Gr 12 FMM

Academic window part 1

Unit 1 : Introduction to Securities Market

Indian financial markets are a complex and dynamic system that plays a vital role in the country's economy. They bring together investors and businesses, providing a platform for capital to flow from those with excess to those with a need. The Indian financial market is made up of a variety of markets, including the stock market, the bond market, the derivatives market, the foreign exchange market, and the money market.

Financial intermediation is the process of bringing these two groups together. It is an essential part of the Indian financial market, and it helps to ensure that capital is allocated efficiently.

Structure of Financial Markets in India

This is popularly referred to as financial intermediation and exists at the core of the Indian economy; bringing investors and businesses together in a symbiotic relationship. Here is what it consists of.

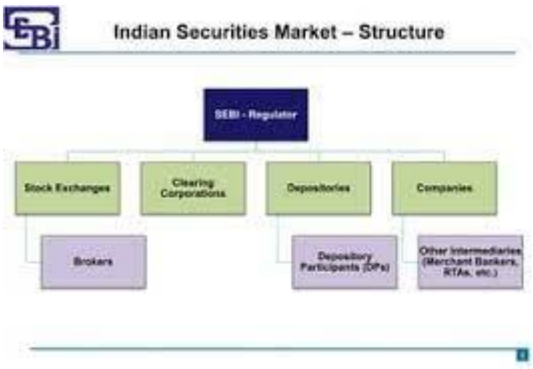
The Banking System

Indian banking has a multi-tier structure. The Reserve Bank of India is the regulator of the banking system and the monetary authority. Its functions include licensing banks and regulation for a strong and stable banking system. RBI is the note-issuing authority and banker to the government and acts as a lender of last resort to the other banks. It also acts as a controller of credit in the monetary system. On the banking front there are PSU banks, private banks; cooperative banks, small finance banks etc. and they combine to define the Indian banking system.

Indian Securities Market

The securities market provides an institutional framework for efficient flow of capital in the economy. Capital markets converts saving into investments for the investor and it converts business pedigree into funding for the businesses. This basic arrangement in the securities markets enables flow of capital from households to business, in a regulated institutionalised framework.

The securities market include equities, index futures, index options, stock futures, stock options, long term bonds, medium term bonds, short term bonds, money market securities, equity funds, debt funds, hybrid funds, structured products, REITS, INVITs etc. Security markets are an important for raising money for corporates and institutions and also for investors to allocate their money.



Indian Commodities Market

Commodity market facilitates transactions between buyers and sellers of commodities. These commodities are broadly dividend into four categories viz. agricultural commodities, precious metals, industrial metals and energy products (oil and gas). Commodities can be traded in India in the spot market (for immediate delivery) or in the futures market (for delivery), or in the futures market (not for delivery) or in the options (so as to devolve into commodity futures). Commodity markets are essentially used by industries, traders, importer and exporters to hedge the commodity price risk

Foreign Exchange Market or Forex Market

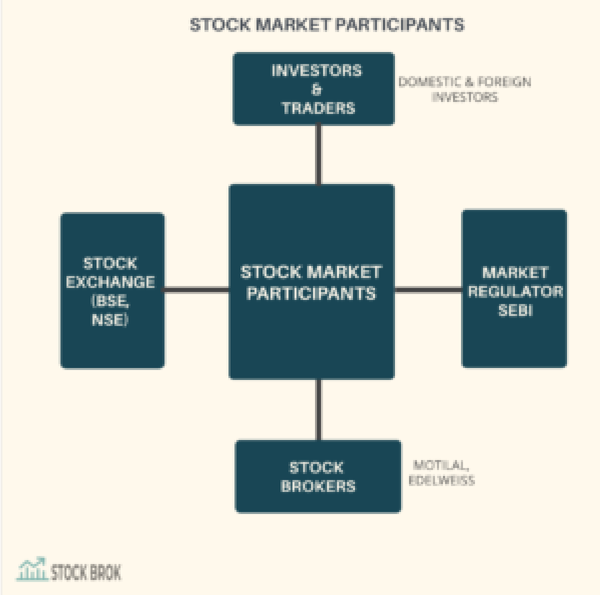
This is where the currencies are exchanged and there are traders, arbitrageurs, speculators and hedgers in these markets. Globally, the forex trading market is the largest compared to other asset classes. The growth of international trade made it necessary to be able to determine the relative value of currencies given the differences in their purchasing power. The need for exchanging one currency to another for settling trades in goods and services brought about foreign exchange risk and that created a robust forex market. India has had the rupee forward market offered by banks for a long time, but that is offered by banks only against actual exposure. Today, it is possible to also trade currency pairs in the currency derivatives segment of the stock exchange. The USDINR pair is, obviously, the most popular and extensively traded currency pair

What role do participants play in the securities market?

Here are the key intermediaries in the securities market and the role that they play.

- Stock Exchanges provide the infrastructure for trading in securities that have been issued at prices that reflect its current value and also helps discover a fair value for the stock. It also provides liquidity to the investors when they require funds. Stock exchanges appoint clearing and settlement agencies and clearing banks to handle clearing and settlement of securities.
- Depository participants facilitate investors to hold and transact in securities in dematerialised form. They service customers on behalf of one of the depositories;

NSDL or CDSL. Demat has gone a long way to make the Indian stock market system clean and transparent.

- 

- Custodians work with institutional investors and hold securities and manage bank accounts on behalf of institutional investors. They manage the transactions pertaining to delivery of securities and money after a trade is made through the broker, and also keeps the accounts of securities and money.

- Stock brokers are registered trading members of stock exchanges. They sell new issuance of securities to investors. They put through the buy and sell transactions of investors on stock exchanges.

- Investment Bank's activities include advisory for business expansions, project financing, mergers and acquisition, investment valuation, among others, new issue management etc. Commercial Banks provide banking services of taking deposits, providing credit and enabling payment services. They provide efficient cash management for businesses.

- Insurance Companies provide service of insuring life, property and income against unexpected and large charge. Life insurance companies deal with insuring the life of individuals while general insurance covers health, motor, travel and other areas, where a sudden large expense can derail the financial situation of a household or business. Insurance companies use channels such as individual and corporate agents, brokers and banks to sell their products. Given the large resources mobilized by insurance companies by way of premiums, they are an important source of long-term funding for government and businesses.

- Pension Funds take contributions from eligible individuals and invest these funds according to the directions of the contributors to create a retirement corpus. These funds provide different options for investment of the contribution, such as debt, equity or a combination. Investors select the type of fund and these are long term retirement funds.

- AMCs and Portfolio Managers are investment specialists who manage a portfolio of securities and other assets. Against this portfolio, these asset managers either issue units or PMS accounts to create wealth over the long run.

- Investment Advisers and distributors help investors to make a choice of securities that they can buy based on an assessment of their needs, time horizon return expectation and ability to bear risk. The idea is to work towards a long term financial plan.

Functions of the Primary Market

Here are some of the key functions that primary markets provide.

1. Primary markets provide access to wider markets and investors to corporates and help investors productively allocate money to create wealth. This includes IPOs, FPOs, and OFS etc.
2. Primary markets provide a transparent Pricing Mechanism by enabling price discovery through book building
3. Primary markets also facilitate Ownership Diversification as new subscribes (retail, HNI, corporates, institutions and trusts) enter the market and become owners.
4. They facilitate Better Disclosure practices due to stringent SEBI regulations and the demands of a competitive market.
5. Primary markets also provide the benefit of Evaluation by Investors as well as an expert view by brokers and analysts to enable an informed call.
6. For anchor investors and early stage investors and, at times, even for promoters, the primary markets provide an exit route.
7. The primary market enables distribution of securities to a large number of investors and paves the way for a liquid secondary market.
8. Regulatory Supervision is a major advantage as all stages of primary markets are closely regulated and monitored by SEBI.

Types of Primary Issues and Types of Issuers

Here are some of the popular primary issue types that are available.

- Public issue – securities are issued to the public

- Private placement – securities issued to select investors

- Preferential issue – securities issued to identified investors

- Qualified Institutional Placement – issued to institutional investors only

- Rights and Bonus issues – issued to existing shareholders on record date

Here are some of the types of issuers of securities

- Central and State governments raise funds through G-Sec, treasury bills, dated securities, State Development Loans (SDLs) etc.
- Public Sector Units (PSUs) raise monies through issue of shares, bonds, tax-exempt bonds, tax-free bonds etc.
- Private Sector Companies raise funds in the market through equity or debt securities, preference shares, and CPs and convertible instruments.
- Banks, DFIs and NBFCs raise funds via equity shares, preference shares, bonds, convertible bonds, commercial paper, certificates of deposits and securitized paper.
- Mutual Funds make NFOs of units in the domestic markets and also through closed ended funds and interval funds.
- REITs and INVITs also issue pass through securities against a portfolio of realty properties or infrastructure project pools.

Regulatory Norms Governing Public Issue of Shares

Here are some of the key regulations governing the issue of shares to the public.

- A public issue will be open for a minimum of 3 and maximum of 10 working days
- Investors can apply during this period
- Book built issue investors can also revise bids in this period.
- Company making a public issue must enter into an agreement with all depositories
- Such companies may get the IPO graded by a credit rating agency registered with SEBI

Functions of the Secondary Markets

Once a company lists through a primary issue, it gets traded in the secondary market. When you buy and sell on the NSE or BSE, it is a case of secondary market trading. Here are some common functions of the secondary market.

1. Secondary markets provide liquidity and marketability to existing securities so that investors wanting to sell shares or debentures have a ready market.

2. Secondary markets enable price discovery of traded securities through a mix of interplay of buy and sell orders as well as constant research and news flow interpretation
3. Market prices provide instant information about issuing companies to all market participants due to the strict disclosure norms prescribed by exchanges
4. Secondary market trading data is used to generate benchmark indices which are a barometer of the strength of the economy and give a market cap valuation.
5. It facilitates efficient governance by facilitating changes in corporate control. This is done through takeovers, mergers, buyouts, restructuring etc.

Secondary Market Structure and Participants

The secondary market consists of the following participants:

- Market Infrastructure Institutions include Stock Exchanges, Clearing Corporations and Depositories. Stock exchanges handle the transaction execution and the first level SRO regulation of markets. Clearing corporations clear and settle trades and also counter guarantee trades. Depositories hold shares in custody behalf of investors.

- Custodians are institutional intermediaries authorised to hold funds and securities on behalf of large institutional investors such as banks, insurance companies, mutual funds, and foreign portfolio investors (FPIs). They settle trades for institutional investors.

- Depository Participants facilitate electronic holding, transfer, transmission, pledge of securities as well as facilitate corporate actions on the holdings.

- Members of Stock Exchanges or brokers act as the intermediary between the exchange and the investors and facilitate the trade conceptually and operationally.

- Finally, it is investors who buy and sell shares among themselves, and form the pivot of the stock markets providing liquidity support and creating wealth for themselves

- Issuers are companies and other entities that get listed on the stock exchange. Equity shares, corporate bonds and debentures as well as securities issued by the government (G-Secs and treasury bills) are admitted to trade on stock exchanges. There are specific eligibility criteria to list securities on the stock market.

Secondary markets are regulated under the provisions of the SCRA and the existing SEBI regulations. The Act has empowered stock exchanges to administer portions of the regulation pertaining to trading, membership and listing.

Corporate Actions

Corporate actions are a type of benefit given to the shareholders of a company. A company conducts several actions, apart from those related to its business, that have a direct implication for the shareholder. These include sharing of surplus with the shareholders in the form of dividend or bonus, changes in the capital structure through the issue of rights shares, buy backs, mergers and acquisitions and delisting. The entitlement to corporate actions is based on the concept of record date. That means; all shareholders that appear in the records of the company on the record date are entitled to receive the benefit of that corporate action. Here is a quick summary of corporate actions and what it entails. hts Issues Rights entail issue of shares (normally at a discount to the market price to the existing shareholders. Rights are also traded separately in the market as an option

Bonus Issues Here the free reserves like general reserves, profits ploughed back and share premium are used to issue additional shares in a predetermined proportion to shareholders

Dividends Dividend is a cash payout to shareholders at a fixed rate on the number of shares they hold in the company

Stock Splits Stock Splits entail split the face value of the stock. For example, changing the face value of a stock from Rs.10 to Rs.5 or Rs.2 is a stock split. The reverse is stock consolidation. Like bonus issues, stock splits are also value neutral

Share buyback The company uses its excess cash to buy back its own shares and extinguish them. This improves the EPS of the company as there are less shares outstanding

Mergers In a merger between two companies, one company ceases to exist and merges into the other. Normally, shareholders of the merged company get shares of the surviving company

Takeovers Here one company is acquired by another company. This acquisition can be a cash transaction or a share swap and is a popular strategy of expansion and diversification

Having understood the concept of corporate actions, let us look at how the calculations work in some of the popular corporate actions.

Rights Issue

The rights shares are offered to the existing investors in a proportion as approved by the board. For example, the company may choose to issue rights in the ratio of 1:1. This would double its capital. Ratio of rights issues can be anything. Investors can either opt for or even forfeit their rights shares. Such entitlements can be sold in the secondary markets.

Bonus Issue

A bonus issue of shares is made to existing shareholders. A bonus issue in the ratio 1:3 entitles the shareholder to 1 bonus share for every 3 held. The company makes the bonus issue out of its free reserves

Dividends

Dividends are the share of profits of the company paid to shareholders. Normally companies declare interim dividends through the financial year and final dividend at the end of the year. Dividends can only be declared out of the profits and not out of capital. A loss-making company cannot therefore pay a dividend to its shareholder. A company which has failed to redeem its preference shares is prohibited from declaring dividends. SEBI has mandated that listed companies shall declare dividends on a per share basis.

Stock Splits

A stock split is where the face value of the existing shares is reduced in a defined ratio. A stock split of 1:5 splits an existing share into 5 shares. In other words the par value of Rs.10 becomes Rs.2 and the number of shares held increases five times. From the company's perspective, there is no change in share value.

Share Buyback

A company may buy back its shares listed on a stock exchange from the investors out of the reserves and surplus available with the company. The shares bought back are extinguished by the company as India does not permit buyback for treasury (unlike the US). From the latest Union Budget 2019, share buybacks are taxed at 20%.

1. Name the two mediums through which the secondary market operates.
 Stock exchange and over the counter exchange
2. How is the market capitalization of companies listed on an Exchange computed?
   It is calculated by **multiplying the price of a stock by its total number of outstanding shares**
3. Are there any entry/exit barriers to the membership of NSE?
   There **are no entry/exit barriers** to the membership of NSE. Anybody can become a member by complying with the prescribed eligibility .

4. How can you invest in primary market ?
   Retail clients can also invest in the primary market, though for the most part it's dominated by institutional investors. For example, with us, you can invest in the primary market for a company's share issue by subscribing to the IPO ahead of time.
5. What is private placement of the New Issues ?
   Private placement offerings are securities released for sale only to accredited investors such as investment banks, pensions, or mutual funds. Some high-net-worth individuals may also purchase the shares through these options.
6. What does 'Market Capitalisation Ratio' measure ?
   Market capitalization, or market cap, is one measurement of a company's size. It's the total value of a company's outstanding shares of stock, which include publicly traded shares plus restricted shares held by company officers and insiders
7. Define 'Dominant Promoter Group'.

   Any person or persons holding 51% either individually or collectively with the following:

   (i) their/his relatives as defined under Companies Act, 2013, as amended from time to time and/or
   (ii) the person(s) falling within the definition of 'Control' under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, as amended from time to time and/or
   (iii) the support of strategic investors in such corporate trading member

   will be eligible to constitute Dominant Promoter Group (DPG).
8. State the role of authorized dealer in the capital market.

9. List the documents required to affiliate the Sub-Broker under Trading Member (Broker).

10. Name the process by which physical share certificates of an investor are converted to an equivalent number of securities in an electronic form.
    Dematerialisation
11. Name the segments of Securities Market.
    The securities market has two interdependent and inseparable segments, viz., the primary market and secondary market
12. List any two categories of participants of 'Securities Market'.
    Investors. , Stock Brokers. ,Listed Companies. ,Depository, Transfer Agents, Credit Rating Agencies, Investment Advisers.

13. Name the issue which is 'an offer to the public to subscribe to the share capital of the company'.
    Initial public offering (IPO)
14. Name the term that refers to 'the legal structure of an exchange whereby the ownership, the management and the trading rights at the exchange are segregated from one another'.
    Demutualisation refers to the legal structure of an exchange whereby the ownership, the management and the trading rights at the exchanges are segregated from one another.
15. State any two main objectives of establishing the securities market regulator.
    To safeguard the interest of all the parties involved in trading. It also regulates the functioning of the stock market.

16. What is meant by NSE Demutualised structure?

Demutualization involves the complex process of transitioning a company's financial structure, from a mutual company into a shareholder-driven model.

17. Define ‘Sub-Broker’.

    A sub-broker is an agent of a broker, working with the client, on their behalf. They act as a link between the stockbroker and the client. A stockbroker entrusts the sub-broker with multiple responsibilities, like sourcing clients, providing services and client management.

18. Name any two Regulators of Securities Market.

    The Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992 and is the principal regulator for Stock Exchanges in India and

NSE has a set of Rules and Regulations specifically applicable to each of its trading segments. NSE as an entity regulated by SEBI undergoes regular inspections by them to ensure compliance.

19. Define Primary market?
20. .Name the informal market where the trades are negotiated.
21. . Which Market segment was initially introduced in National Stock Exchange?
    a. Retail Debt Market b. **Wholesale Debt Market** c. Currency Derivatives Market d. Over-the –Counter Market
22. Which entity cannot apply for the membership in National Stock Exchange?
    a. **Social Welfare societies** b. Individuals c. Partnership Firms d. Body Corporate
23. How does Demutualization help to govern the stock exchanges efficiently ?
24. How does Globalisation provide an international platform to the Indian securities ?
25. What is the Capital Market Segment of National Stock Exchange ? Write the types of securities tradable here.