i4E INVESTKUL

An Introduction to

Stock Markets

What Are Shares?

Shares are units of ownership in a company, also known as equities. When you buy a share, you're purchasing a partial ownership stake in a company, entitling you to certain benefits. Companies issue shares to raise money in order to finance operational needs and to fuel growth, and investors buy those shares for an opportunity to generate a return on their investment.

A stock provides you financial security. Equity is established on a per share basis, and the owners are often referred to as shareholders or stockholders.

Thus, when you buy a share, you are purchasing a proportionate claim on a company's net assets and future earnings.

Types Of Equity Shares

Ordinary Shares

Such shares are issued by a company to secure funds to meet long-term expenses and business expansion. Equity shareholders become partial owners of the company, wherein an individual gains access to various management segments involved in running of operations. An individual possessing a large number of these types of equity shares have substantial voting rights while individuals holding smaller number of equity shares (<50%) are called minority shareholders.

Preference Shares

Preference equity shares are generally issued to an investor as a guarantee of the payment of cumulative dividend before returns are distributed among ordinary shareholders. However, preference shares do not have any associated voting and membership rights which are provided to common shares.

Bonus Shares

These types of equity shares are issued out of retained earnings of a business, wherein the profits are distributed among investors in the form of an additional stake in the company.

Right Shares

These shares are issued by a company to its investors at a discounted price as an invitation to increase their stake in the respective business. A firm only sells Right Shares for a stipulated time to raise the required finances to meet its expenditures incurred.

What Are Stock Markets And How It Works

The stock market broadly refers to the collection of stock exchanges where the buying and selling of shares of publicly held companies takes place. Such financial activities are conducted through institutionalized formal exchanges. While both the terms "stock market" and "stock exchange" are often used interchangeably, the latter term generally comprises a subdivision of the former. For example, you cannot buy or sell shares of a public company like Reliance Industries without transacting through the stock markets, if you are a buyer of a share, the stock market helps you meet the seller and vice versa.

Meaning of Stock Exchange

A stock exchange is an important factor in the capital market. It is a secure and regulated place where trading is done in a systematic way. Here, the securities are bought and sold as per well-structured rules and regulations. Securities mentioned here includes shares and debentures issued by a public company that is listed at the stock exchange, debenture and bonds issued by the government bodies, municipal and public bodies.

In India, there are two major stock exchanges- The Bombay Stock Exchange (BSE) and National Stock Exchange (NSE).

How stock market works

The stock market works through a network of exchanges — as discussed above the two major exchanges in India are NSE & BSE. Companies list their shares at the exchanges through a process called an initial public offering or IPO. Investors can buy or sell those shares through exchanges, when an investor transacts in shares listed at the exchanges they are called secondary market transactions and when companies raise money to grow its business via an IPO it is known as primary market transaction. Once IPO is done investors can then buy and sell these stocks among themselves.

IPO, FPO And Other Concepts.

Angel investors

Let us imagine a budding entrepreneur has a brilliant business idea to manufacture a fashionable clothing line. The designs are unique, has attractive price points and the best quality fabric is used to make these cloths. She is confident that the business idea will be a roaring success and is all excited to covert her idea into a functioning revenue generating business.

However, she is likely to be hit by the typical entrepreneurial problem of where is she going to fund her business idea? Assuming that she has no business background she will not attract any serious investor at the initial stage. Most likely she would approach her friends and family to pitch the idea and raise some money. A bank loan can prove to be a risky option when the business is still an idea.

Now, let's assume that she pools in her own money and also convinces 2 of her friends to invest in her business idea and they invest 2crs. These friends are investing at the pre revenue stage and taking a blind bet on the entrepreneur they would be called the Angel investors. Please note, the money from the angels is not a loan, it is actually an investment made by them.

Seed Fund

Now let's assume that she a.k.a. promoter and her 2 friends who are called angels manage to raise in 3cr in capital, this initial capital which is used to kick start business operations is called the 'Seed Fund'. Once the seed fund money is deposited in the company's bank account it is referred to as Share Capital of the company.

In return of the initial seed fund investment, the original investors (promoter plus her angels) will be issued share certificates of the company which entitles them an ownership in the company.

The only asset that the company has at this stage is cash of 3crs, hence the value of the company is also 3crs. This is called the company's valuation.

Issuing shares is quite simple, the company assumes that each share is worth Rs.10 and because there is Rs.5 crore as share capital, there has to be 50 lakh shares with each share worth Rs.10. In this context, Rs.10 is called the 'Face value' (FV) of the share. The face value could be any number. If the FV is Rs.5, then the number of shares would be 1 crore, so on and so forth.