UNIT 4 INDIAN STOCK MARKET : ORGANISATION AND FUNCTIONING

Objectives

The objectives of this unit are to:

- distinguish between primary market and secondary market
- highlight various types of traded securities, market players and trading arrangements which exist in India
- to discuss organization and functioning of primary and secondary markets for various types of securities in India

Structure

4.1 INTRODUCTION

Market is a place where buyers and sellers meet and exchange products. This definition is universal and applies to all markets. In this course, we will discuss more about the market called capital market. It is a place, where capital of different types is exchanged. Often individuals, like you, are the lenders or the suppliers of capital. Companies and various other institutions are the borrowers or the receivers of capital. The market is organized or divided into different ways. At a very broad level, the market is divided into (a) Short-term Capital Market (money market) and (b) Long-term capital market (also, called stock market). Another way of classifying the market is (a) Institutional Market and (b) Direct Market. As an investor you can deal with the market in different ways. Let us understand the market from individual's perspective.

If the surplus money you have can be spared only for a short period, you have to look for savings of short-duration. Since the amount available is fairly small in such cases, you have to look for some institutional support for such savings. In other words, individuals don't directly deal with the money market, which specialize in short-term capital. Often, individuals approach an institution for this purpose. You can save your short-term surplus in a bank deposit or a mutual fund, which offer money market schemes.

If the surplus money you have can be spared for a long-term, you have to look for investments of longer duration. Again, you can go to an institution, which offers long-term products or you can directly participate in the market. That is, you can deposit your money in a long-term fixed deposit or invest in a mutual funds scheme or directly buy securities in the market. When you intend to deal with the market on your own, you can deal with the market in two ways. The markets are accordingly classified into primary and secondary market. Primary market is the one in which the company approaches investors to raise capital. They can approach for debt capital or equity capital or combination of both. Dealing in primary market is fairly simple today. Like fixed deposit opening, you have to take up an application form of the issue and deposit the amount after filling up the form. Brokers and sub-brokers will normally help you to get forms and guide you to fill up the forms. What is important is you have to make sure that investments fit with your objective. Here too, financial dailies and magazines publish analytical report on primary market issues for the help of small investors. After your submission of application forms and if the company accepts the same, you will get a certificate or credit in your depository. In the event of too many people applying for the offer, the company may reject some applications. In such cases, you will get refund of the money that you have invested initially.

Since the price is fixed in primary market, there will be competition for good issues. The uncertainty of getting allotment forces many investors, who are directly willing to deal with the market, to turn into secondary market. It is a place where an investor sells to another investor. Since there are large number of sellers and buyers, the market is dynamic. Securities prices change depending on the demand and supply of the securities. Secondary market exists for different types of securities like debt, equity and others. Investment in secondary market has also become easy, thanks to developments in Information and Computing Technologies. You have to open an account with the members of any stock exchanges of your choice. The procedure to open an account is fairly simple and it is somewhat similar to opening a Savings Bank Account with your banker. You can place your buying and selling orders over phone and often you get immediate confirmation of your purchase or sale. Today, it is also possible for you to buy and sell securities through internet. In this Unit, we will discuss more on how the stock market is organized and how investors can transact in buying and selling of securities in the market.

4.2 PRIMARY MARKETS

Primary market is the segment in which new issues are made whereas secondary market is the segment in which outstanding issues are traded. It is for this reason that the Primary Market is also called New Issues Market and the Secondary Market is called Stock Market. In the primary market, new issues May be made in three ways, namely, public issue, rights issue, and private placement. Public Issues involves sale of securities to members of public. Rights issue involves sale of securities to the existing shareholders/debenture holders. Private placement involves selling securities privately to a selected group of investors. In the primary market, equity shares, fully convertible debentures (FCD), partially convertible debentures (PCD), and non-convertible debentures(NCD) are the securities commonly issued by non-government public limited companies. Government companies issue equity shares and bonds. Primary market has become very active in India after the abolition of Controller of Capital Issue. You can refer Unit I (Tables 1.1 to 1.3) to find out the level of activities in primary market during the last few years.

In the primary market, issues are made either 'at par' or `at premium'. Pricing the new Issues is regulated under `Guidelines on Capital Issues' or what are also known as "Guidelines for Disclosure and Investors Protection" issued by the Securities and Exchange Board of India (SERI). The SEBI guidelines on Disclosure and Investor Protection is now available in the SEBI website, www.sebi.gov.in. These are detailed guidelines covering all issues relating to capital offerings. Prior to the promulgation of the ordinance no.9 of 1992 by which the Capital Issues (Control) Act has been repealed, the pricing of the new issues was regulated under the Controllers of Capital Issues' (CO) pricing formula.

All Issues by a new company has to be made at par and for existing companies the issue price should be justified as per Malegam Committee recommendations by

- The earnings per share (EPS) for the last three years and comparison of pre-issue price to earnings (P/E) ratio to the P/E ratio of the Industry.
- Latest Net Asset Value,
- Minimum return on increased networth to maintain pre-issue EPS. A company may also raise finance from the international markets by issuing GDR's and ADR's.

4.2.1 Principal steps of a Public Issue

A draft prospectus is prepared giving out details of the Company, promoters background, Management, terms of the issue, project details, modes of financing, past financial performance, projected profitability and others. Additionally a Venture Capital Firm has to file the details of the terms subject to which funds are to be raised in the proposed issue in a document called the `placement memorandum'.

Some of the steps involved in a public issue are

a) *Appointment of underwriters:* The underwriters are appointed who commit to shoulder the liability and subscribe to the shortfall in case the issue is under-subscribed. For this commitment they are entitled to a commission upto maximum of 2.5 % on the amount underwritten.

b) *Appointment of Bankers:* Bankers along with their branch network act as the collecting agencies and process the funds procured during the public issue. The Banks provide temporary loans for the period between the issue date and the date the issue proceeds becomes available after allotment, which is referred to as a `bridge loan'.

c) *Appointment of Registrars:* Registrars process the application forms, tabulate the amounts collected during the Issue and initiate the allotment procedures.

d) *Appointment of the brokers to the Issue:* Recognized members of the Stock exchanges are appointed as brokers to the Issue for marketing the Issue. They are eligible for a maximum brokerage of 1.5%.

e) *Filing of prospectus with the Registrar of Companies:* The draft prospectus along with the copies of the agreements entered into with the Lead Manager, Underwriters, Bankers, Registrars and Brokers to the issue is filed with the Registrar of Companies of the state where the registered office of the company is located.

f) *Printing and dispatch of Application forms: The* prospectus and application forms are printed and dispatched to all the merchant bankers, underwriters, brokers to the issue.

g) *Filing of the initial listing application: A* letter is sent to the Stock exchanges where the issue is proposed to be listed giving the details and stating the intent of getting the shares listed on the Exchange.

h) *Statutory announcement: An* abridged version of the prospectus and the Issue start and close dates are published in major English dailies and vernacular newspapers.

i) *Processing of applications:* After the close of the Public Issue all the application forms are scrutinized, tabulated and then shares are allotted against these applications.

j) *Establishing the liability of the underwriter: In* case the Issue is ;lot fully subscribed to, then the liability for the subscription falls on the underwriters who have to subscribe to the shortfall, in case they have not procured the amount committed by them as per the Underwriting agreement.

k) *Allotment of shares:* after the Issue is subscribed to the minimum level, the allotment procedure as prescribed by SERI is initiated.

l) *Listing of the Issue:* The shares after having been allotted have to be listed compulsorily in the regional stock exchange and optionally at the other stock exchanges.

4.2.2 Eligibility for an IPO

An Indian Company is allowed to make an IPO if:

1) The company has a track record of dividend paying capability for 3 out of the immediately preceding 5 years;

2) A public financial institution or scheduled commercial bank has appraised the project to be financed through the proposed offer and the appraising agency participates in the financing of the project to the extent of at least 10% of the Project cost. Typically a new company has to compulsorily issue shares at par, while the companies with a track record can issue shares at a premium.

4.2.3 Rights Issue

The rights Issue involves selling of securities to the existing shareholders in proportion to their current holding. When a company issues additional equity capital, it has to be offered in the first instance to the existing shareholders on a pro-rata basis as per Section 81 of the Companies Act, 1956. The shareholders may by a special resolution forfeit this right, partially or fully by a special resolution to enable the company to issue additional capital to the public or alternatively by passing a simple resolution and taking the permission of the Central Government. There is no restriction on pricing of rights Issues.

4.2.4 Private Placement

A private placement results from the sale of securities by the company to one or few investors. The issuers are normally the listed public limited companies or closely held public or private limited companies which cannot access the primary market. The securities are placed normally with the Institutional investors, Mutual funds or other Financial Institutions. In a number of cases, Indian companies have also offered shares to promoters under this route. SEBI has issued a separate guideline for pricing of such preferential offers.

4.2.5 SEBI Guidelines for IPO's

For complete details of SEBI guidelines on IPO, you have to visit www.sebi.gov.in, where you can download the complete guideline on Disclosure and Investor Protection) Guidelines, 2002. The salient features of these guidelines are given below:

1. Promoters should contribute a minimum of 20% of the total issued capital , if the company is an unlisted one. Promoter's contribution is subject to a lock-in period of 3 years.

2. Net Offer to the General Public has to be at least 25% of the Total Issue size for listing on a Stock Exchange.

3. Minimum of 50% of the Net offer to the Public has to be reserved for Investors applying for 10 or less than 10 marketable lots of shares.

4. In an Issue of more than Rs. 100 crores the issuer is allowed to place the whole issue by book-building.

5. There should be at-least 5 investors for every 1 lakh of equity offered.

6 Allotment has to be made within 30 days of the closure of the Public Issue and 42 days in case of a Rights Issue.

7. All the listing formalities for a Public Issue has to be completed within 70 days from the date of closure of the subscription list.

8. Indian Development Financial Institutions and Mutual Funds can be allotted securities upto 75% of the Issue Amount.

9. Allotment to categories of FII's and NRI's/OCB's is upto a maximum of 24% which can be further extended to 30% by an application to the RBI - supported by a resolution passed in the General Meeting.
10. 10% individual ceiling for each category a) Permanent employees b) Shareholding of the promoting companies
11. Securities issued to the promoter, his group companies by way of firm allotment and reservation have a lock-in period of 3 years. However shares allotted to FII's and certain Indian and Multilateral Development Financial Institutions and Indian Mutual Funds are not subject to Lock-in periods.
12. The minimum period for which a Public Issue has to be kept open is 3 working days and the maximum for which it can be kept open is 10 working days. The minimum period for a Rights Issue is 15 working days and the maximum is 60 working days.
13. A public issue is effected if the issue is able to procure 90% of the Total issue size within 60 days from the date of earliest closure of the Public Issue. In case of over-subscription the company may have the right to retain the excess application money and allot shares more than the proposed Issue which is referred to as the `green-shoe' option.
14. A Rights Issue has to procure 90% subscription in 60 days of the opening of the Issue.

4.3 SECONDARY MARKETS

The secondary market is the segment in which outstanding issues are traded and thus provide liquidity. Investors, who seek both profitability and liquidity, need both primary and secondary markets. There is thus a direct and complementary interface between the primary and secondary markets. Secondary market exists both for short-term (money market) securities and long-term securities. It exists for debt, equity and a variety of hybrid securities. While the secondary market activities in money market securities are conducted over phone or through market makers, the trading is more organized for long-term securities and conducted through stock exchanges. Buying and selling securities in secondary market is fairly simple. Investors have to open an account with a member of stock exchange and then place orders through the member.

For an orderly functioning of market, a set of institutions is required. The role of institutions assumes importance in securities market because the market deals with high value financial assets. Institutions connected with securities markets are Stock Exchanges (http:// www.bseindia.com and http://www.bseindia.com), Members of Stocks Exchanges (popularly called brokers), Clearing Corporation, Depository (http://www.nsdl.co.in and http:// www.centraldepository.com) Transfer Agents and Securities and Exchange Board of India (SEBI) (http://www.sebi.gov.in).

Technology has converted stock exchanges into a virtual institution. Earlier, there was an importance for the physical location of stock exchange because it was a place where brokers or their assistants negotiate the prices (outsiders can hear only some noise but brokers understand the meaning) and enter into transactions on behalf of their client-investors. Since the telecommunication was very poor in India, one or two stock exchanges have been opened up in every state to cater to the needs of the investors of the region. India is one of the few countries with a large number of stock exchanges. Thanks to development in telecommunication and information technology, the physical constraint was removed during the last few years. National Stock Exchange today has its presence everywhere in the country. Bombay Stock Exchange has also expanded its network. Many other stock exchanges are finding it difficult to compete with these two principal stock exchanges and trying to come together and create new business. This new development has improved transparency of operations and brought down the cost. Today, stockbrokers are operating from their office through computer network and investors can see the price at which the transactions are settled. Internet based stock braking (http://www.icicidirect.com or http:// www.5pnisa.com) allows investors to enter into transactions by themselves without contacting their brokers directly. Competition has brought down the brokerage from 2% to in India around 0.5% and today the brokerage rate in India is one of the lowest in the world. This transformation has taken place in a matter of few months.

Members of stock exchanges, called stock brokers, are intermediary between buyers and sellers. Buying and selling securities through members of stock exchange is beneficial, legally and functionally. Entry of major institutions like ICICI, Kotak Mahindra, into brokerage services and development in technology including intenet based broking service have improved the quality of service. Many of these brokerage houses offer a number of facilities to the investors at no extra cost.

Clearing corporation enables the members to settle the transactions entered among themselves on behalf of their client-investors. It operates something similar to cheque clearing service offered by RBI for the banks. Earlier when securities are traded in physical form, a large number of securities have to be exchanged between members and clearing corporation had a major work on this part. Today, after depository facility was introduced, the workload of the clearing corporations has come down significantly. Clearing corporation today facilitate the members to transfer (or receive) securities to (or from) depositories and also settle monetary part of the transactions. It is an institution exclusively serving the brokers.

Depository service is another major development in the Indian stock market. It allows investors to hold securities in electronic form (like you are holding cash in your bank account) and transfers electronically when they sell the shares. The operation is fairly simple. Investors have to open a depository account with a member of depository service provider (we have two depository service providers in India - National Securities Depository Ltd and Central Depository Services (India) Limited). Investors can give physical securities that they are holding for cancellation (provided depository facility is available for the securities/company) and convert them in to electronic holding. A large number of companies have depository holding facility and SEBI has put it compulsory to trade certain stocks only under depository mode. When an investor apply new shares next time in the primary market, they can ask the issuer to credit the depository account in the event of successful allotment. Any new purchases in the secondary market can also be credited in the depository account. Investors will get periodical statement on their holding from the member with whom the depository account is maintained. Many depository participants allow the investors to see their account through Internet. There was some resistance from retail investors for this change but today everyone started seeing the benefit of this service. A significant part of volume traded today is settled through depository mode.

Apart from holding the stocks electronically, there are other benefits from depository services.- There is no need to apply for transfer of shares after the purchase of shares. If an investor buys securities in physical form and desire to transfer the shares in her/his name, she/he has to fill-up the transfer deed, affix transfer fee (0.5% of market value of stock) and then send the same to transfer agent. There is a cost, time and uncertainty involved in the transfer. Under depository mode, the shares are transferred in a short period of time without any further action from your side. For more details about depository, visit one of the web sites (http://www.nsdl.co.in or http://www.centraldepository.com) of depository service providers or the members of depository service providers.

Transfer agents maintains the members register of the companies. On the instructions of the company, they transfer the shares from the existing members to new member. When an investor buys a share in a physical mode and intend to transfer the share in her/his name, she/he has to send the transfer deed along with share certificate to the Transfer Agent. There are many transfer agents like Karvy Consultants Ltd (http://www.karvy.com) and MCS Ltd. After initial verification, they will place the shares received for transfer for the approval of company's Board. The shares are transferred in the name of investors after the approval of the Board and investor will receive communication to this effect along with share certificates from the Transfer Agent. Some companies perform this transfer of shares internally whereas many leading companies have outsourced this service by appointing one of these transfer agents. The process of verification and other formalities connected with transfer has been simplified after the introduction of depository services.

Securities and Exchange Board of India (SEBI) regulates the Institutions and Intermediaries connected with the securities to protect the interest of investors, Particularly the small investors. SERI is a government sponsored but independent body. SEBI has prescribed detailed regulations and guidelines for various activities related to transactions of securities market (See http://www.sebi.gov.in). Regulations are primarily intended to protect small investors. Despite strong resistance, SEBI is pushing several reforms connected with securities market. Some of the major achievements of SEBI so far are bringing transparency in the securities market operation, speeding up the technological progress and improving disclosure norms. SERI is struggling hard to prevent insider trading and price rigging. Since regulation is a complex task, it will take time to complete the process.

Activity -1

i) Write brief note on a recent public issue of a company. The note may include the size of the issue, type of security offered, price, justification of premium, registrar, banker to issue, underwriter, etc.

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ii) Visit any one or more of the web sites and describe your additional learning on the regulation of Primary and Secondary Markets.

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4.4 STOCK MARKET IN INDIA

From scattered and small beginnings in the 19th Century, India's stock market has risen to great heights. By 1990, we had 19 Stock Exchanges in the country and by 2002 there were 23 Stock Exchanges as listed in the later sections of this unit. You might be interested in knowing more about the origin and the growth of stock market in India. What functions does it perform? What is the form of organization of stock exchanges in India? How are these administered? We shall, now, address to these and other questions.

4.4.1 Origin and Growth

Organizations and institutions, whether they are economic, social or political, are products of historical events and exigencies. The events continually replace and/or reform the existing organizations, so as to make them relevant and operational in contemporary situations. It is, therefore, useful to briefly acquaint ourselves with the origin and growth of the stock market in India.

Stock exchanges of India in a rudimentary form originated in 1800 and since that time have developed through six broad stages.

1800-1865 : The East India Company and few commercial banks floated shares sporadically, through a very small group of brokers. According to a newspaper in 1850, in Bombay during 1840-1850 there were only half a dozen recognised brokers. The year 1850 marked a watershed. A wave of company flotations took over the market ; the number of brokers spurted to 60. The backbone of industrial growth and the resulting boom in share flotation was the legendary personality of the financial world, Premchand Roychand.

In 1860 the stock market created a unique history. The entire market was gripped by what is known as 'share mania'. The American Civil War created cotton famine. Indian cotton manufacturers exploited this situation and exported large quantities of cotton. The resulting increase in export earnings opened opportunities for share investments. New companies started to come up. Excessive speculation and reckless buying became the order of the day. This mania lasted upto 1865. It marks the end of the first phase in the Indian stock exchange history because with the cessation of the Civil War, demand for Indian cotton slumped abruptly. The share became worthless pieces of paper. To be exact, on July 1, 1865 all shares ceased to exist because all time bargains which had matured could not be fulfilled.

1866-1900: We find another distinct phase during 1866-1900. The mania effect haunted the stock exchange of Bombay during these 25 years. Above everything else, it led to foundation of a regular market for securities. Since the market was established in Bombay, it soon became and still is the leading and the most organized stock exchange in India. A number of stock brokers who geared up themselves, set up a voluntary organization in 1887, called Native Share and Stockbrokers Association. The brokers drew up codes of conduct for brokerage business and mobilized private funds for industrial growth. It also mobilized funds for government securities (gilt edged securities), especially of the Bombay Port Trust and the Bombay Municipality. A similar organization was started at Ahmedabad in 1894.

1901-1913: Political developments gave a big fillip to share investment. The Swadeshi Movement led by Mahatma Gandhi encouraged the indigeneous trading and business class to start industrial enterprises. As a result, Calcutta became another major centre of share trading. The trading was prompted by the coal boom of 1904-1908. Thus the third stock exchange was started by Calcutta stock brokers. During Inter-war years demand for industrial goods kept increasing due to British involvement in the World Wars. Existing enterprises in steel and cotton textiles, woolen textiles, tea and engineering goods expanded and new ventures were floated. Yet another stock exchange was started at Madras in 1920.

The period 1935-1965 can be considered as the period of development of the existing stock exchanges in India. In this period industrial development planning played the pivotal role of expanding the industrial and commercial base of the country. Two more stock exchanges were set up, at Hyderabad in 1943 and at Delhi in 1947. At the time of Independence seven stock exchanges were functioning located in the major cities of the country. Between 1946 and 1990, 12 more stock exchanges were set up trading the shares of 4843 additional listed companies.

There are 23 stock exchanges in the country, 23 of them being regional ones with allocated areas. Three others set up in the reforms era, viz., National Stock Exchange (NSE), the Over the Counter Exchange of India Limited (OTCEI), and Inter-connected Stock Exchange of India Limited (ISE) have mandate to nationwide trading network. The ISE is promoted by 15 regional stock exchanges in the country and has been set up at Mumbai. The ISE provides a member-broker of any of these stock exchanges an access into the national market segment, which would be in addition to the local trading segment available at present. The NSE and OCTEI, ISE and majority of the regional stock exchanges have adopted the Screen Based Trading System (SBTS) to provide automated and modern facilities for trading in a transparent, fair and open manner with access to investors across the country. 9,877 companies were listed on the stock exchanges as on 31 March 1999, and the market capitalization was 5,30,772 crore. The number of primary listed companies at various stock exchanges in India was 9,644 as on end of March, 2002. The market capitalisation at NSE was Rs. 6,36,861 crore by March 2002. The following are the names of the various stock exchanges in India.

1. The Bombay Stock Exchange
2. The Ahmedabad Stock exchange Association
3. Bangalore Stock Exchange
4. The Calcutta Stock Exchange Association
5. Cochin Stock Exchange

6. The Delhi Stock Exchange Association
7. The Guwahati Stock Exchange
8. The Hyderabad Stock Exchange
9. Jaipur Stock Exchange
10. Kanara Stock Exchange
11. The Ludhiana Stock Exchange Association
12. Madras stock Exchange
13. Madhya Pradesh Stock Exchange
14. The Magadh Stock Exchange
15. Mangalore Stock Exchange
16. Pune Stock Exchange
17. Saurashtra Kutch Stock Exchange
18. The Uttar Pradesh Stock Exchange Association
19. Vadodara Stock Exchange
20. Coimbatore Stock Exchange
21. Over The Counter Exchange of India
22. The National Stock Exchange of India
23. inter-connected Stock Exchange of India Limited

4.4.2 Role and Functions

The history of stock exchanges in foreign countries as well as in India shows that the development of joint stock enterprise would never have reached its present stage but for the facilities which the stock exchanges provided for dealing in securities. Stock exchanges have a very important function to fulfil in the country's economy. In Union of India vs. Allied International Products Ltd (1971) 41 Comp Cas 127 (SC) : (1970) 3 SCC 5941], the Supreme Court of India has enunciated the role of the stock exchanges in these words:

"A Stock Exchange fulfils a vital function in the economic development of a nation: its main function is to `qualify' capital by enabling a person who has invested money in, say a factory or a railway, to convert it into cash by disposing off his shares in the enterprise to someone else. Investment in joint stock companies is attractive to the public, because the value of the shares is announced day after day in the stock exchanges, and shares quoted on the exchanges are capable of almost immediate conversion into money. In modern days a company stands little chance of inducing the public to subscribe to its capital, unless its shares are quoted in an approved stock exchange. All public companies are anxious to inform the investing public that the shares of the company will be quoted on the stock exchange".

The stock exchange is really an essential pillar of the private sector corporate economy. It discharges three essential functions in the process of capital formation and in raising resources for the corporate sector. They are :

First, the stock exchange provides a market place for purchase and sale of securities viz., shares, bonds, debentures, etc. It, therefore, ensures the free transferability of securities which is the essential basis for the joint stock enterprise system. The private sector economy cannot function without the assurance provided by the stock exchange to the owners of shares and bonds that they can be sold in the market at any time. At the same time those who wish to invest their surplus funds in securities for long-term capital appreciation or for speculative gain can also buy stocks of their choice in the market.

Secondly, the stock exchange provides the linkage between the savings in the household sector and the investment in corporate economy. It mobilizes savings, channelises them as securities into those enterprises which are favoured by the investors on the basis of such criteria as future growth prospects, good returns and appreciation of prevalence on the Indian scene of such interventionist factors as industrial licensing, provision of credit to private sector by public sector development banks, price controls and foreign exchange regulations. The stock exchanges discharge this function by laying down a number of regulations which have to be complied with while making public issues e.g. offering at least the prescribed percentage of capital of the public, keeping the subscription list open for a minimum period of three days, making provisions for receiving applications at least at the centres where there are recognised stock exchanges and allotting the shares against applications on a fair and unconditional basis with the weightage being given to the applications in lower categories, particularly those applying for shares worth Rs.500 or Rs.1,000, etc. Members of stock exchanges also assist in the floatation of new issues by acting as managing brokers/official broker of new issue. In that capacity, they, inter alia, try to sell these issues to investors spread all over the country. They also act as under-writers to new issues. In this way, the broker community provides an organic linkage between the primary and the secondary markets.

Thirdly, by providing a market quotation of the prices of shares and bonds, a sort of collective judgement simultaneously reached by many buyers and sellers in the market-the stock exchanges serves the role of a barometer, not only of the state of health of individual companies, but also of the nation's economy as a whole. It is often not realised that changes in share prices are brought about by a complex set of factors, all operating on the markets simultaneously. Share values as a whole are subject to secular trends set by the economic progress of the nation, and governed by factors like general economic situation, financial and monetary policies, tax changes, political environment, international economic and financial developments, etc. These trends are influenced to some extent by periodical cycles of booms and depressions in the free market economies. As against these long-term trends, the day-to-day prices are influenced by another variety of factors notably, the buying or selling of major operators, the buying and selling of shares by the investment financial institutions such as the U.T.I. or L.I.C. which have in recent years emerged as the largest holders of corporate securities, speeches and pronouncements by ministers and other government spokesmen, statements by company chairmen at annual general meetings and reports of bonus issues or good dividends by companies, etc., while these factors, both long-term and short-term, act as macro influences on the corporate sector and the level of stock prices as a whole, there is also a set *of* micro influences relating to prospects of individual companies such as the reputation of the management, the state of industrial relations in the enterprises, the volume of retained earnings and the related prospects of capitalization of reserves, etc., which have a bearing on the level of prices. In the complex interplay of all these forces, which leads to day-to-day quotation of prices of all listed securities, speculation plays a crucial role. In the absence of speculative operations, every purchase by an investor has to be matched by a sale *of* the same security by an investor-seller, and this may lead to sharp fluctuation in prices. With speculative sale and purchases taking place continuously, actual sale and purchase by investors on a large scale are absorbed by the market with small changes in prices. There are always some professional operators who are hoping that the prices would rise. There are others predicting that prices will fall. Both these groups acting on their respective assumption buy or sell continuously in the market. Their operation helps to bring about an orderly adjustment of prices. Without these speculative operations, a stock exchange can become a very mechanical thing. However, excessive speculation endangers market equilibrium and must be discouraged through appropriate safeguards. The regulatory authorities should always take necessary precautionary measures to prevent and penalize excessive speculation and to discipline trading.

A fact which needs to be emphasized is that the stock exchanges in India also serve the joint sector units as also to some extent public sector enterprises. There is substantial private participation in the share capital of a number of government companies such as Balmer Lawrie, Andrew Yule, Gujarat State Fertilizers

Corporation, Gujarat Narmada Fertilizers Corporation, State Bank of India, ICICI, etc. In recent times some of the Central public sector companies have gone in for public debentures through the stock exchanges. Also, there are some public sector companies like VSNL which have made their share capital open for public subscription.

Another important function that the stock exchanges in India discharge is of providing a market for gilt-edged securities i.e. securities issued by the Central Government, State government, Municipalities, Improvement Trusts and other public bodies. These securities are automatically listed on the stock exchanges when they are issued and transactions in these take place regularly on the stock exchanges.

4.4.3 Membership, Organisation and Management

By virtue of the century-old tradition, stock exchanges is a highly organized and smooth functioning network in the world. The membership of stock exchanges initially comprised of individuals and partnership firms. Later on companies were also allowed to become members. A number of financial institutions are now members of Indian stock exchanges. Over the years, stock exchanges have been organized in various forms. For example, while the Bombay Stock Exchange, Ahmedabad Stock Exchange and M.P. (Indore) Stock Exchange were organised as voluntary non-profit making association of persons, the Calcutta Stock Exchange, Delhi Stock Exchange, U.P. (Kanpur) Stock Exchange, Ludhiana Stock Exchange, Cochin Stock Exchange, Gauhati Stock Exchange, Jaipur Stock Exchange, and Kanara (Mangalore) Stock Exchange were organised as public limited companies. Quite a few others have been organised as companies limited by guarantee.

The internal governance of every stock exchange rests in a Governing Board Comprising Members of the Board and Executive Director/President. Members of the Governing Board include brokers and non-brokers. Governing Bodies of stock exchanges also have government nominees. The Executive Director/President is expected to ensure strict compliance by all members of the exchange of rules/by laws, margin regulations and trading restriction, etc. Subject to the previous approval of SEBI, under the law, Governing Bodies of stock exchanges have wide powers to make bye-laws. Governing Bodies can admit, punish, censure and also expel any member, any partner, any remisier, and authorised clerk and employee. It has the power to adjudicate disputes. Above all, it has the power to make, amend, suspend and enforce rules, by-laws, regulations and supervise the entire functioning of a stock exchange.

4.4.4 Trading System

Trading system differ from exchange to exchange. In the next few pages, the trading system followed by the National stock Exchange is described. Students desire to know more about the trading system of other exchanges in India as well as outside India can visit respective web sites of stock exchanges.

NSE operates on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. NSE consciously opted in favour of an order driven system as opposed to a quote driven system. This has helped reduce jobbing spreads not only on NSE but in other exchanges as well, thus reducing transaction costs. Till the advent of NSE, an investor wanting to transact in a security not traded on the nearest exchange had to route orders through a series of correspondent brokers to the appropriate exchange. This resulted in a great deal of uncertainty and high transaction costs. NSE has made it possible for an investor to access the same market and order book, irrespective of location, at the same price and at the same cost.

Market Types

The NEAT system has four types of market. They are :

Normal : All orders which are of regular lot size or multiples thereof are traded in the Normal Market. For shares which are traded in the compulsory dematerialised mode, the market lot is one share. Normal market consists of various book types wherein orders are segregated as Regular lot orders, Special Term orders, Negotiated Traded orders and Stop Loss orders depending on their order attributes.

Odd Lot Market : All orders whose order size is less than the regular lot size are traded in the odd-lot market. An order is called an odd lot order if the order size is less than regular lot size. These orders do not have any special terms attributes attached to them. In an odd-lot market, both the price and quantity of both the orders (buy and sell) should exactly match for the trade to take place. Currently the odd lot market facility is used for the Limited Physical Market as per the SEBI directives.

Spot Market : Spot orders are similar to the normal market orders except that spot orders have different settlement periods vis-à-vis normal market. These orders do not have any special terms attributes attached to them. Currently the Spot Market is being used for the Automated Lending & Borrowing Mechanism (ALBM) session.

Auction Market : In the Auction Market, auctions are initiated by the Exchange on behalf of trading members for settlement related reasons.

There are 3 participants in this market :

- **Initiator :** The party who initiates the auction process is called an initiator.
- **Competitor :** The party who enters orders on the same side as of the initiator is called a Competitor.
- **Solicitor :** The party who enters orders on the opposite side as of the initiator is called a Solicitor.

Order Books

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

- Best Price

- Within Price, by time priority.

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

The Capital Market segment has following types of books:

Regular Lot Book : The Regular Lot Book contains all regular lot orders that have none of the following attributes attached to them.

- All or None (AON)

- Minimum Fill (MF)

- Stop Loss (SL)

Special Terms Book : The Special Terms book contains all orders that have either of the following terms attached:

- All or None (AON)

- Minimum Fill (MF)

(Note : Currently, special term orders i.e. AON and MF are not available on the system as per the SEBI directives.)

Negotiated Trade Book : The Negotiated Trade book contains all negotiated order entries captured by the system before they have been matched against their counterparty trade entries. These entries are matched with identical counterparty entries only. It is to be noted that these entries contain a counterparty code in addition to other order details.

Stop-Loss Book : Stop Loss orders are stored in this book till the trigger price specified in the order is reached or surpassed. When the trigger price is reached or surpassed, the order is released in the Regular lot book.

The stop loss condition is met under the following circumstances:

SELL ORDER - A sell order in the Stop loss book gets triggered when the last traded price in the normal market reaches or falls below the trigger price of the order.

BUY ORDER - A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.

Odd Lot Book : The Odd lot book contains all odd lot orders (orders with quantity less than marketable lot) in the system. The system attempts to match an active odd lot order against passive orders in the book. Currently, pursuant to a SEBI directive, the Odd Lot Market is being used for orders which have a quantity less than or equal to 500 (Qty more than the market lot) for trading. This is referred as the Limited Physical Market (LPM).

Spot Book : The Spot lot book contains all spot orders (orders having only the settlement period different) in the system. The system attempts to match an active spot lot order against the passive orders in the book. Currently the Spot Market book type is being used for conducting the Automated Lending & Borrowing Mechanism (ALBM) session.

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

Order Matching Rules

The best buy order is matched with the best sell order. An order may match partially with another order resulting in multiple trades. For order matching, the best buy order is the one with the highest price and the best sell order is the one with the lowest price. This is because the system views all buy orders available from the point of view of a seller and all sell orders from the point of view of the buyers in the market. So, of all buy orders available in the market at any point of time, a seller would obviously like to sell at the highest possible buy price that is offered. Hence, the best buy order is the order with the highest price and the best sell order is the order with the lowest price.

Members can proactively enter orders in the system which will be displayed in the system till the full quantity is matched by one or more of counter-orders and result into trade(s) or is cancelled by the member. Alternatively, members may be reactive and put in orders that match with existing orders in the system. Orders lying unmatched in the system are `passive' orders and orders that come in to match the existing orders are called `active' orders. Orders are always matched at the passive order price. This ensures that the earlier orders get priority over the orders that come in later.

Order Conditions

A Trading Member can enter various types of orders depending upon his/her requirements. These conditions are broadly classified into three categories: time related conditions, price-related conditions and quantity related conditions.

Time Conditions

- DAY - A Day order, as the name suggests, is an order which is valid for the day on which it is entered. If the order is not matched during the day, the order gets cancelled automatically at the end of the trading day.
- GTC - A Good Till Cancelled (GTC) order is an order that remains in the system until it is cancelled by the Trading Member. It will therefore be able to span trading days if it does not get matched. The maximum number of days a GTC order can remain in the system is notified by the Exchange from time to time.
- GTD - A Good Till Days/Date (GTD) order allows the Trading Member to specify the days/date up to which the order should stay in the system. At the end of this period the order will get flushed from the system. Each day/date counted is a
calendar day and inclusive of holidays. The days/date counted are inclusive

of the day/date on which the order is placed. The maximum number of days a GTD order can remain in the system is notified by the Exchange from time to time.

- IOC - An Immediate or Cancel (IOC) order allows a Trading Member to buy or sell a security as soon as the order is released into the market, failing which the order will be removed from the market. Partial match is possible for the order, and the unmatched portion of the order is cancelled immediately.

Price Conditions

- Limit Price/Order - An order which allows the price to be specified while entering the order into the system.
- Market Price/Order - An order to buy or sell securities at the best price obtainable at the time of entering the order.
- Stop Loss (SL) Price/Order - The one which allows the Trading Member to place an order which gets activated only when the market price of the relevant security reaches or crosses a threshold price. Until then the order does not enter the market.

  SELL ORDER

  A sell order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or falls below the trigger price of *the* order.

  BUY ORDER

  A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order. e.g. If for stop loss buy order, the trigger is Rs. 93.00, the limit price is Rs. 95.00 and the market (last traded) price is Rs. 90.00, then this order is released into the system once the market price reaches or exceeds Rs. 93.00. This order is added to the regular lot book with time of triggering as the time stamp, as a limit order of Rs. 95.00

Quantity Conditions

- Disclosed Quantity (DQ)- An order with a DQ condition allows the Trading Member to disclose only a part of the order quantity to the market. For example, an order of 1000 with a disclosed quantity condition of 200 will mean that 200 is displayed to the market at a time. After this is traded, another 200 is automatically released and so on till the full order is executed. The Exchange may set a minimum disclosed quantity criteria from time to time.
- MF - Minimum Fill (MF) orders allow the Trading Member to specify the minimum quantity by which an order should be filled. For example, an order of 1000 units with minimum fill 200 will require that each trade be for at least 200 units. In other words, there will be a maximum of 5 trades of200 each or a single trade of 1000. The Exchange may lay down norms of MF from time to time.
- AON - All or None orders allow a Trading Member to impose the condition that only the full order should be matched against. This may be by way of multiple trades. If the full order is not matched it will stay in the books till matched or cancelled.

4.4.5 Stock Market Information System

Stock exchange quotations and indices published in daily newspapers are the main source of information on stock exchange trades and turnover. Dailies like Economic Times, Financial Express, Business Standard, Business Line, Times of India and Hindustan Times publish daily quotations and indices. As for Bombay Stock Exchange quotations published in Economic Times, information on equity shares, starting from the first column, is presented in the following order: Company's name; previous day's closing price in brackets; all the daily traded prices as published by the BSE ; key financial parameters such as earnings per share (EPS), cash earnings per share (CPS), cash P/E (price to earnings ratio), return on net worth (RN W) and gross profit margin (GPM) etc. on different days; P/E ; and the high and low prices in the preceding 52 weeks.

The first traded price is the day's opening price. If only one such price is recorded, it is also the day's closing price. If there are two prices, then the middle quote is either the high or low price. If there are four prices, then one of the middle quotes is the day's high and the other, the low. If there are no transactions in a company's share on any day, the previous day's closing price is presented in brackets.

The EPS is the average net profit after tax per equity share and the CPS the average cash profit (after adding back depreciation) per share. The cash P/E is the ratio of the day's closing price to the cash earnings per share as distinct from the P/E ratio, which relates price to the net profit per share. PE values are not printed when earnings are either nil or negative.

The RNW is the net profit as a percentage of the net worth and measures the return earned on the shareholders' fund i.e. equity capital plus reserves. The GPM is the gross profit margin (before depreciation and tax) as a percentage of gross sales and measures the company's profit margin which is available to absorb depreciation charges arising from capital expenditure, tax payments, dividend distribution and profit ploughback. All the figurers are taken from the latest available results (audited / unaudited) of the company.

The 52-week high and low prices of each share are worked out every day on the basis of the highest and lowest points scaled during the immediately preceding 52 weeks. The high and low prices are adjusted for bonus and rights issue of equity shares. If any of the day's traded price is a yearly high or low, the entire line, including the name of the company, is shown in bold types, with a 'H' attached to the high value or `L' attached to the low value. Whenever there is a significant change in the day's closing value as compared to the previous closing, it is shown in bold types with a `plus' or `minus' sign as the case may be, after the closing value. For specified shares, a three per cent change and for non-specified shares a 15 per cent change is treated as significant. Whenever a share goes ex-divided or ex-bonus or ex-rights, it is indicated by notation XD or XB or XR, as the case may be placed next to its closing price. Symbol of face values other than Rs. 10. are also indicated along with the names. Since Indian regulations allow stock splits, a number of firms have face value other than Rs. 10.

For debentures, the information starting from the first column, is presented in the following order: the nominal rate of interest on the face value, company name, face value, previous day's closing price, the day's opening price, yield to maturity (YTM) and yield (both annualized). The yield is nominal interest expressed in percentage terms of closing value. The YTM adjusts the nominal return for the maturity period, frequency of interest payments, manner of principal repayment, redemption premium, if any, and thereby enables investors to compare different investment options in debentures on a uniform scale. If there are no quotations for a company's debenture on a day, the opening price is shown as nil, and the closing price the same as the previous day's closing.

Besides these quotations share price indices are also published in different dailies. Bombay Stock Exchange's 30- share 'Sensex' and 100 -share `National' indices are quite popular. In addition, NSE-50 (Nifty) has also become popular with institutional and retail investors in recent times. Besides these, there are other indices also which include The Economic Times Index of Ordinary Share Price, Business Standard Index of Ordinary Shares Price and a few others. Reserve Bank of India also publishes Share Price Index.

Activity-2

1) Take a look at the Bombay Stock Exchange quotations published in Economic Times and write out hereunder price quotations for five Shares and five Debentures.

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2) Take a look at Economic Times or any other financial daily and compare and contrast 30-share Sensex and 100-share National Index of Bombay Stock Exchange and also NSE-50 Index.

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3) Write out two sources of stock market information other than a newspaper.

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4.5 SUMMARY

In this Unit, we have discussed two segments of Indian securities market namely primary market or new issues market and secondary market or stock market. We have highlighted recent trends in the primary market and discussed various types of market players and trading arrangements which exist in the Indian stock market. Different aspects of the Indian stock market viz., origin and growth, role and functions, membership, organisation and management, trading systems, and stock market information system have been explained so that you as a student of this course are able to clearly visualise the environment in which investment and portfolio management decisions are made. In the following Unit we shall focus on the legal frame of Indian securities market.

4.6 SELF-ASSESSMENT QUESTIONS/EXERCISES

1. What are the basic constituents of the securities market?

2. What are the different types of securities markets? What are their role and functions?

3. What are different categories of players operating in primary and secondary markets?

4. Write a brief note on the management of stock exchanges in India.

5. Briefly discuss recent trends in the development of the primary market in India.

6. What is OTCEI and NSE? How are they different from other stock exchanges ?

7. Critically evaluate stock market indices as indicators of the mood of the market and health of the economy.

4.7 FURTHER READINGS

1. *Bombay Stock Exchange Official Di'ectory,* Bombay Stock Exchange, Bombay

2. Gupta, L.C. 1992, *Stock Exchange Trading in* India-Agenda *For Reform, Society* For *Capital Market Research* and *Development,* New Delhi.

3. SEBI Act and Regulations on various intermediaries and capital offerings