thus the existence of stock exchange provides for mobility of funds i.e. movement or flow of funds in the economy as a whole. Industries which have potentials of growth are able to attract the savings of people towards their ventures relatively more than those which have no such prospects. Thus, financial resources of the economy are allocated on a reasonable basis. It is said that "without the stock exchange, the savings of the community, the sinews of economic progress and productive efficiency, would be used much less completely and be much more wasteful, than they are now".

Secondary Functions

- 1 Safety of investment and equity in dealings: The stock exchanges do not allow trading in each and every company's securities. Companies which want their securities to be traded on the floor of a stock exchange have to fulfil certain conditions. The stock exchange satisfies itself about the genuineness and soundness of the company to protect the investors from being cheated. There are a wide variety of securities. The investors have the opportunity to assess the relative advantages of investing in securities of companies dealing in various products (engineering goods, consumer goods, etc.) having wide markets and situated in different parts of the country. Every region or state and every industry gets a fair share of the investor's attention for investment of their savings.
- 2 Easy liquidity: The investors usually prefer liquidity of their investment i.e., easy conversion into cash, besides adequate return on their investment. The stock markets provide that assurance to investors. These are markets which facilitate buying and selling of securities. As such the investors readily come forward to subscribe to new issues. Thus, stock exchange assures liquidity of investments which goes to serve the investor's need.
- 3 Accurate and continuous report regarding sales: All stock exchanges maintain regular record of the securities traded each day and the prices at which deals are finalised. This information is supplied to newspapers and other information media alongwith the prices of important securities which ruled at closing time. The statistics relating to prices at which securities were traded are published in weekly bulletins for the information of the investors. This information helps in ascertaining the trend of price fluctuations and promotes healthy speculation.
- 4 Full information regarding listed companies: The organised stock exchanges collect information about the companies listed with them and publish the information in the form of "Official Year Book". This proves very useful to the investors in making investment decisions.
- 5 Helpful in re-investment decisions: The investors sometimes want to switch their investments from one type of securities to others depending on which will be more rewarding. If shares or debentures of a company are in greater demand there is a rise in their market price indicating that the investors have assumed the company's performance and prospects to be better than others. On the other hand, if shares or debentures are offered for sale by many, the price tends to fall indicating that

investors are not satisfied with the earnings and future prospects of the company. **Thus**, changes in the prices of securities provide a fair index of demand and supply of securities of **particular** companies. The investors can make their investment decisions accordingly.

- 6 Safeguards to investors: Every stock exchange has its own rules and regulations for the control of operations of the exchange. Only members are allowed to deal in securities and make transactions. As the members have to transact their business strictly according to the rules, the investors' interests are safeguarded against dishonesty or malpractices.

7.4 METHOD OF TRADING ON A STOCK EXCHANGE

All the securities issued by companies and other bodies are not permitted to be quoted on a recognised stock exchange. Only the listed securities are permitted to be traded. You will study about listing of securities in detail later in this unit. Only members of the stock exchange or their authorised agents can buy or sell securities on the floor of the stock exchange. Suppose you want to buy or sell securities you have to contact a stock broker who is a member of the stock exchange.

When you wish to buy some shares you have to place an order with the broker for the purchase of those shares. You can also depend upon the broker for selecting the type of securities you should buy. After taking the decision about the securities you are to buy, you have to deposit the estimated cost of the securities with the broker.

The broker usually entrusts the task to his authorised clerk in the hall of the stock exchange who announces his requirement by 'shouting in the hall' during the time allotted for dealings in the particular class of securities. He will announce the particulars of the securities, the quantity required as also the price which he offers. Some other broker shall respond to your broker's call. He will either accept the offer made by your broker or may make a counter call/offer. Through such process the bargain/deal is struck,

Each broker has a note book, known as sauda bahi, on which he obtains the signature of the broker from whom he has bought the securities. The signature is obtained as a confirmation of the transaction by the other party. At the end of the day, every broker submits his copy of the transactions recorded in his book to the stock exchange. This is done to reconcile all purchase transactions with those of sales. On the settlement day, the broker takes the delivery of the securities and makes the necessary payment.

You have to pay to your broker the cost of securities purchased and the commission. This commission is a fixed percentage as per the schedule fixed by the stock exchange. The broker prepares a contract note in favour of the client and forwards it to him. The contract note mentions the quantity and the description of the securities bought and the price (inclusive of his commission) at which they are bought.

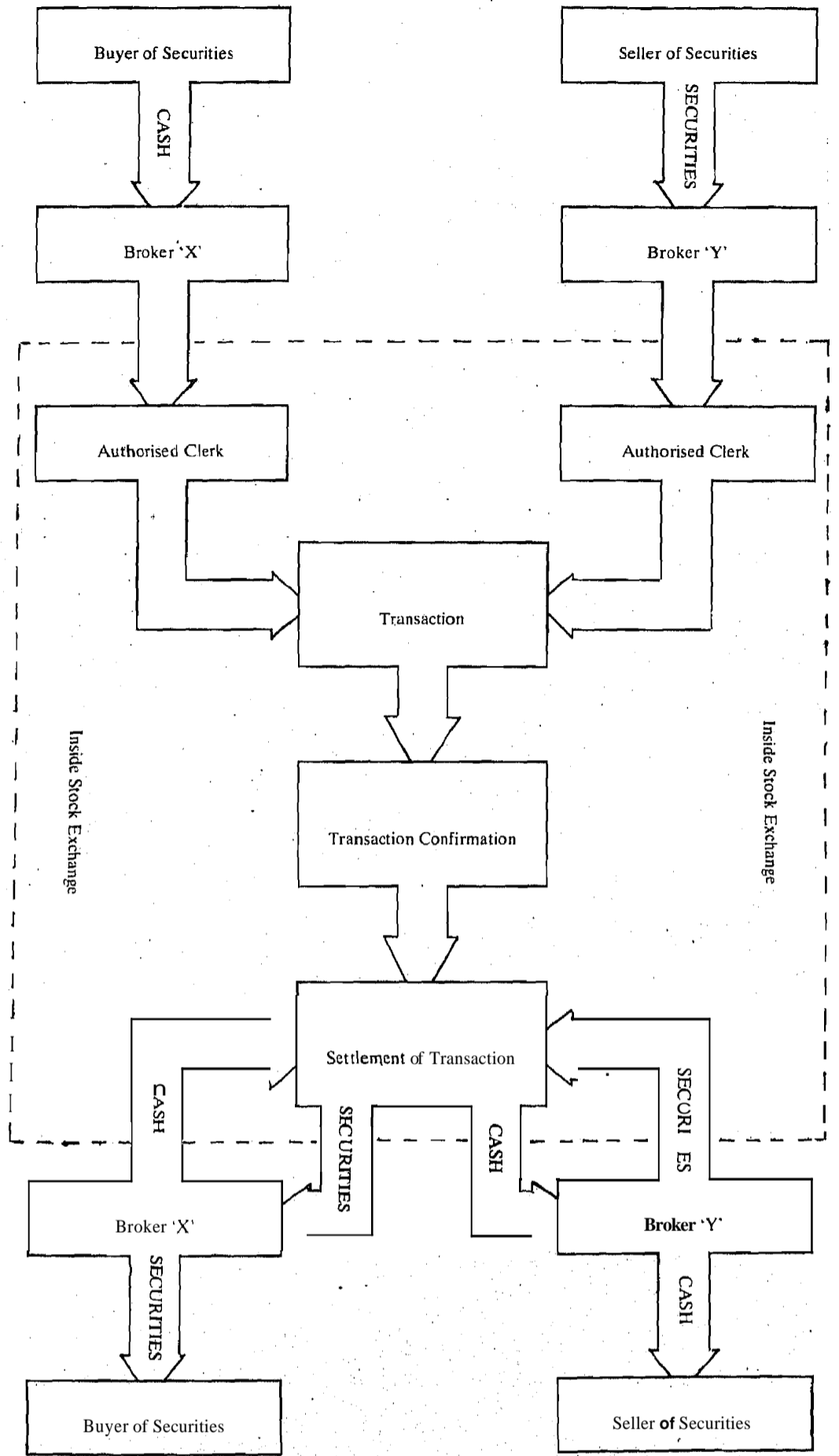
A similar procedure is followed when some security is to be sold. Look at figure 7.1 which depicts the process of purchase and sale of securities in the stock exchange.

7.5 TYPES OF DEALINGS IN A STOCK EXCHANGE

There are various types of dealings in stock exchanges. Let us now discuss about them briefly.

- 1 Spot delivery contracts: Such contracts are settled on the spot i.e., the delivery and payment are made on the day of the transaction itself or latest by the following day. It is not a common practice now-a-days.
- 2 Ready delivery contracts: Such contracts are settled within a short period of time. Usually the period allowed is twelve days and the settlement takes place on the following settlement day. No postponement is allowed in case of ready delivery contracts.

Figure 7.1 : The Process of Purchase and Sale of Securities in the Stock Exchange



3 Forward Delivery Contracts: Such contracts are also due for settlement on the following settlement day but they can be postponed to the next settlement day, if so desired. This facility is provided by the stock exchange only in those scrips which are included in the specified list (List A). Such transactions are meant for speculation where the buyer has no intention to take delivery and make payment. He simply covers it by another transaction and earns or loses the difference in prices.

For example Mr. Sanjay buys 1,000 shares of Modi Rubber at Rs. 50 per share in the hope that its price will go up. If the price rises as expected, he will settle it by a transaction for sale of 1,000 shares and pocket the difference. If the price falls, he may decide to settle it by a transaction for sale at a lower price and pay the difference. Alternatively, expecting the price to rise, he may seek postponement of its settlement to the next settlement day by paying the necessary charges. Technically, such postponement is known as 'Carry Over' or '**Badla**' and the charges paid are called '**badla** charges' (also known as **contango** or backwardation as explained later in this unit). Sometimes the professional badlawalas may advance the necessary sum of money to finance purchase of shares by the hull speculator at certain rate of interest and thus help him to postpone the sale.

Forward delivery contract is not the same **thing** as future trading. Future trading means entering **into** a transaction to sell or buy at a future **date**. **This** kind of trading is prohibited in India.

7.6 SOME IMPORTANT TERMS

The terminology used by the operators on the stock exchange is somewhat different from what is commonly used in business. The terms have been adopted for official records as well as reports on stock exchange transactions.

Bull or Long: A person who buys securities in the expectation of a rise in their prices, is called 'Bull'. He becomes active whenever there is anticipation of a rise in the prices of securities. He buys with the object of selling them in future. He is also known as tejiwala. If his expectations come true, he earns a profit. If the market goes against his expectation, he incurs a loss. Suppose, he makes a deal for purchase of 100 shares at Rs. 105, expecting it will go up. On the settlement day the price of the share rises to Rs. 110. He informs his broker to settle the deal. He earns a profit of Rs. 500. On the other hand, if the market price of the share goes down he may incur a loss on settlement of the transaction. In such a situation he can postpone the settlement due to unfavourable price by paying **budla** charges (also called **contango**). He is called 'bull' as he has a tendency to raise the price artificially like a bull who generally throws his victim upwards.

Bear: A person who sells short i.e., sells what he does not possess at the time of selling, is called a 'Bear'. He does so in the hope of buying at a lower price at the time of delivery. Thus a bear anticipating a fall in price in future sells at the current price which is high. If his expectations come true, he gains, otherwise he loses. If the market goes against him i.e. if the market prices rises, he can postpone his settlement by paying **badla** charges (also called backwardation). A sale of securities by bears is called 'short selling'. He has to buy them from the market for making delivery to the buyer.

Stag: A person is called a 'stag' if he deal's in the new issues of companies. He applies for shares on the basis of prospectus, and sells these shares at a premium soon after the allotment is made to him. He is just like a bull, since he also foresees a rise in the price of the securities. He applies for a big allotment, since he has to pay only application money to the company at the time of application. A stag sometimes creates artificial demand for the securities in the market so as to cause a rise in their prices. If the response for such shares is poor, and he is allotted all the shares applied for, then he has to sell these shares at a discount. In such conditions he sustains loss.

Contango: **Budla** charges paid by a bull to the broker for carrying over his transaction to the next settlement date, is called 'contango', **Contango amount**

depends upon the class of securities, their quantity, value, and interest rates prevailing in the market at the time of transaction. Usually it is equivalent to the 'middle price' of the difference between the agreed price and the market price prevailing on the day of the settlement.

Backwardation: This is also a type of **badla** charge payable to the bull by the bear seeking postponement of the transaction to the next settlement date.

Cum-Dividend: Cum means 'with' or 'including'. Where shares are quoted as Cum-Dividend, the buyer gets a right to receive the dividend on such shares which is payable after the date of sale. The purchase price includes the amount of dividend due. This is because the buyer becomes a registered shareholder and he is entitled to get dividend as and when it is declared by the company. Most transactions in securities are cum-dividend.

Ex-Dividend: This term refers to the price of shares purchased without the right to get the dividend from the company. The dividend declared or accrued is payable to the person whose name appears in the books of the company. Hence, when the buyer purchases the shares after the closure of the books of the company, he buys them ex-dividend.

Cornering: Cornering refers to the condition in the market in which almost the entire supply of a particular security is held by an individual or a group of individuals. In such a situation the bears find it difficult to buy them to meet their commitments of delivering the scrips. This term also refers to purchase of securities by an outsider in large quantities in order to oust the existing management of a company or to put them in an embarrassing situation.

Margin Trading: It refers to the practice of buying and selling securities by depositing with the broker a certain percentage of the value of the securities involved in the transaction. The percentage of value so deposited is called 'Margin Money' or 'Margin'. The objective is to meet the loss, if any, out of this deposit. When the margin money is deposited, the broker credits the Margin Account of the customer. Deposit of margin money is a precondition for the securities to be held on account of the client. Where the margin falls short of the amount of loss suffered by the client on the securities held in his account, the broker may ask the client to deposit additional amount to cover the shortfall. In case he does not deposit such amount, the broker can sell the securities and recover the amount.

Arbitrage: Buying in one market where the price is low and selling the same securities in another market where the price is comparatively higher is termed as 'Arbitrage Operation'. Such dealings confer all the benefits of a continuous market, and bring the divergent prices of various stock exchanges to a uniform level. The scope of operations of the stock exchange is also expanded through such operations. The prices are equalised subject to the cost of communication and transfer of funds from one place to another..

Rigging the Market: When the prices of particular shares are artificially forced up in the market, it is known as 'Rigging'. This is generally the result of activities of bulls (speculative buyers) who raise the demand and thereby push up the market price. Those who hold large blocks of shares often buy and sell to make the market active and then gradually unload their holdings at a profit.

Settlement Day: In every stock exchange a particular day is fixed for the settlement of transactions between buyers and sellers. This day may be every Monday or every Saturday of the week. In other words, there is a weekly settlement. The speculators may settle their deals on a particular settlement day or postpone it to the next settlement day on payment of the 'badla' charges. As stated earlier, postponement of settlement is allowed only in case of shares included in the specified list (List A) of the stock exchange concerned.

Blank Transfer: When shares are sold, the seller has to sign a transfer deed giving necessary particulars about the shares and the transferee. It also involves stamp duty which is payable at the prescribed rates. When the deed is filed with the company, the transfer is duly registered and the name of the transferee is recorded in place of that of the transferor. However, when the seller signs the transfer deed without

filling in the name of the transferee it is known as 'blank transfer'. This type of transfer is found to be convenient where the speculators carry over their deals involving temporary purchase and sale of securities. Blank transfer permits speculators to buy and sell securities without paying stamp duty for some time. This tends to encourage excessive speculation. Hence, to discourage blank transfers it is required that the transfer deed in a prescribed form must be presented to the Registrar of Companies before it is signed by the transferor. The date of presentation is endorsed on the deed. Thereafter, the transfer deed must be delivered to the company for registration of the transfer within a certain period. In the case of listed securities, it must be delivered before the first closure of the Register of Members after the date of presentation endorsed on it. In the case of non-listed securities the deed must be delivered within two months from the date of presentation endorsed on it.

List A Securities or Specified Securities: In every stock exchange, there are certain specified securities in respect of which carry over facility is permitted. These securities are known as 'List A Securities' or 'Specified Securities'.

List B Securities or Cash Securities: Securities other than List A Securities are known as 'List B Securities' or 'Cash Securities'. The transactions in such securities have to be settled within a limited period. No postponement is allowed.

Jobber: There are two types of members in the London Stock Exchange known as brokers and jobbers. Every member of the London Stock Exchange has to declare whether he will act as a broker or a jobber. A broker is to act on behalf of the customers and derive his income through the commission he will charge on the purchase and sale of the securities. He is not allowed to buy or sell in his own name. The jobber, on the other hand, is an independent dealer in securities. He can purchase and sell securities in his own name and deal with a broker or with another jobber. He does not work on behalf of non-members. The distinction between a broker and a jobber is not followed in India. The member of the stock exchange can act as a broker and also buy and sell in his own name. At the Bombay Stock Exchange the members are unofficially divided into two categories: (i) **brokers**, and (ii) **tarawaniwalas**. A member who acts both as a broker and a jobber is known as 'Tarawaniwala'. In India most members fall in this category.

Check your Progress B

1 You want to buy 100 scrips of Gama Ltd. State the various stages through which you have to proceed for the purpose.

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2 What is the difference between Spot Delivery Contract and Ready Delivery Contract?

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3 What is a Forward Delivery Contract?

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4 State whether the following statements are True or False.

- i) Stock exchange provides liquidity to investment.
- ii) Fluctuations in the value of securities reflect the economic and business conditions in the country.
- iii) Stock exchange does not lead to excessive speculation.
- iv) Buying of securities in one market where price is lower and selling the same in another market where the price is higher is called arbitrage operation.
- v) Stock exchanges facilitate capital formation in the country.

5 Fill in the blanks.

- i) A person who buys securities in the expectation of a rise in the price is called
- ii) Ready delivery contracts are settled within days of the transaction.
- iii) If the settlement is deferred at the request of the seller, the budla charges he pays is called
- iv) Artificial forcing up of the market price of a particular share is called
- v) Scrips are usually sold dividend.

7.7 LISTING OF SECURITIES ON A STOCK EXCHANGE

We have stated earlier that all securities issued by companies and other bodies are not traded in stock exchanges but only the listed securities are traded. Now, let us discuss in detail about this listing. Listing means addition of new securities to the existing list of securities being traded on a stock exchange. If a joint stock company or any other body who has issued new securities want them to be traded on the floor of stock exchange and their prices duly published, it has to get the securities included in the list of the stock exchange. For listing, the company has to make an application and furnish the prescribed information to the stock exchange. Section 19 of the Securities Contracts (Regulation) Rules 1957 lays down the minimum requirements with respect to the listing of securities on a stock exchange. **Listing implies that the securities have met the satisfaction of stock exchange authorities, in respect of certain prescribed standards of legality, security and work-manship.** When a security is admitted to dealings on a stock exchange, it does not guarantee the soundness or profitability of the company, in any manner. It is also not a certificate of the stock exchange for consideration by the investors. However, it indirectly gives an impression to the investor that the quoted security can be considered for investment, as the issuing company has satisfied the management of the stock exchange by fulfilling the required conditions and that there is no concealment. Listing provides a reasonable basis upon which the investor may assure himself about the genuineness of the company.

Advantages of Listing: The main advantage of listing of securities is that the investor gets all the required information about the securities he wants to buy or sell. Certain other advantages of listing are:

- 1 It provides a continuous market for securities.
- 2 It enhances the prestige of the company.
- 3 It provides an indirect check against manipulation of prices by the management.

From the point of view of a company, listing of securities is beneficial in two ways: i) it enhances credit worthiness of the company, and ii) it widens the market of the securities. From the point of view of investors, listing provides safety of dealing and liquidity.

But listing of securities of a company does not guarantee the financial soundness of a company. It also does not recommend the purchase of securities. It only **indicates that at the time of listing the company was legally incorporated and was solvent as a going concern.** This creates a favourable climate for the securities listed.

The word 'speculation' is derived from the Latin word 'speculare' which means 'to see from a distance or take a decision in anticipation of future happenings'. However, in the share market, it means dealing in securities keeping in view the present and future prices with the object of making profits from the difference of the two prices. Emery of USA has stated the meaning of speculation in the following words: "Speculation consists of buying and selling commodities, or securities, or other property, in the hope of a profit from anticipated changes of value" Speculative transactions are different from investment transactions. Graham, Dodd and Cottle have explained the difference between speculation and investment as follows:

"Investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculation".

You can very well understand this difference if you know the working of a stock exchange. The stock exchange provides an arrangement for the marketing of listed securities which are also called 'scrips'. The actual functioning of this market consists of buying and selling of these scrips. The buyers and sellers undertake two types of operations; one for investment and the other for speculation. Those who buy securities so as to earn a regular income from the investment are called 'genuine investors'. They get delivery of the scrips on payment of the price. Such transactions are called investment transactions. In the second type of transactions, the object is to deal in the difference of price. The buyers buy scrips with the object of selling them in future at a profit, or sell now in the expectation of buying at a lower price in future. They are known as speculators and their transactions are known as speculative transactions.

Speculation and Investment: Even though speculation and investment are different in some respects, in practice it is very difficult to say who is a genuine investor and who is a pure speculator. Buyers and sellers are partly speculators and partly investors. There is a difference of degree only, Let us take the following example. A buyer agrees to purchase 100 shares at Rs. 110 per share. On the settlement date, the price goes up to Rs. 120 per share. The buyer may either ask the seller to deliver 100 shares and pay him at the rate of Rs. 110 and complete the transaction, or ask the seller to pay the difference of the two prices i.e. the price prevailing on the date of transaction (Rs.110) and the price prevailing on the date of settlement (Rs.120). If he insists on the delivery of shares, we may call it an investment transaction. But, if he settles the transaction by taking up the difference of Rs. 10 per share, it will be called a speculative transaction. Sometimes, a person who purchased shares with the intention of investment may decide to sell the shares and reap the benefit if the price of shares goes up very high. On the other hand, if the price declines very low, he may decide to sell to avoid heavier loss. Thus, a genuine investor may also think of buying and selling securities and take advantage of changes in the prices over time. But he cannot be called a speculator because his intention is to invest and not to make profit out of changing prices.

Speculation and Gambling: One may be inclined to think that speculation and gambling are synonymous. No doubt, speculation and gambling have some common features. For instance, both depend upon uncertain happenings of the future, both involve risk of loss, and both lead to gain for someone and loss for another. In spite of these similarities, however, we can make the following distinctions.

- 1 Speculation is based on foresight while gambling does not involve use of foresight.
- 2 In speculation the intention is to gain from difference in prices while gambling is purely based on betting, either winning the bet or losing it.
- 3 The risk of loss is assumed and anticipated in speculation while gambling artificially creates risk of loss.
- 4 Speculation is a rational activity, based on reasoning while gambling is a kind of blind or reckless activity.
- 5 Speculation is a recognised activity, while gambling is a punishable act.

7.9 FACTORS AFFECTING PRICES IN A STOCK EXCHANGE

The prices of securities, particularly those of equity shares, sometimes fluctuate very widely and critically. The changes in price take place mainly because of buying and selling activities of speculators. But underlying their speculative dealings, there are one or more other factors responsible for the price fluctuations. Generally speaking, the fluctuations are due to the following factors.

- 1 **Interest rate:** If there is a change in the rate of interest charged by banks on loans and overdrafts, there is a change in the speculative activities, and security prices also change as a consequence of it. Thus, if banks allow credit at lower interest rate, it may induce people to borrow money from banks and engage more in speculative activities to make profits. Hence, price of securities may go up as a result of speculative buying. However, if the interest on bank credit goes up, borrowing will be reduced and demand for securities will be relatively lower. Hence prices of securities will tend to go down.
- 2 **Activities of the financial institutions:** When financial institutions start buying securities on a large scale, prices tend to move up because it leads to high expectation among the public about the prospects of the company and there is increased demand all around. Similarly, if there is large scale selling of securities by financial institutions, the price tends to go down.
- 3 **Performance of the company:** The prospects of a company as regards future profits and dividend payment are often reflected in the rising or falling prices of its shares. This is because the profit earning capacity and expected dividend rates influence the expectations of investors about the rate of return on investment and future rise in prices. If the prospects are good, there is increased demand for shares, and prices move up. On the contrary, if a company's performance in terms of profit earning and dividend payment shows an unsatisfactory trend, the price of its shares start declining due to reduced demand.
- 4 **Business cycles:** Business conditions are periodically found to be subject to prosperity and depression. Prices of securities continue to rise during prosperity as bull speculators are active and go on purchasing securities. However, when speculators are unable to meet their liabilities due to lack of adequate funds, they are forced to bargain for sale as a result of which prices rapidly decline and cause a state of depression in the market.
- 5 **Changes in Board of Directors:** Sometimes, security prices change as a result of changes in the Board of Directors of particular companies. The death or resignation of a well known director may cause doubt or apprehension about the future prospects of the company concerned. In that situation, generally, there would be an adverse effect on the price of shares of that company.
- 6 **Sympathetic fluctuation:** The prices of securities traded in more than one stock exchange often change due to changes in another exchange. If the prices of some securities fall in one stock exchange due to some particular reason, it leads to a decline in the prices of the same securities in other exchanges too. This happens due to immediate communication among speculators.
- 7 **Political events:** Changes in the composition of government, changes in international relations, conflicts and political upheavals and wars between nations are always found to cause changes in the securities prices. This is because conditions of business and industry are generally affected by political events.
- 8 **Changes in government policy:** The changes in government policy with regard to taxation, import-export, price controls, licensing, etc. also influence the prices of securities. For example, if government decides to exempt dividends from income tax, the share prices will go up. If, on the other hand, government decides to raise income tax rates on company profits, the prices may fall. In fact, these days the policy changes by the government have become a major cause for an upswing or a downswing in prices of shares.

9 **Miscellaneous** factors: Various factors which may not be directly related with stock exchanges also affect prices of securities due to the psychological reaction of speculators. For example, unexpected changes in weather conditions, inadequate or excessive rainfall (which affects agricultural output), may bring about changes in the prices of shares of companies manufacturing **fertilisers**, edible oils, cotton textiles, etc. Similarly, lockout for a prolonged period may cause prices of shares to decline or illness of a powerful head of government may cause fall in security prices.

Check Your Progress C

1 Why is listing of securities necessary?

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2 What is speculation?

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3 State whether each of the following statements is True or False.

- i) Speculation is the same as gambling.
- ii) It is normally difficult to distinguish between a speculative transaction and an investment transaction.
- iii) In speculative transaction the intention is to gain from difference in prices.
- iv) Speculation helps in establishing uniform prices of scrips in different stock exchanges.
- v) Excessive speculation is not harmful.
- vi) Listing of securities on a stock exchange guarantees that the company is financially sound.
- vii) Listing of a security implies that the security has met the requirements of the stock exchange authorities.
- viii) If a company's profits and the dividend rate are satisfactory, the prices of its shares will have a falling trend.
- ix) Any security can be treated at the stock exchange.

4 Fill in the blanks.

- i) Listing of security means addition of security to the list of securities traded on a stock exchange.
- ii) Listing of security provides a market for the security.
- iii) If bear speculators are active, security prices have a tendency to go
- iv) If interest on bank loan the prices of securities tend to go down.

7.10 ADVANTAGES AND SHORTCOMINGS

7.10.1 Advantages

Having discussed the functions of stock exchanges, we may outline their advantages from the point of view of:

- 1 Companies
- 2 Investors
- 3 Society as a whole

From the Companies' Point of View

- i) **Increase in the credit and goodwill of the company:** Every company is not allowed to have its shares traded on the stock exchange. Permission is to be obtained by the company for getting its shares included in the list of securities to be bought and sold on the floor of the stock exchange. Before granting the permission, stock exchange authorities check whether the company is financially sound and managed by qualified people. Therefore, companies whose securities are listed are supposed to be sound companies. They enjoy better goodwill and credit in the market as compared with other companies.
- ii) **Extensive markets:** The securities issued by companies and other corporate bodies are quoted on the stock exchanges and are traded on the floor of the exchanges. This increases the marketability of the securities. Investors all over the world come to know about the securities and get an opportunity to invest in such securities.
- iii) **Increase in the value of securities:** As investors all over the world come to know about the availability of certain securities, the value of securities increases as a result of higher demand.
- iv) **Knowledge about investment to the company:** The companies come to know from stock exchange quotations fluctuations in the price of securities as well as the intensity of buyers' demand. While planning for raising additional capital, proper decisions can be taken whether to issue shares or debentures and about the terms of issue.

From the Investor's Point of View

- i) **Facility of investment:** The stock exchange provides facility of investment to the investors. Liquidity as well as safety of investment in securities are assured through the mechanism of stock exchange. Investors can buy and sell securities on the floor of stock exchange as and when they want to do so.
- ii) **Protection of investors' interest:** Stock exchanges are well organised markets and are regulated under the Securities Contracts (Regulation) Act, 1956. Thus, they work under the control of the Central Government. Hence, the interest of the buyers and sellers of securities is safeguarded and protected.
- iii) **Publication of quotations:** All the stock exchanges regularly publish the prices quoted for securities on the floor. This facilitates buyers as well as sellers in getting information of the prices of securities, which in turn helps them to decide whether to purchase or sell.
- iv) **High collateral value:** Listed securities are preferred by banks and creditors as collateral against losses, since they can easily sell such securities in case of default of borrowers and debtors who have pledged these securities with them.
- v) **Best possible use of capital:** Stock exchanges provide opportunities to the investors to compare the relative demands of different securities on the basis of sale and purchase of those securities. Consequently, the profitable companies attract more investors and get an edge over the less profitable ones. Thus, the investors are able to invest their savings in more profitable companies.

From the Point of View of Society as a Whole

If we look at the operations of a stock exchange from the point of view of society as a whole, its usefulness may be found in the role it plays in creating congenial environment for savings and investment.

- i) **Facilitates capital formation:** The existence of stock exchange induces people to save as it provides avenues of investment and facilitates buying and selling of securities without difficulty. This leads to increased capital formation in the country, i.e., savings become productive capital.
- ii) **Promotes industrial growth:** Long-term capital for large industrial firms can be procured by companies as savings become available for investment with the

organised markets facilitating purchase and sale of securities. Promotion and expansion of industrial units in turn contribute to the industrial growth of the economy. The buying and selling of securities in stock exchanges take place not only among investors from within the country but also among foreign investors. The existence of stock exchange encourages flow of capital from abroad, and thus adds to the growth of industries.

- iii) **Proper use of capital:** Investors are generally attracted towards the more profitable and growing industrial units. Since stock exchanges facilitate investments to be withdrawn from the less profitable and loss making companies (by sale of securities) and invested in more profitable undertakings, the financial resources are put to proper use and the economy as a whole benefits from it.
- iv) **Reduces fluctuation of security prices:** When particular securities are purchased in anticipation of future rise in price, the existing low prices tend to go up. On the other hand, selling in anticipation of future decline in price leads to the existing high prices being checked. Thus, wide fluctuations in the prices of securities are prevented due to regular dealings in securities.
- v) **Facilitates government borrowing:** Government securities which are issued by the Reserve Bank of India can also be bought and sold on the floor of stock exchanges. Investors who subscribe to the issue of government securities find it convenient to hold them as long as they want and also to sell them easily without loss due to the existence of stock exchanges. Hence governments depend a great deal on stock exchanges while raising loans.

7.10.2 Shortcomings

So far we have discussed how beneficial the stock exchanges are from the point of view of companies, the investors and the society as a whole. But, like other institutions, stock exchanges too are not free from limitations. If operations on stock exchanges are not controlled, they may be harmful to companies as well as investors. Let us, therefore, examine the shortcomings of the stock exchanges.

Briefly, the shortcomings of stock exchanges arise out of brokers' and jobbers' tendency to engage in speculative buying and selling of securities without legitimate reasons. This causes severe fluctuations in the security prices.

Excessive speculation: It is one of the common evils associated with stock exchange operations. Speculation implies buying or selling securities in anticipation of future prices. Speculators generally deal in securities with the main objective of gaining from the difference in prices. They do not have the intention of paying for the securities or taking delivery of securities if they are speculative buyers. Prices go up just because they make bids to buy. On the other hand, speculative sellers do not possess the securities, nor do they intend to receive payment and deliver securities. But, their bids to sell pushes prices down. When there is no genuine reason for prices to move up, high prices may suddenly crash if buyers are required to pay for the securities which they cannot generally do for lack of funds. Similarly, if the sellers are required to deliver securities they may not be able to do so. This kind of situation does not permit real investors to rely on the changes in securities prices as an index of the future prospects of a company.

Wide fluctuations in prices: Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as due to rumours which may be spread by interested parties. Sudden changes in social, economic and political factors are not easily predictable. Speculators with knowledge and skill normally help to reduce price fluctuations. But when rumours are spread by speculators only to raise or reduce prices of particular securities for their own profit, there is excessive rise or fall of prices, and genuine investors are unable to decide whether to buy or sell. Many of them get panicky when prices of securities steeply decline. Others buy in haste just because prices are rising. In both cases, the investors may repent for selling or buying securities which may lead to losses.

7.11 REGULATION AND CONTROL OF STOCK EXCHANGES

We have discussed earlier the importance, functions and working of stock exchanges. They play an important role in the capital formation and industrial growth of the country. The members of the stock exchange, brokers, investors and speculators are the people who engage in stock market operations. All these people derive advantages from the working of the market. However, stock markets suffered from a number of evils in the past and were regarded as gambling dens of the brokers.

The attention of the Government was drawn from time to time to the ills of stock markets as a result of which the Securities Contracts (Regulation) Act, was passed in 1956 to regulate and control stock market operations in the wider interests of the financial markets, institutions and the public. The main provisions of this Act are as follows:

- 1 There shall be only one recognised stock exchange in one region. This will have a unitary control.
- 2 Dealers and brokers outside the area of the recognised stock exchange will be licensed.
- 3 A recognised stock exchange shall be entitled to frame its own bye-laws for regulation and control of contracts subject to the approval of the Central Government. The bye-laws may regulate (i) opening and closing of market; (ii) regulation of trading hours; (iii) establishment of clearing house; (iv) regulation of prohibition of blank transfer (now these are regulated by the Companies Act); (v) listing of securities on the stock exchange; (vi) regulation or prohibition of carry over or budla system; (vii) limitations on the volume of trading by members and on their open positions; (viii) fixing minimum and maximum prices for securities in emergencies; and (ix) separation of functions of jobbers and brokers and regulation of tarawani (jobbing) business.
- 4 The Central Government is empowered to make and amend bye-laws after consulting the governing bodies of these exchanges.
- 5 Dealings in future are prohibited, since they are regarded as gambling contracts.
- 6 The Central Government has a right to withdraw recognition to, or supersede, the governing body of the exchange in, abnormal situations.
- 7 A recognised stock exchange must submit periodical returns relating to its affairs and give information as required by the Government from time to time.
- 8 Central Government has wide powers relating to the listing of securities. It can compel any public limited company to list its securities. It can vary or set aside the refusal of a stock exchange to list securities on an appeal made by a company.

The Government of India has recently set up a high-power body known as the Securities Exchange Board of India which will provide necessary guidance for the healthy and orderly development of securities markets which will instil confidence among the investors and provide adequate protection to them.

Check Your Progress D

- 1 State whether the following statements are True or False.
 - i) Stock exchanges increase the credit and goodwill of a company.
 - ii) Stock exchange ensures safety to dealings in securities.
 - iii) Stock exchanges are regulated under the Companies Act, 1956.
 - iv) Dealings in future transactions in securities are not permitted in stock exchanges in India.
- 2 Tick mark the correct answer.
 - a) Stock exchanges facilitate buying and selling of securities as a

- i) local market. ()
 - ii) provincial market. ()
 - iii) national market. ()
 - iv) international market. ()
- b) Stock exchanges serve the need of
- i) companies which need capital. ()
 - ii) persons who want to invest. ()
 - iii) society which wants to improve. ()
 - iv) all the above ()
- c) Stock exchange operations lead to
- i) wide fluctuations in prices. ()
 - ii) normalisation of prices. ()
 - iii) both (i) and (ii) ()
 - iv) none of the above ()
- d) Stock exchanges come under the purview of
- i) central government. ()
 - ii) state government. ()
 - iii) local municipality. ()
 - iv) none of the above ()
- e) Stock exchanges facilitate
- i) purchase and sale of securities. ()
 - ii) speculation in securities. ()
 - iii) gambling in securities. ()
 - iv) all of them ()

7.12 LET US SUM UP

Stock exchange is an important part of capital market. It means a market place for buying and selling of securities already issued by joint stock companies, public trusts, central and state governments and local authorities. It is an organised market controlled and recognised by the Central Government under the Securities Contracts (Regulation) Act, 1956. The members are entitled to deal in securities either on their own or through their agents (authorised clerks). All transactions on the floor of a stock exchange are regulated by the rules and bye-laws of the concerned stock exchange. The stock exchange provides avenues for savings to be invested not only at the national level but sometimes at international level. Stock exchanges not only provide liquidity and safety to the investor, but also provide capital to the industrial units and thus assist the industrial growth of the country.

To make a deal on the floor of a stock exchange, you have to contact a broker, seek his advice and place an order with him. Three types of transactions are generally undertaken in the stock exchange: i) spot delivery transactions, ii) ready delivery transactions, and iii) forward delivery transactions.

Bulls, Bears and Stags are three types of dealers who operate in the stock exchange. Bulls are those who expect price of securities to rise. Bears expect securities prices to fall in future. Stags deal in new securities issued by companies. They apply for a large number of securities and sell them soon after they are allotted to them. Certain terms used in the dealings on stock exchange have their special meaning. Examples of such terms are **contango**, backwardation, cornering, arbitrage, etc.

All securities of every company are not quoted on stock exchanges. The company has to take permission from the concerned stock exchange for getting its securities quoted. Such **permission** is termed as Listing of Securities and is granted only after the company fulfilled the requirements.

It is said that stock exchange encourages speculation and leads to fluctuations in the prices of securities quoted on its floor. But speculation also has its advantages. It equalises and normalises price fluctuations, apart from mobilising capital and widening the market of the securities. There are various factors which influence the prices on the stock exchange such as the financial position of the companies, speculative pressures, business cycles, political events and the activities of the financial institutions, etc.

Stock exchanges have several important economic functions and are advantageous to investors, companies and the society at large. Due to several malpractices in the working of these stock exchanges, the Central Government had to enact the Securities Contracts (Regulation) Act in 1956. Since then the stock exchanges have to get recognition from the Central Government and work under its control. They have also to frame their rules and bye-laws.

7.13 KEY WORDS

Arbitrage: Buying in one market where the price is low and selling it in another market where the price is comparatively high.

Authorised Clerk: An employee of the broker who is authorised to transact business at the stock exchange on behalf of the broker.

Backwardation: Badla charges paid by the seller (bear) for the postponement of transactions to the next settlement date.

Bears: Speculators who anticipate fall in prices in future and so they sell securities in the present to buy them in the future when the prices fall.

Badla Charges: Charges paid for the postponement of transactions to the next settlement date.

Bulls: Speculators who anticipate rise in the price of securities in future and so they buy securities in the present to sell them in future when the prices rise.

Carry Over: Postponing the settlement of a transaction to the next settlement day on payment of badla charges.

Contango: Badla charges paid by the buyer (bull) for the postponement of transactions to the next settlement date.

Contract Note: A statement sent by the broker to a client showing details of securities (including price) bought or sold on behalf of the client.

Cum-div: When the shares are quoted cum-div, the buyer gets a right to receive the dividend on such shares, payable or declared after the sale of such securities.

Ex-div: When the shares are quoted ex-div, the buyer is not entitled to receive the dividend to be declared or payable after the sale of such shares.

Forward Delivery Contract: A contract for purchase or sale of securities the settlement of which can be postponed to the next settlement day.

Jobber: A member of a stock exchange who buys and sells securities in his own name.

Margin: A deposit made by the customer with the broker to cover the anticipated loss.

Ready Delivery: A contract settled within seven days of the transaction i.e., on the settlement day fixed by the stock exchange.

Remisier: A person who helps in securing business for the broker.

Sauda Bahi: A note book used by brokers for daily record of purchases and sales of securities made on the floor of the stock exchange.

Scripts: Securities like shares, debentures, bonds, etc.

Settlement Day: The day fixed for the settlement of transactions on a stock exchange.

Speculation: Dealings in securities with the object of making profit from the difference in prices.

Spot Delivery: Contract settled on the same day on which the transaction takes place.

Stags: Speculators having bullish tendency, who apply in bulk for new issues of securities and sell them in the market soon after the allotment is made to them.

Stock or Securities Market: An organised market place on the floor of which securities are bought and sold.

Tarawaniwala: A member of the stock exchange who acts as a broker as well as a jobber.

7.14 SOME USEFUL BOOKS

Bhushan, Y.K. 1987. *Fundamentals of Business Organisation & Management*, Sultan Chand & Sons: New Delhi. (Part Eight, Chapter 4).

Ramesh, M.S. 1985. *Principles & Practice of Modern Business Organisation, Administration & Management*, Kalyani Publishers: New Delhi. (Volume III, Chapter 17).

Singh, B.P., and T.N. Chhabra, 1988. *Business Organisation and Management*, Kitab Mahal: Allahabad. (Section Five, Chapter 19).

Sohni, S.K. 1985. *Stock Exchanges in India—Practices Problems Prospects*, North Publishing Corporation: Delhi.

7.15 ANSWERS TO CHECK YOUR PROGRESS

A 1 a) iii b) iv c) iii

B 4 i) True ii) True iii) False iv) True v) True

5 i) bull ii) 7 iii) backwardation iv) rigging v) cum

C 3 i) False ii) True iii) True iv) True v) False

vi) False vii) True viii) False ix) False

4 i) new ii) continuous iii) down iv) rises/increases

D 1 i) True ii) True iii) False iv) True

2 a) iii b) iv c) iii d) i e) i

7.16 TERMINAL QUESTIONS

- 1 Define a stock exchange and explain fully its economic functions.
- 2 Explain briefly the importance of stock exchange in a modern society. What are its shortcomings?
- 3 Why is the stock exchange called a barometer of the economic and business conditions in a country?
- 4 Explain the following terms used in connection with dealings of securities.
i) Arbitrage ii) Forward Delivery Contracts iii) Bull iv) Rigging v) Contango
vi) Cum-dividend vii) Margin Trading viii) Authorised Clerk.
- 5 Why do prices of securities traded on a stock exchange fluctuate widely and frequently? Discuss the causes briefly.
- 6 What do you mean by listing? State briefly the advantages of listing securities on a stock exchange from the point of view of a company and an investor.
- 7 Describe the method of trading on a stock exchange. State the procedure to be followed if you decide to sell 500 shares of a company which you hold. The shares were allotted to you at par value of Rs. 10 each.

8 What were the reasons of passing the Securities Contract (Regulation) Act, 1956?
State its main features.

Note: These questions will help you to understand the unit better. Try to write answers for them. But do not send your answers to the university. These are for your practice.

APPENDIX TO UNIT 6: SOURCES OF LONG-TERM FINANCE AND UNDERWRITING

Ever since the Government of India initiated the economic liberalisation programme in 1991, there are several developments in capital market. Hence there is a need to revise this unit to incorporate all such changes. Some of the major developments in the capital market which are relevant to you are discussed in this Appendix.

In Section 6.3.1 Capital Market of this Unit, the discussion on Control of Capital Issues (pages 26 & 27) is to be deleted. This deletion is necessary in view of the abolition of the Controller of Capital Issues in June 1992.

In section 6.3.4 Foreign Sources (Page 31) we have discussed three main foreign sources viz., foreign collaborators, international financial institutions and non-resident Indians, as sources of long-term finance. In this context you have to add International Capital Market as the fourth source. From 1992 onwards Government of India permitted Indian companies to raise capital in the international capital markets in the form of Global Depository Receipts (GDRs) and Bonds. This is briefly stated under point 12 of Capital Market Reforms discussed below.

CAPITAL MARKET REFORMS

The Government of India initiated several capital market reforms, as part of economic reforms programme started in June 1991. The capital market reforms programme of the government is mainly aimed at protecting investors' interest, improving market efficiency, making stock market transactions more transparent, curbing unfair trade practices, and bringing Indian capital market upto international standards. The main aspects of capital market reforms are listed below:

1. **Abolition of Controller of Capital Issues :** Capital Issues (Control) Act 1947 was repealed and the office of the Controller of Capital Issues (CCI) was abolished in June 1992. Thus, all the controls over price and premium of shares were removed. Companies are now free to approach capital market whenever they want and fix the premium on shares as they wish, after getting clearance from Securities Exchange Board of India (SEBI).
2. **Statutory Recognition to SEBI:** Statutory recognition was granted to the Securities Exchange Board of India (SEBI) in February 1992 to regulate and reform the capital market in India. SEBI has been vested with powers concerning various aspects of the capital market such as (a) regulating the stock exchanges, various intermediaries and mutual funds, (b) promoting investor's education and training of intermediaries and (c) prohibiting insider trading, fraudulent and unfair trade practices in the securities market. SEBI initiated several measures in this direction.
3. **Measures in the Primary Market:** New reforms by SEBI in the primary market included improved disclosure standards in the public issue documents, introduction of prudential norms and simplifications of issue procedures. Companies are now required to disclose all material facts and specific risk factors associated with their projects while making public issues. All the issue documents are to be compulsorily vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate, so that the investors in the primary market are able to take informed investment decisions.

'Merchant Banker' and 'Banker to the Issue' are brought under the regulatory frame work of SEBI and a code of conduct issued.

The due diligence certificate by lead managers regarding the disclosures made in the offer document has been made a part of the offer document itself for better accountability and transparency on the part of the lead managers.

SEBI introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. To reduce cost of issue, underwriting of issues is made optional. However, this is subject to the condition that if an issue was not underwritten and was not able to collect 90 per cent of the amount offered to public, the entire amount collected would be refunded to the investors.