Chapter 1: Introduction

1.1 Nature of the Problem

Indian Economy is the tenth largest economy in the world by nominal GDP and fourth largest in the world by purchasing power parity. The Global Investment bank, "Goldman Sachs", predicted that by 2035 Indian would be the third largest economy of the world just after US and China.

The stock market of India is the 4th largest stock market in Asia and 8th largest in the world with a market capitalization of US$ 1.63 trillion as of December 2010, with 5034 companies listed in it. The index of the Indian stock market SENSEX has gone upto 21000 level in January 2008 from the level of 3000 on April 2003. Right now it is at 19000 level. This surge is due to high FII (Foreign Institutional Investors), FDI (Foreign Direct Investment) and MF (Mutual Fund) inflow in the Indian Stock market.

The average income of general people in India is also growing and average household income is estimated at Rs.65041 per annum. On the other hand the savings of Indian households stood at Rs.1232723 crores for the year 2010 – 2011.
In spite of all these positive factors, the participation of general people in the Indian stock market is declining. It is a fact that the notable pattern of holdings in the stock market is that, it is held almost by promoters (Indian), Government (Indian), Foreign Institutional investors, Foreign Promoters, Insurance Companies etc. and the vast Indian public holds only 10% of the market capital including their investments in stock market through Mutual Funds.

In the early 90's, contribution of the household sector to equities was nearly 12 – 15% of their savings. But of late, this sector had contributed a meager 1.4% of their savings towards equity and equity related assets and at present it is only 4% of their savings that is invested in equity.

It has been observed that Indians mostly put their savings in fixed income bearing securities getting an annual return of 7 – 8% whereas investments in equity for the last 10 years have given a return of 15 – 20% on an average. So, the general public in India, are missing a great opportunity to build substantial capital out of their savings, which works out to be quite high in value with the power of compounding @ 15 – 20%.

Thus, in the above context, the present study is being undertaken for the general people of India. This study tries to analyze the causes and consequences of the lack of participation by general people of India in the
capital market investment in India. The study also tries to evolve various techniques as solution to this problem. This study also tries to impart knowledge to the general people by planning out a systematic approach that is suitable for small retail investors, for investing in stock market.

This study will have tremendous impact on that section of people in India having huge potentiality for investing in stock markets. As the Indian economy is rapidly developing and has high future growth potential which will lead to a fundamentally strong stock market, the participation by this segment by investing in stock market will prove to be very beneficial to them.

1.2 Literature Review

There are several studies in respect of investors' behavior in stock market but specific research on retail investor aversion to stock market is missing. There are several articles on retail aversion to stock market and also there are several books on general investor behavior in stock market. Both are correlated to one another and the aversion is due to the sentimental or behavioral aspect of retail investors. Both of these works i.e. the articles on retail investor aversion to stock market and the one on investors' behavior in stock market have equal importance on the outcome of the final study of
the sentimental behavior of investors causing aversion to stock market investment. Some of these works are as follows:

1. Edward Lovinger (1990) : “Psychology and Stock market”, an article in the journal “Teaching Psychology - Volume 17”.
3. Arshad Khan (1999) : “Psychology Indicators in stock market (sentiment and psychology to monitor the pulse of the market)”, an article of 541 words.
8. Huzaifa Husain (2010) “Stick to high quality companies at fair valuations”, www.fundsupermart.co.in

20. Babar Zaidi (2010): “Retail Investor may be left out if the markets rise very fast”, http://businesstoday.intoday.in


The work on sentimental factor of investors has been done in the context of NYSE (New York Stock Exchange) in particular. But these are not suitably workable in the Indian Stock Market and in the Indian Socio-economic scenario, because the factors governing the stock market operations and the economic activities do basically and characteristically differ in their nature from one country to another. Apart from that the basic nature, tradition, nature, conservative outlook, inherent sentiments and philosophy of life of Indians are different from the people of other western countries. The level of income, cost of living, level of savings and investment scenario of other financial securities are also different from one country to another.
In this study all the above factors were considered while analyzing the sentimental aspect of general investors.

The retail investors' participation in stock market has been discussed in various articles and journals, but the sentiment behind that reluctance to participate has not been researched.

The causes of lack of participation by general investor in stock market in India and the consequences of this as well as the solution to this problem has been addressed in the research work.

1.3 Objectives and Methodology

The main objective of the study is to identify, explore and analyze the problem of lack of participation of general people of India in the Indian stock market and finding solutions to this problem. More specifically the study attempts to:

A. Identify the problem of lack of participation by general people in the Indian stock market. (Chapter 3)
B. Explore and analyze the causes of the lack of participation by general people of India in the Indian stock market. (Chapter 4)
C. Study the investment behavior of general people of India and participation by general people of India in the Indian Stock Market. (Chapter 5)

D. Evaluate the basic concepts of stocks, stock prices, stock markets, stock trading, SENSEX, sectors, newspapers and magazines about stock markets, stock tables and corporate scoreboards. (Chapter 1)

E. Evaluate the current position of the Indian stock market. (Chapter 2)

F. Evaluate the possible solution to this problem. (Chapter 6)

The present study is exploratory in nature. It includes both academic study with the help of various books, journals and mainly internet based websites. It uses various secondary data to study the current position of the Indian Stock market, to study the income and savings of the general people in India to analyze their investment capacity, to study the lack of participation by them in Indian stock market and to evaluate the possible solutions to the problem.

The study also included empirical study by a survey on investment behavior of general people of urban areas (4 metropolitan cities i.e. Kolkata, Delhi, Chennai, Mumbai), semi – urban areas (around 4 metropolitan cities i.e. area around Kolkata - Baranagar, area around Delhi - Gurgaon, area around Chennai - Rajanagar and area around Mumbai - Thane) and rural areas (Shibnibas, Bhajanghat and Krishnagunj in Nadia District, West Bengal)
through structured questionnaire by direct interviews, mailing method of interviews and also interviews over telephone. Then convenient sampling has been used for data collection. Processing of data has been made by editing, classifications (by tally sheets) and tabulations. Then qualitative data frequency tables, cross tables were made. The period of survey was 2008 - 2009 and the survey was conducted among 780 people out of which 642 were male respondents and 138 were female.

1.4 Plan of Work

To achieve the objectives as stated in section 3, the proposed work is divided into the following chapters:-

1. Introduction:

   It includes problem identification, literature review, objectives and methodology and plan of work. It also includes the concepts about stock, stock price, stock market, stock trading, SENSEX, sectors, newspapers and magazines, stock tables and corporate scoreboard.

2. Indian Stock Market:

   This chapter includes history of the Indian stock market, current position of Indian stock market, FII, FDI and MF inflow into the Indian stock market, current position of Indian economy, ups and
downs of the Indian stock market and future prospect of Indian Stock Market.

3. Retail Investors' aversion to stock market:
   This chapter includes household income of Indians, household savings of Indians and details of participation of general people in the stock market of India. Thus, it includes problem identification.

4. Factors Responsible For Retail Investors' Aversion to Stock Market:
   This chapter includes analysis of the problems by finding out the causes of lack of investment by general people of India in the Indian stock market. Thus it includes concept and characteristics of human sentiments in the stock market, how news, rumors and recommendations, shocks and scams and other associated factors influence human sentiments about stock markets and the co-relation between human sentiments and the movement of the SENSEX.

5. An Empirical Study:
   This chapter analyses the primary data on participation of general people in Indian stock market in the urban areas (in selective locations in some cities), semi urban areas (around some cities) and rural areas (some villages).
6. Conclusions and suggestions:

Based on the findings of the research work, conclusions and solutions to the various problems are stated. The limitations of this study and the prospects for further research are also outlined.
Basic Concepts of Stock Market:

1.5 What is Stock Market and How Stocks are traded

A Stock Market is a place where one can buy and sell stocks. Whether one say stock, share or equity all mean the same. When someone wants to buy vegetables, that person has to go to the vegetable market, likewise. If a person likes to buy or sell a stock it is has to be from a stock/share market and most likely with the help of a brokerage firm. Though it is theoretically possible to buy and sell stock, there are some practical and legal problems with this approach. The stock market is highly regulated. So one can't just hang a shingle and buy stocks unless you are properly registered and licensed. Now as in a market there are several shops from where one can buy goods, in stock market also there are several exchanges from where one can buy stocks. However, the basic difference between stock market and general market is that, if someone buys a vegetable or cloth that person does not intend to sell it. But if someone buys a stock from stock market, that person buys it with the intention to sell the stock. If a person buys a stock at a lower price and sells it at a higher price that person makes profit and if someone buys a stock at a higher price and sells at a lower price that person makes a loss. The price at which each buying and selling transaction takes is determined by the market forces (i.e. demand and supply for that particular stock).
Let us take an example for a better understanding of how market forces determine stock prices. ABC Co. Ltd. Enjoy high investor confidence and there is an anticipation of an upward movement in its stock price. More and more people would want to buy this stock (i.e. higher demand) and very few people would be willing to sell this stock at current market price (i.e. less supply) Therefore buyers will have to bid a higher price for this stock to match the asking price from the sellers which increases the stock price of ABC Co. Ltd. On the contrary, if there are more sellers than buyers (i.e. high supply and low demand) for this stock in the market, its price will come down. The purpose of a stock market is to facilitate the exchanging of stocks between the buyers and sellers, reducing the risk of investing. Just imagine how difficult it would be to sell shares if you had to go around the neighborhood trying to find a buyer.

Stock market is divided into two types i.e. first is the primary market and the second is the secondary market. Primary market is where stocks are created by means of an IPO (Initial Public Offering). IPO is the first sale of stock by a limited company to public. IPOs are often issued by smaller and younger companies seeking the capital to expand, but can also be done by large privately owned companies seeking the capital to expand, and by large privately owned companies who desire that their stock should be traded. In an IPO the issuer (i.e. the company) obtains the assistance of an underwriting firm which helps it to determine what type of stock to issue (there are different types of stock, for example ordinary shares or preferential, etc. which will be discussed in details
later), the best offering price and the time to enter the market. A newly issued
IPO will be considered as primary market trade where shares are first
purchased by investors from the underwriting firm at a pre-decided price. IPOs
are also referred as “Public Offering”. After that any shares traded will be in the
secondary market, between investors themselves at a market price. The price at
which stock is traded in the secondary market is called market price. It must be
noted that in any secondary market trade, the cash proceeds go to the investors
not to the underwriting firm or to underlying company/entity directly. It is also
very important to note that secondary market is what people refer to when
they talk about stock market. In India two national stock exchanges i.e. BSE
(Bombay Stock Exchange) and NSE (National Stock Exchange) and other 21
regional stock exchanges are all secondary markets. The market opens at 9 am
and closes at 4 pm. Both the exchanges are open from Monday to Friday
excluding public holidays and remain closed on both Saturdays and Sundays.

1.6 How to buy and sell stocks

(A) Direct Stock Broking:

Some exchanges are actual locations where transactions are carried out on the
trading floor. You have probably seen pictures of a trading floor, in which
traders are widely throwing their arms up, waving, yelling and signaling to
each other. Behind these frenzied spectacles, however there is a methodical and
organized system of trading that prevails. The other type of exchange is virtual, composed of a network of computers where trading is done electronically. This is more popularly known as online trading. Thankfully, to buy or sell stocks one doesn’t have to go down into the trading pit yelling and screaming for a buy or a sell order; the most common method to buy and sell a stock is to use a brokerage. Brokerages come in two different formats i.e. full service brokerage and discount brokerage. Full service brokerages offer you (supposedly) expert advice and personal attention, but their transaction charges are very high. On the other hand discount brokerage offer little in the way of personal attention but are much cheaper. At one time, only the wealthy could afford the services of brokers as only the expensive, full service brokers were available. With the introduction of internet came the explosion of online discount brokers. Thanks to them nearly anybody can now afford to invest in the market.

While a discount broker charges 0.3% of the traded value i.e. if someone buys 100 shares of a company whose market price is say Rs.50/- per share then the total traded amount stands at Rs.5000/-, so here a brokerage of just Rs.15/- has to be paid (i.e. 0.3% x Rs.5000/-). Moreover, a person having just Rs10000/- can seek the help of a discount broker and start buying and selling stocks. But if someone wants to avail the service of a full service broker then the minimum amount of trade should be Rs.1 crore per transaction and the brokerage is at least 20 times more than that the discount broker.
Here the operations of both types of brokerages will be discussed. Firstly, if someone opts for a full service brokerage, then that person needs to go personally to the office of that brokerage firm and do the needful paperwork to be its client. After that the brokerage firm will guide that person about how to utilize the funds i.e. in which stocks to invest, when to buy those stocks and when to sell them etc. The investor can select his/her own choice of the stock. Then the brokerage firms only execute the buy and sell orders. For this, that person has to call up the brokerage firm on the phone and place an order for the number of shares of the company selected Within a few minutes that investor will receive a confirmation that the order has been placed. Behind the scene, however, lot of action takes place between the placement of the order and the confirmation. What happens actually is listed below

1. Suppose, a person places an order with the broker to buy 100 shares of Reliance Industries Ltd @ (say Rs.500/each).
2. The broker sends the order to his department.
3. That department sends the order to the firm’s representative who works on the floor of exchange where shares of Reliance are traded.
4. That representative gives the order to the firm’s floor trader, who also works on the exchange floor.
5. The floor trader goes to the specialists’ post for Reliance and finds another floor trader who is willing to sell shares of Reliance.
6. Both the traders agree on a price.
7. The order is executed.
8. The floor trader reports the completion of the order to the representative and the order department.
9. The order department confirms the order to the broker.
10. The broker confirms the completion of the purchase order to the investor.

(B) ONLINE SHARE TRADING:

On the other hand discount broker is what common investors opt for investment in shares nowadays. With the revolution brought about by the internet the discount broking service has become online i.e. one can buy and sell shares with the help of computer after getting registered with an online discount broker.

The investor has to register with an online brokerage firm and get into an agreement with them to trade on his/her behalf in different securities under the terms and conditions listed in that agreement. Then the investor has to open an account with the online brokerage firm. After this account, is opened, the investor has to open account in the same bank as the online firm and connect his/her account with the firm’s account for the settlement of accounts. If the investor already has an account in the bank with which the online broking firm maintains its account then the investor need not open a new account, the existing account of the investor can be connected to the account of the online
broking firm which is called the E-trade account. If the investor opens a new account with the bank with which the online broking firm’s account will be connected, then the investor has to deposit a certain sum of money in that bank account and with the help of the balance in that account the investor will be able to conduct his share trading transactions. For example if the investor has a balance of say Rs.10000/- and buys 1000 shares of a company for Rs.50/- each, then the transaction will be for Rs.50 x 100 = Rs.5000/- plus the brokerage i.e. 3% so Rs.5000 x $\frac{3}{100}$ = Rs.150 So a sum of Rs.5150 will be deducted from his bank account and a balance of Rs.4850/- (Rs.10000 - Rs.5150/-) will be left in that a/c. Now, if he sells that particular stock for say Rs.60/- then Rs.60/- x 100/- = Rs.6,000/- minus the brokerage i.e. 3% so Rs.6000 x $\frac{3}{100}$ = Rs.180/- so Rs.6,000 - Rs.180 = Rs. 5820 will be deposited in his bank account The bank balance then will be Rs.4850 + Rs.5820 = Rs.10,670/-. It shows that he has made a profit of Rs.670/-. Similarly, if he sells the stock at a lower price than the price at which it was bought then balance will definitely be less than Rs.10000/- and he would be incurring a loss. These are all done electronically with no manual intervention.

To place an order of purchase or sale of stock the investor first has to have a computer with internet facilities and he/she has to open the website of the respective online broking firm. Then he/she has to login with the help of his or her user Id and password that will be provided by the online broking firm.
After that the investor has to just follow the instructions that are provided by them to buy and sell stocks.

1.7 What is SENSEX and Calculation of SENSEX

Now, there is an indicator in terms of points for every exchange. This indicator gives you a general idea about whether the market prices of most of the stocks have gone up or have fallen.

The indicator of all the major companies of BSE is called “SENSEX”.

The indicator of all the major companies of NSE is called “NIFTY”

If the SENSEX rises i.e. points of SENSEX rises it means that the prices of the stocks of most of the major companies listed in the BSE have gone up. If the SENSEX goes down i.e. points of SENSEX, it tells you that the prices of most of the major stocks on the BSE have fallen.

Just like the “SENSEX” represents the top stocks of the BSE, the “NIFTY” represents the top stocks of the NSE.

The calculation of SENSEX:

SENSEX is calculated using the “Free-float Market Capitalization” methodology. As per the this methodology, the level of index at any point of
time reflects the Free-float market value of 30 components stocks relative to a base period. The market capitalization of a company is determined by multiplying the price of its stock by the number of shares issued by the company. This market capitalization is further multiplied by the free-float factor to determine the free-float market capitalization.

The base period of SENSEX is 1978-79 and the base value is 100 index points. This is often indicated by the notation 1978-79=100. The calculation of SENSEX involves dividing the free-float market capitalization of 30 companies in the Index by a number called Index Divisor. The Divisor is the only link to the original base period value of the SENSEX. It keeps the Index comparable over time and is the adjustment point for all Index adjustments arising out of corporate actions, replacement of scripts etc. During market hours, prices of Index scripts, at which latest trades are executed, are used by the trading system to calculate SENSEX every 15 seconds and disseminated in real time.

Dollex - 30:
BSE also calculates a dollar-linked version of SENSEX and historical values of this Index are available since inception.

Understanding Free-float Methodology:
Free-float Methodology refers to an index construction methodology that takes into consideration only the free-float capitalization of a company for the purpose of index calculation and assigning weight to stocks in Index. Free-float
Market capitalization is defined as that proportion of total shares issued by the company that are readily available for trading in the market.

It generally excludes promoters’ holding, government holding, strategic holding and other locked-in shares that will not come to the market for trading in the normal course. In other words, the market capitalization of each company in a Free-float index is reduced to the extent of its readily available shares in the market.

SENSEX is the index in India to be based on the globally accepted Free-float methodology.

Example:

Suppose the index consists of only 2 stocks Stock A and Stock B. Suppose company A has 1000 shares in total of which 200 are held by promoters so that only 800 shares are available for trading to the general public. These 800 shares are the so called free-floating shares.

Similarly, company B has 2000 shares in total out of which 1000 are held by promoters and the rest are free-floating.

Now suppose the current market price of stock A is Rs.120. Thus the total market capitalization of company A is Rs.1,20,000 (1000x120) but its free-float capitalization is Rs.96,000 (800x120).
Similarly, suppose the current market price of stock B is Rs.200. The total number of market capitalization of this company will thus be Rs.4,00,000 (2000x200) but its free-float market capitalization will be Rs.2,00,000(1000x200).

So as of today market capitalization of the index (i.e. stocks A and B) is Rs.5,20,000 (Rs.1,20,000+Rs.4,00,000), while the free-float market capitalization of the index is Rs.2,96,000 (Rs.96,000 + Rs.2,00,000).

The year 1978-79 is considered the base year of the index with a value set to 100. What this means - suppose at that time the market capitalization of the stocks comprised the index then was say 60,000 (remember at that time there may have been some other stocks in the index, not A and B but that does not matter), then we assume that an index market cap of 60,000 is equal to an index- value of 100.

Thus the value of the index today is \( \frac{2,96,000 \times 100}{60,000} = 493.33 \).

This is how index is calculated.

1.8 The Bulls, the Bears and the Farm

When the “SENSEX” or “NIFTY” rises it is called “Bull market” and when “SENSEX” or “NIFTY” falls it is called “Bear Market”.

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A bull market is when the economy is doing great, people are finding jobs and stocks are rising. In a bull market investors are very optimistic. Investors are called bulls who feel that the prices of stocks will continue to go up and thus buy stocks making the demand for stocks rise and as a result the stock prices rise. Bull market cannot last forever though and sometimes they can lead to dangerous situations if stocks are overvalued. If a person is optimistic and believes that value of the stocks will go up, he or she is called a “bull” and is said to have a “bullish outlook”.

On the other hand bear market is when the economy is bad, people are losing jobs and share prices are falling. In a bear market investors are very pessimistic. These investors are called bears who feel that prices of stocks will fall further and thus sell stocks making the demand for stocks decrease and as a result the stock prices fall. Bear market also cannot last forever. Here if a person is pessimistic, believing that stocks are going to drop, he or she is called a “bear” and said to have a bearish outlook.

A bear market should not be confused with a market correction which is a short term trend that usually lasts for less than two months. A correction is a short term price decline of about 5% to 20%. A correction is a downward movement that is not large enough to be termed as a bear market.
The other animals in the Farm - chickens and pigs. Chicken are those investors who are afraid of losses. Their fear overrides their need to make profits and so they trade only in money market securities or they opt out of the market entirely. Money market security is a segment where only financial instruments with high liquidity and short maturity are traded. While it is true that the choice of investments should not cause anxiety and sleepless nights, it is also certain that the returns on the investments would be very low if no risks are taken and investments in the stock market is avoided completely. Pigs are the high risk investors looking for one big deal in a short period. They buy on getting hot tips and invest in companies without doing any in-depth study. They get impatient, greedy and emotional about their investments. They are also drawn towards high risk securities without putting in efforts to learn about these instruments.

Professional traders love these pigs as it is only from their losses that the bears and bulls earn their profits. There are plenty of different investment opportunities and strategies in the share market to choose from. Even though the bears and bulls are constantly at odds against each other, they both can make money from the cyclical changes that occur in share investments. Even the chicken earns some profit but very low. The ones who lose in this scenario are the pigs.
1.9 What is Stock and Stock Price

Stock, share or equity all mean the same. We are aware that there are many small, medium and large sized companies doing business and at some point or the other each of them needs money to expand the business. There are many options for them to raise money like either borrowing from some source or raise it by selling a part of the company in the form of shares, which is known as Issuing stock. A company can also borrow by taking loans from the banks or by issuing bonds, bills or notes to individual investors and / or institutional investors. In return for lending the money, the institutions or individuals become creditors of that company and receive a promise that the principal and interest on the debt will be repaid. Both the methods come under the umbrella of debt financing. On the other hand, the act of raising money for company activities by selling common or preferred stock to individuals or institutional investors is called Equity financing. This form of is advantageous for company as the company is not required to repay the money or pay interest on them. All that the shareholders get in return for their investments is the hope that the shares will someday be worth more than what they had paid for. A company which has issued stock is called listed company. Here listed means that the company is listed in the stock exchange as stocks are bought and sold in the stock exchanges. A company can be listed in one stock exchange or in more than one stock exchange. For example, a company can be listed in Bombay.
Stock Exchange as well as in National Stock Exchange or in any one of the other exchanges.

So, plain and simple stock is a share in the ownership of a company. Holding a company's stock means that you are one of the many owners (shareholders) of a company and as such you have a claim (though usually very small) to everything the company owns. Yes, this means technically that you own a tiny sliver of every piece of furniture, every trademark and every contract of the company.

A person who owns even one share in a company is a shareholder. He may also be referred to as a “Stock holder”. As shareholders are the owners of the company, they have the potential to benefit if the company does well, but that comes with the potential loss if the company fares poorly.

Being a shareholder in a company does not mean that having a say in the day to day running of the business. It means that for every share held, giving one vote to elect the board of directors in the annual general meeting of the company is the extent to which an investor has a say in the company. For instance, being a Infosys shareholder does not mean you can call up Mr.N.Narayanmurthy and tell him how you think the company should be run. In the same line of thinking, being a shareholder of ITC does not mean that you can walk into the factory and grab a free case of ITC cigarettes or any of their other products.
The management of the company is expected to increase the value of the firm for shareholders by running the company profitably. If this does not happen, the shareholder can vote to have the management removed, but that is in theory. In reality, ordinary individual investors do not own enough shares to have any substantial say in the company matters and policies. It is really the big investors like large institutional investors and billionaire entrepreneurs who can influence the decisions. Institutional investors are non-banking organization trading securities in large volumes or in foreign currencies that they qualify for preferential treatment. Some examples of institutional investors are pension funds and insurance companies.

For ordinary shareholders not being able to manage the company is not such a big deal. The importance of being a shareholder is that you are entitled to a portion of companies profit and have a claim on assets. But again holding of shares of individual shareholders are so small that it is just a theoretical explanation and in practice there is nothing that an individual shareholder can claim from the assets of the company. While they are entitled to a portion of company's profit there is no guarantee if the company will be making profit or not. It is important to note that sometimes the company distributes the profit in the form of dividend. Dividend is the distribution of a fixed portion of a company's profits as decided by Board of Directors. The Board of Directors is a group of individuals that are elected as or elected to act as, representatives of
the shareholders to form corporate management related policies and to make decisions on major company issues.

Such issues include the hiring / firing of executives, declaration and percentage of dividend policies, option policies and executive compensation. Every public company must have a Board of Directors.

In general the Board makes decisions on behalf of the shareholders. Most importantly the Board of directors must be a fair representation of both the management’s and the shareholders’ interests. Too many insiders serving as directors will mean that the board will take such decisions that are beneficial to the management. On the other hand, possessing too many independent directors may mean management will be left out of the decision making process and this may cause good management to leave in frustration.

Dividend is given in terms of rupee amount for each share (i.e. dividend per share). It can also be quoted in terms of a percent of the current market price, referred to as dividend yield. Most secure and stable companies offer dividends to shareholders. High growth companies rarely offer dividends to shareholders because all their profits are re-invested to help sustain growth higher than average. The more shares you won, the larger is the portion of profits you get.
But there is no obligation to pay out dividends even for those firms that have traditionally given them. Without dividends, an investor can make profit on a stock only through its appreciation in the market price i.e. if the market price of the stock at which it was purchased will increase and then the investor will sell that stock at that higher price than the price at which it was purchased and make a profit. But again there is no guarantee that there will be a rise in the price of the stock. The prices may fall too.

Another very important feature of the stock is its limited liability, which means that, as an owner of a stock, you are not personally liable if the company is unable to pay its debts in case of bankruptcy or closure. Other companies such as partnerships are set up in such a manner that if partnership goes bankrupt the creditors can claim their dues from the partners in their individual capacities. They can be forced to sell off their houses, cars, and other assets to reimburse the creditors’ claims. Whereas being a shareholder means that no matter what the total liability of the company whose share one holds, the maximum value one can lose is the value of the investment. Even if a company goes bankrupt, a shareholder can never lose his/her personal assets.

A stock is represented by a stock certificate. This is a fancy piece of paper that is the proof of shareholder’s ownership. In today’s computer age, you won’t actually get to see this document because your brokerage firm keeps the record electronically in dematerialized form. In the past when a person wanted to sell
his or her shares, that person had to physically take the certificates to the brokers. Now, trading is done with the click of a mouse making life easier for everybody.

1.10 What Causes Stock Prices To Change

The stock prices change every day as a result of market forces. By this it is meant that share prices change because of the simple theory of supply and demand. If more people want to buy a particular company’s stock (demand) than sell (supply), then the price of those shares moves up. Conversely, if more people want to sell a stock rather than buy it, the supply will be greater than the demand, and the price will fall.

Understanding supply and demand is easy. What is difficult to comprehend is what makes people prefer a particular stock and reject others. There are many answers to this phenomenon and each investor when asked has his/her own ideas theories and strategies.

That being said, the principal theory is that the price movement of a stock indicates what investors feel that a company is worth. But a company’s value should not be equated with its stock price. The value of a company is its market capitalization, which is the stock price multiplied by the number of shares outstanding in the market. Here outstanding shares means stock currently held
by the investors including restricted shares owned by the company’s officers and insiders as well as those held by the public. This number is shown on a company’s balance sheet under the heading “capital stock”. For example if a company that quotes at Rs.50/- and has 5 million shares outstanding (Rs.50/- x 5 million = Rs.250 million) has higher value than a company whose share price trades at Rs.100/- per share and has 1 million shares outstanding (Rs.100 x 1 million = Rs.100 million).

To further complicate things, the price of a stock not only reflects a company’s current value, it also reflects the growth that investors anticipate in the future.

The most important factor that affects the value a company is its earnings. Earnings are the profit that a company makes, and in the long run no company can survive without them. The amount of profit that a company earns during a specific period, which is usually defined as quarter (three calendar months) or a year, is what determines the share value of the company. Earnings typically is referred to as net income after tax. Ultimately, a business’s earnings are the main determinant of its share price, because earnings and the circumstances relating to them can indicate whether the business will be profitable and successful in the long run. Earnings are perhaps the single most studied number in a company’s financial statements because they show a company’s profitability. A business’s quarterly and annual earnings are typically compared to analyst estimates and guidance provided by the business itself. In most of the
situations, when earnings do not meet either of these estimates, a business stock price will tend to fall. On the other hand when actual earnings beat estimates by a significant margin, the share price will most probably surge. Public companies are required to report their earnings four times a year (once in each quarter). The reason behind this is that the analysts base the calculation of the future value of a company on their projections of the company's estimated earnings. If a company's results surprises (are better than expected), the price rises. If a company's results disappoints (are less than expected), the price falls. Of course, it is not just earnings that can influence the sentiment towards a particular stock (which in turn changes its price). It would be a rather simple world if this were the case. During "dotcom bubble", for example, dozens of internet companies rose to have market capitalization in the several cores of rupees without ever making any profit. As we all know, that the valuations of those companies did not stand the test of times, and most of them found that their values shrank to a fraction of their highs. Still, the fact that prices did move that much demonstrates that there are factors other than current earnings of a company that influence stock prices. Investors have developed literally hundreds of these variables, ratios and indicators. Some of them are very much heard of such as price earnings ratio (P/E ratio) while the other variables are extremely complicated and obscure with names like chaikin oscillator or moving average, convergence divergence etc.
So, why do stock prices change? The best answer is that nobody really knows for sure. Some believe that it is not possible to predict how stock prices change while others think that by drawing charts and looking at past price movements, you can determine when to buy and sell. The only thing that is known and accepted is that stock prices are volatile and can change rapidly. Here one thing must be noted that volatility of each stock varies from one to another. A higher volatility stock means that the stock value can potentially be spread out over a larger range of values. This means that the price of the stock can change dramatically over a short period in either direction. A lower volatility means that the stock value does not fluctuate dramatically but changes in value at a steady pace over a period of time.

One measure of the relative volatility of a particular stock to the market is its beta. A beta approximates the overall volatility of return of a stock against the return of a relevant benchmark. In India BSE and NSE are the two most important benchmarks. BSE benchmark index is known as SENSEX. On the other hand NSE benchmark index is known as NIFTY. For example, a stock with beta value of 1.1 has historically moved 110% for every 100% more in the Benchmark, based on price level. Conversely, a stock with a beta of 0.9 has historically moved 90% for every 100% more in the underlying index.

But it must be remembered that stock is a fabulous category of financial instrument and without any doubt one of the greatest tools ever invented for
building wealth. Stocks are a part if not the cornerstone, of nearly any investment - portfolio. When you start your road to financial freedom, you need to have a solid understanding of stocks and how they are traded in the stock market. Stocks can (and do) create, massive amount of wealth, but they are not without risks. The only solution to this is education. The key to protecting yourself in the stock market is to understand where you are putting your money.

1.11 Different type of stocks

There are mainly two types of stock i.e. “Common stock” and “Preferred stock”. The above discussed stock is known as common stock. And its shareholders are known as common stockholders. In U.K., they are called “ordinary shares” and such shareholders are called “ordinary shareholders”.

On the other hand preferred stock is a different class of ownership in a company or corporation that has a higher claim on the assets and earnings than common stock. Preferred stock generally has a dividend that must be paid out before dividends to common shareholders but the shares holders of preferred stock usually do not have voting rights. The precise details as to the structure of preferred stock are different in each company/corporation. With preferred shares, investors are usually guaranteed a fixed percentage every time dividends are declared. This is different from common stock, which has variable
dividends but is never guaranteed. Another advantage is that in the event of liquidation preferred shareholders are paid off before the common shareholders (but still after the other debt holders are paid off). Preferred stocks may also be redeemable, meaning that the company has the option at any time to purchase the shares back from those shareholders for any reason (usually at a premium). However the best way to think of preferred stock is as a financial instrument that has characteristics of both debt (fixed dividends) and equity (potential appreciation).

The common stocks listed in BSE can be classified into different groups like “A” group, “B₁, B₂” group, “C” group, “T” group” and “Z” group.

These groupings are done primarily on the basis of

A) Compliance with SEBI parameters.
B) Trading and settlement cycles.

Now, compliance with SEBI parameters:
SEBI is the regulator for the securities market in India. It was formed officially by the Govt. of India in 1988 with SEBI Act 1992 being passed by the Indian Parliament Chaired by U.K. Sinha (SEBI has its headquarters in the popular business district Bandra - Kurla complex in Mumbai, and has Northern, Eastern,
Southern and Western regional offices in New Delhi, Kolkata, Chennai and Ahmedabad, respectively). The basic objectives of Board were identified as:

1. To protect the interests of investors.
2. To promote the development of securities market.
3. To regulate the securities market
4. For matters connected therewith or incidental thereto.

Now, trading & settlement cycle:

After a share transaction is done through a broker, the trade has to be settled. This means the buyer has to receive his shares and the seller has to receive his money. Settlement is just the process whereby payment is made by all these who have made purchases and shares are delivered by all those who have made the sales. The settlement cycles in India is T + 2 days i.e. Trade + 2 days. T + 2 means the transactions done on the Trade day, will be settled by exchange of money and securities on the second business day (excluding Saturday, Sunday, Bank and Exchange Trading holidays) Pay in and pay out for securities settlement is done on a T + 2 basis. Now a person can carry forward this settlement and in common parlance the carry forward system is known as ‘Badla’ which means something in return. Badla is the charge, which the investor pays for carry forward his position. It is a hedge tool where an investor can take possession of a script without actually taking delivery of the stock. He can carry forward his position on the payment of a small margin. In case of
short selling the charge is termed as "Undha Badla". The carry forward system serves three needs of the stock market:

(i) Quasi - hedging - If an investor feels that the price of a particular share is expected to go up / down, without giving or taking delivery of the stock he can participate in the volatility of the share.

(ii) Stock Lending - If he wishes to short sell without owning a underlying security, the stock lender steps into the carry forward system and lends his stock against payment of fees.

(iii) Financing Mechanism - If he wishes to buy the share without paying the full consideration, the financier steps into the carry forward system and provides the finance to fund the purchase. This scheme is known as "Vyaj Badla" or "badla financing". For example, if X has bought a stock and does not have the fund to take delivery, he can arrange a financier through the stock exchange badla mechanism. The financier would make the payment at the prevailing market rate and would take delivery of the shares on X's behalf, who only pays interest on the funds borrowed. Vis-à-vis if you a sell position and do not have the shares to deliver you can still approach for a lender of securities through the stock exchange.

The demand for money is, in turn, determined by the net outstanding position, which is the difference between the long purchases arising from vyaj badla and short sales from undha badla. The net of this position, at the end of the
settlement period, is carried forward. If this figure is large, badla rates will be higher.

As the settlement is done on a weekly basis, badla is allowed for one week at a time. At the end of the cycle, the stockholder has to either deliver the shares sold or pay money for the shares bought.

“A” group is a category where companies comply with all the parameters of SEBI.

Also, in “A” group, there is a facility for carry forward (badla) to the next settlement cycle. These are companies with fairly good growth record in terms of dividend and capital appreciation (appreciation in the market price of the stock).

And lastly the stocks under “A” group category are of high equity capital, high market capital, high trade volume and longer years of listing.

Here,

(i) Equity capital is - the capital raised from the owners of the company. Owners are shareholders of the company. This capital is raised by issue of equity shares at a price and this issue is called IPO (Initial Public Offering). So, equity capital is the number of equity shares multiplied by the face value of each share. Face value of a share is the value which is decided by the company
issuing it, at the time of initial offering. Face value has nothing to do with the market price of that share. It is mentioned on the face of the share certificates, bond certificates or other financial instruments. Market value of shares changes depending on several conditions. Face value changes only when splitting (dividing the shares into smaller numbers) takes place. It is also known as the par value. From this comes terms such as at par, over par and under par. By deciding a face value the company promises not to issue any share below this face value or par value. Capital is the factor that decides the face value of a share. Capital of any company is its total assets less its current liabilities.

Suppose there is a company ABC Ltd., having assets of Rs.1400/- crores and liabilities of Rs.400/- crores, the capital of the company is Rs.(1400 – 400) crores = Rs.1000/- crores.

If this company decides Rs.10 as face value of its shares, then there will be 100 crores shares of ABC Ltd in the market. Market value of these shares may be lower or higher than Rs.10/- depending upon the performance of the company and several other factors.

If this company wants to increase the number of shares five times, then company has to split the face value of each share to Rs.2, by doing which the company can have 500 crores shares, in the market. It is not necessary that market value of the shares will become exactly one fifth of its market value.
prior to this split. The particular date on which company announces split ratio is known as the record date.

Now as said the “A” group companies are of high market capital.

Here,

(ii) Market Capitalization is - It is the total rupee market value of company’s total outstanding shares. Market capitalization is calculated by multiplying a company’s shares outstanding by the current market price of one share. The investment community uses this figure in determining a company’s size, as opposed to sales or total assets. The term should not be confused with a company’s “Capitalization”, which is a financial statement term that refers to the sum of a company’s shareholders’ equity and its long-term debt.

The stocks of large, medium and small companies are referred to as large – cap, mid cap and small – cap respectively. Investment professionals differ on their exact definitions, but the current approximate categories of market capitalization are:

Large Cap: Rs.10000 crores plus and include the companies with the largest market capitalization.

Mid Cap: Rs.2000 crores to Rs.10000 crores

Small Cap: Less than Rs.2000 crores
Here it must be noted that outstanding stock or shares are stocks currently held by investors, both the restricted shares owned by the company’s officers and insiders, as well as those held by the public. Shares that have been repurchased by the company are not considered while computing the figures for outstanding stock. Share repurchase is a programme by which a company buys back its own shares from market place, reducing the total number of shares available in the market. This is usually an indication that, the company’s management thinks that the shares are undervalued i.e. market price of the shares are lower than what it should be. Because share repurchase reduces the number of shares available for trading (i.e. supply), earning per share increases and this tends to elevate the market value of the remaining shares. When a company repurchases shares, it will usually announce something along the lines of, “we find no better investment than our company.”

Thus, “A” group companies are of high trade volume.

Here,

(iii) Trading Volume is - Trading volume, sometimes simply referred to as volume, is the number of shares of a security traded (both purchased and sold) during a defined time period. Most commonly, trading volume is measured daily, but depending on the security that is being traded, volume may be measured on longer time lines such as a week or a month. For example, investor Bob has purchased 5000 shares of stock from XYZ Corporation, which means he has increased the volume by 5000 for the day. If investor Bob would have
sold 5000 shares of XYZ Corporation, he would have also increased their volume by 5000 for the day.

To an investor or a financial analyst a large increase in volumes, may indicate a significant change in the price of the security. The trading volume increases significantly four times in a given year, usually when quarterly financial statements are released by a company. So, it can be said that significant losses and earnings will generally lead to movement in the trading volume in that stock. When a company announces earnings and there is also a hike in the trading volume of the stock of that company, it can be said that there is a warm and fuzzy feelings about that security from the investors. On the other hand if a company announces poor financial results the investors generally approach the broker to dump the stock of those companies before they incur any further loss.

In addition to earning reports, significant volume spikes may indicate some other important news taking place. For example, prediction of an increased corn crop, followed by record breaking spring rains and floods decreasing the normal corn supply, will increase demand, and in turn, increase price. As a result of the floods, speculator and investor race to their brokers to purchase stocks of those companies which will be benefited by this situation.

Institutional investors from large brokerage firms buy and sell securities in large quantities when they invest on behalf of their clients. When analyzing trading
volume, you may see a hike in volume that is not explained by earnings reports on the news circle. These hikes are most likely because of heavy transactions made by these institutions.

Although, volume is a very simple measurement, the average person or novice investor may not understand how important and useful this information can be. Trading volume is a powerful market tool. Movements in volume may indicate investors' sentiment, important events taking place in the market or institutional trading of the securities.

Here
BSE “A” group companies should have longer years of listing.

Here,
(iv) Number of years listing is – Listing means admission of securities for dealings on any of the recognized stock exchanges. The Bombay Stock Exchange (BSE) has a dedicated listing department to grant approval for listing of securities of companies in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, Securities Contracts (Regulation) Rules, 1957, Companies Act, 1956, Guidelines issued by SEBI and Rules by Laws and Regulations of BSE.
BSE "A" group companies shall have at least 25% public shareholding. This feature is applicable to BSE "B1, B2" group, "C" group, "T" group and "Z" group companies also.

Here,

(v) Public shareholding is – Public shareholding means the shareholding held in a company by persons other than the promoters, the acquirers or persons acting in connect with them. Promoter of a company is the person who organizes starting of that company, with the help of accountants, lawyers and other specialists. Promoter is not specifically defined in legal term, but it is understood to be a person or an entity who takes active actions and steps in the formation, organization or financing of a company. An acquirer is a company or person who buys another existing company.

Lastly, "A" group companies must have at least 25% floating stock.

Here,

(vi) Floating stock is - Floating stock is the total number of shares of a company that is traded in the stock exchange, usually a fraction of the total number issued and outstanding. For example, a company may have 1 crore outstanding shares, but only 70 lakhs are traded in the stock market.
Then, "B₁, B₂" group is a subset of the other listed shares that enjoy higher market capitalization and liquidity than the rest.

Here, Liquidity means:

(1) The extent to which a stock can be bought or sold in the market without affecting the price - Liquidity is characterized by a high level of trading activity. Stocks that can be easily bought and sold are known as liquid assets.

(2) The ability to convert a stock into cash quickly. Also, known as “marketability”.

(3) It is safer to invest in liquid assets than non-liquid ones because it is easier for an investor to convert his / her investment into cash.

(4) Examples of assets that can be easily converted into cash include blue chip stocks. Blue chip shares or blue chip stocks are stocks of well-established companies having steady earnings and no unusually large liabilities. Blue chip stocks pay regular dividends, even when business is generating lesser profit than usual. The term Blue chip is derived from casinos, where blue chips represent the greatest value among all other chips of different colors.

Then, “C” group covers the odd lot securities in A, B₁ & B₂ groups.

Then, “T” group which is also termed as the trade to trade group comprising of shares which have to be settled in delivery for all buys and sells. Squaring off of
bought and sold positions during the day is not permitted. This is a part of the surveillance from BSE to counter any awkward and unwanted movements in such scripts.

Then, “Z” group companies comprises of the stocks of the companies which do not comply with the rules and regulations of the stock Exchange and are at times suspended from trading due to this reason.

1.12 What is a Sector and Different types of Sectors

Here, it must be noted that one of the many ways an investor can classify stocks is by the type of business. The idea is to put companies in similar industries together for the purpose of comparative analysis. Most analysts and financial media, group these industries as “sectors” and one can often read or hear about how certain sector stocks are doing. One of the most common classifications breaks the market into 11 different sectors. Investors consider two of these sectors “defensive” or “non-cyclical” and the remaining nine “cyclical”. Let’s look at these two categories and see what they mean to the individual investors.

Defensive stocks include (1) utilities and (2) consumer staples. These companies usually do not suffer much in a market downturn because generally people do not stop using energy or eating. However the same safety factor, which does not allow the prices of defensive stocks usually fail to climb with a rising
market, provides protection in a falling market for the opposite reasons; people do not use significantly more energy or eat more food.

Cyclical stocks, on the other hand, cover everything else and tend to react to a variety of market conditions. The prices of these stocks go up or down, with the ups and downs of the market and their business.

Here is a list of the nine sectors considered Cyclical:

1. Basic Materials
2. Capital Goods
3. Communications
4. Consumer Cyclical
5. Energy
6. Financial
7. Health Care
8. Technology
9. Transportations

Most of these sectors are self-explanatory. They all involve businesses with which any investor can readily identify. Investors call them cyclical because the share prices in this sector tend to move up and down in accordance with the business cycles and other influences of the companies under this sector.
To start with defensive or non-cyclical sectors, the first one is “Utilities Sector”

(1) Utilities Sector - A category of stocks for utilities, such as gas and power etc. Companies in the business of electric, gas and water firms and integrated providers fall under Utilities sector.

Because utilities require heavy infrastructure, these firms often carry large amounts of debt. With a high debt load, utilities companies become sensitive to changes in the interest rates. As interest rates fluctuate, the cost of the debt segment also changes. The utilities sector performs best when interest rates are falling or remain low.

The list of industries under utilities sector is,
(1) Electric Utilities
(2) Natural Gas Utilities
(3) Water Utilities

The next sector that is included in defensive or non-cyclical category is the “Consumer Staples Sector”

(2) Consumer Staples - Consumer staples sector is composed of companies whose primary line of business is food, beverages, tobacco and other household items. Consumer staples are household necessities - products that most of us use
on daily basis. Since the regular purchases represent only a relatively small portion of most of the consumers’ annual income, demand tends to be fairly consistent throughout the year. Due to this consistency, the sales and the earnings growth in this sector tend to remain constant both in good times and in difficult times. Usually, no one cuts back on purchases of food or dishwashing liquid, even during recessionary period. With this in mind, safe and defensive names in the consumer staples sector can provide investors a good opportunity to hedge overall portfolio risks. These types of companies have historically been characterized as non-cyclical in nature as compared to their close relative, the consumer cyclical sector.

To start with cyclical sectors, the first one is “basic material sector”

(1) Basic Material Sector - A category of stocks of companies involved with discovery, development and processing of raw materials. The basic material sector includes the mining and refining of metals, chemical manufacturers and forestry products. This sector is sensitive to changes in the business cycle. Because the sector supplies materials for construction and developmental projects, existence of a strong economy which encourages developmental projects is very necessary. This sector is also sensitive to supply and demand fluctuations because the price of raw materials, such as gold or other metals is largely demand driven. For example a company under basic material sector producing lumber, the stock of these companies will tend to rise when the
housing market is active. However if activities in real estate market slows down, there will be less building activities and there will be reduction in the demand for lumber. This automatically brings reduction in their share prices. The Basic material sector includes the following industries.

(1) Agricultural Chemicals
(2) Aluminum
(3) Chemicals - Major diversified.
(4) Copper
(5) Gold
(6) Independent Oil and Gas
(7) Industrial Metals & Minerals.
(8) Major integrated oil and gas.
(9) Non-metallic Mineral Mining
(10) Oil and Gas Drilling and Exploration
(11) Oil and Gas Equipment and Services
(12) Oil and Gas pipelines
(13) Oil and Gas refining and Marketing
(14) Silver
(15) Specialty Chemicals
(16) Steel and Iron
(17) Synthetics
The next cyclical sector is "Capital Goods Sector"

(2) Capital Goods Sector - A category of stocks related to the manufacturing or distribution of manufactured goods. This sector comprises of diverse companies that manufacture machineries that are used to create - capital goods, electrical equipments, equipments for aircraft industry, manufacturing and defense equipments, equipments for ship-building industry and equipments for engineering and construction projects.

This sector is also referred to as the "industrial sector".

Performance in the capital goods sector is also sensitive to fluctuations in the business cycle. Because it relies heavily on manufacturing, the sector does well when the economy is booming or expanding. If economic conditions worsen, the demand for capital goods drops, invariably lowering the prices of stocks in the sector.

Here, it must be noted that - capital goods basically are basic tools for production. Individuals, organizations and governments use capital goods to manufacture other goods or commodities. Capital goods include factories, machinery, tools, equipment and various buildings which are used to produce other products for consumption. Capital goods, then, are the products which are not produced for immediate consumption, rather, they are the basic objects
that are used to produce other goods and services. These types of goods are important economic factors because they are the key to result in a positive return from manufacturing other products and commodities.

Manufacturing companies also use capital goods. Capital goods help their companies make functional goods to sell individual valuable services. As a result capital goods are sometimes referred to as producers' goods or means of production. An important distinction should also be made between capital goods and consumer goods, the latter being products directly purchased by consumers for their personal or household uses.

For example, cars are generally considered as consumer goods because they are usually bought by an individual for personal use. Dump-trucks, however are considered capital goods, as they are used by construction and manufacturing companies to haul various materials used in order to create other products such as building roads, bridges, dams and buildings etc. Similarly, a chocolate candy-bar is an example of consumer goods but the machines used to produce the chocolate candy bar are considered capital goods.

One should not confuse the economic term capital goods and the financial term capital used in (economics); the latter simply means wealth.
The capital goods sector includes the following industries:

(1) Aerospace and Defense
(2) Construction and agro machinery
(3) Construction - Supplies and Fixtures
(4) Construction - Raw Materials
(5) Construction - Services
(6) Miscellaneous Capital goods

The next cyclical sector is “Communication Sector”

(3) Communication Sector - Communication sector is the sector involved in the business of transmitting messages by telegrams, cable, telephone, radio or television. Though telegram, radio and television play a role for transmitting messages to some extent, telephone and cable (i.e. mobile) are the two most important players for transmitting messages in this modern age. This sector can be classified into two industrial categories:

(1) Cables - telephone
(2) Telecommunication - Service Providers

The next cyclical sector is “Consumer cyclical”
(4) Consumer Cyclical Sector - The cyclical consumer goods and services sector consists of corporations/companies engaged in a wide range of production, including automobiles, homebuilding, household goods, textiles and apparels, as well as running of casinos, leisure homes, hotels, and media etc. It also includes retail operators and services providers. These goods are used by consumers only periodically.

This sector can be classified into following 12 industrial categories:

(1) Apparels / accessories
(2) Appliances and tools
(3) Audio and Video equipments
(4) Automobiles and trucks manufacturers
(5) Parts for automobiles and truck
(6) Foot wears
(7) Furniture and fixtures
(8) Jewellery and Silverware
(9) Recreational Products
(10) Textiles - Non Apparel
(11) Photography
(12) Tires

The next cyclical sector is “energy sector”
Energy Sector - This category of stocks relate to companies/corporations producing or supplying energy. It includes companies involved in the exploration and development of oil or gas reserves, drilling for both exploration and pumping out oil and gas, and companies generating integrated power. Performance in this sector is largely driven by the supply and demand for worldwide energy. Producers in this sector will do very well during times of high oil and gas prices, but earn less when the cost of energy falls. The other factor that makes this section sensitive is the political events which historically have influenced the pricing of oil and other related products. This is the reason why stock market always indicates strong fluctuations in the prices of the energy producing companies.

The energy industry is a generic term for all the industries involved in the production and sale of energy including fuel exploration, fuel extraction, manufacturing, refining and distribution. Modern society consumes large amounts of fuel and the energy sector plays a crucial part of in the infrastructure and maintenance of economy in most of the countries.

In particular, the energy industry comprises of:

1. The petroleum industry, including oil companies involved in the exploration and extraction of crude oil, oil refineries, transportation of fuel to different points of sale including petrol pumps and gas stations
(2) The gas industry; including natural gas extraction and coal gas manufacturers, as well as distribution and sales.

(3) The electrical power industry including electricity generation, electric power distribution and sales.

(4) The coal industry

(5) The nuclear power industry

(6) The renewable energy industry, comprising companies manufacturing alternative energy and sustainable energy, including those involved in hydroelectric power, wind power and solar power generation and the manufacture, distribution and sale of alternative fuels.

(7) Traditional energy industry based on the collection and distribution of firewood, which is still used for cooking and heating, is common in under developed countries.

The next cyclical sector is 'Financial Sector’

(6) Financial Sector - A Category of stocks comprising of firms which provide financial services to commercial and retail customers. This sector includes commercial banks, investment bankers and insurance companies.

Financial service performs best in low interest rate environments. A major portion in this sector generates revenue from mortgages and loans, which gain value as interest rates drop. The financial sector also benefits from additional
investments when the business cycle is on the upswing. Improved economic conditions usually lead to implementation of more capital projects and increased personal investing. New projects require financing, which usually leads to a large quantum of loans which again is beneficial to the financial sector which provides these loans.

A “Commercial bank” is what is commonly referred to as simply a “bank”. The term “commercial” is used to distinguish it from an “investment bank”, a type of financial services entity which instead of lending money directly to a business, helps business raise money from other firms in the form of bonds (debt) or stock (equity). Another type of bank is private bank. Private banking means those banks providing banking services exclusively to high network individuals. Many of these private banks require a person or family to have a certain minimum net worth to qualify for availing their services. Private Banks often provide more personal services, such as wealth management and tax planning, than commercial retail banks.

An investment banker is a firm that pools funds from a number of retail investors and invests the same on their behalf for a fee. Thus, an investment fund manager enables investors to gain exposure to a broad range of options. Investment funds are suitable for investors who wish to invest in stocks without studying the characteristics of the various options. Private Bankers, trust managers or other advisors often direct some or all of the assets of their clients towards fund investments. This is a collective investment scheme which
is a way of investing along with many others to participate in a wider range of investments which otherwise is not feasible for most of the individual investors, and to share the costs and benefits of doing so. Terminology for investment fund varies in different countries but such collective investment schemes are often referred to as mutual funds, investment funds, managed funds or simply funds. Around the world large markets have developed around this concept of collective investment and these funds account for a substantial portion of volume of trading on major stock exchanges. For every collective investment fund there is a:

(i) A fund manager or investment manager who takes the investment decisions.

(ii) A fund administrator who manages the trading, reconciliations, valuation and unit pricing

(iii) A board of directors or trustees who safeguard the assets and ensure compliance with laws, regulations and rules.

(iv) The shareholders or unit holders who own (or have rights to) the assets and associated income

(v) A “marketing” or “distribution” company to promote and sell shares / units of the fund. As there is a price of each stock or share, there is a price for each unit of an investment fund which is called the net asset value (NAV) per unit of the fund. (Net asset value is the value of a scheme’s assets less the value of its liabilities). The method for calculating this varies between scheme types and jurisdiction and can be subject to complex regulation.
Now in Law and Economics, insurance is a form of risk management primarily
used to hedge against the risk of contingent and uncertain loss. Insurance is
defined as the equitable transfer of the risk of a loss, from one entity to another,
in exchange of payment. An insurer is a company selling the insurance. The
insured or the policy holder is the person or entity buying the insurance policy.
The insurance rate is a factor used to determine the amount to be charged for a
certain amount of insurance coverage, called the premium. The transaction
involves the insured assuming a guaranteed and a relatively small loss in the
form of payment to the insurer in exchange gets the insurer’s promise to
compensate (indemnify) the insured in the case of a large, a possible devastating
loss. The insured receives a contract called the insurance policy which details
the conditions and circumstances under which the insured will be
compensated.

Financial sector can be classified into 20 categories. Namely,

1) Accident and Health Insurance
2) Asset Management
3) Closed End Fund – Debt
4) Closed End Fund – Equity
5) Closed End Fund – Foreign
6) Credit Service
7) Diversified Investment
8) Foreign Money Centre Banks
9) Insurance Brokers
10) Investment Brokerage – National
11) Investment Brokerage – Regional
12) Foreign Regional Banks
13) Life Insurance
14) Money Centre Banks
15) Mortgage Investment
16) Property and Casualty Insurance
17) Property Management
18) Real Estate Development
19) Savings & Loans
20) Surety and Title Insurance

The next cyclical sector is “healthcare sector”

(7) Healthcare Sector - A category of stocks relating to medical and healthcare goods or services. The healthcare sector includes hospital management firms, health maintenance organizations (HMOS), biotechnology and a variety of medical products.

Stocks in the healthcare sector are often considered to be defensive because the products and services are essential. Even during economic downturns, people will require medical aid and medicines to overcome illness. Having a consistent
demand for goods and services makes this sector less sensitive to business cycle fluctuations.

Healthcare sector can be classified into 16 categories, namely

1) Biotechnology
2) Diagnostic substances
3) Drug Delivery
4) Drug Manufacture - Major
5) Drug Manufactures – Other
6) Drug related products
7) Drugs – Generic
8) Health care plans
9) Home health care
10) Hospitals
11) Long – term care facilities
12) Medical Appliances and Equipment
13) Medical Instrument & Supplies
14) Medical Laboratories and Research
15) Medical Practitioners
16) Specialized Health Services

The next cyclical sector is “technology sector”
Technology Sector - A category of stocks relating to the research, development and/or distribution of technology based goods and services. This sector comprises business revolving around the manufacturing of electronics, creation of software, computers or other peripheral products and services relating to information technology.

The technology sector offers a wide range of products and services for both customers and other businesses. Consumer goods like personal computers, audio music systems and televisions are continuously improved and upgraded, offering the latest technology and benefits of from software and database systems, which allow the companies to make strategic business decisions.

Technology sector can be classified into 11 categories:

1) Communications Equipment
2) Computer Hardware
3) Computer Networks
4) Computer Peripherals
5) Computer Services
6) Computer Storage Devices
7) Electronic Instruments and controls
8) Office Equipment
9) Scientific and Technical Instruments
10) Software and Programming
11) Semiconductors
The next cyclical sector is the "Transport Sector"

(9) Transport Sector - A category of stocks relating to the transportation of goods or customers. The transportation sector is made up of airlines, railroads and roadways.

The performance of the transportation sector is sensitive to the fuel prices. Because operations revolve around the use of vehicles, cost of fuel is major factor in the cost of operations of transportation companies. If the price of fuel rises, transportation companies will earn less. These companies do well when the cost of fuel decreases.

The transportation sector can be classified into 6 categories:

1) Air Couriers
2) Airlines
3) Miscellaneous. Transportation
4) Railroads
5) Roadways
6) Water transportation

1.13 How to know about the stock market and stock

There are some step by step actions that one should take to start knowing about stock market. The first step is subscribing the proper newspaper.
In “Economic Times” newspaper, the names of the listed companies both at Bombay Stock Exchange and National Stock Exchange are given along with the price details on a daily basis, i.e. from Monday to Friday as both BSE and NSE are open from Monday to Friday and remain closed on Saturday and Sunday. It is given in a table form which is called “Stock Table”.

In the stock table, BSE A group shares prices are given first followed by prices of other shares including B1, B2, T and Z groups. Here it must be noted that in the newspaper B1, B2, T and Z groups are together quoted as “Others.”

The name of the companies are given in alphabetical order.

An example of the quotation is stated below,

Co.,(Pre.Cl),Op,Hi,Lo,Cl(Vol.,Tra.)
Co.,(Pre.Cl),Op,Hi,Lo,Cl(Vol.,Tra.)P/E,M.Cap,52WKH/L,Div%(yr)

ACC(2)(1200)1210,1210,1187[224K,748]28,5166,1682/367,80(09)
[N](1202)1209,1210,1187[727K,2719]28,5165,1682/366

How to read stock table:

Now, the method of how to read the above “Stock table”, is discussed in detail below.
Firstly, “Co.” is given which stands for the company’s name and just below that “ACC” is written which is the name of a company.

Just beside the name of the company i.e. ACC “(2)” is written which means that the face value is Rs.2 per equity share of the company.

Just below “(2)” [N] is given which stands to indicate that the figures in this line belongs to National Stock Exchange.

Beside, “Co.” there is (Pre.Cl.) is written which means previous close i.e. market price at which the stock was last traded in the previous day.

Below, “Pre.Cl.” in the first line ‘(1200)’ is written which means the market price at which the stock was last traded during the previous day is at Rs.1200 at Bombay Stock Exchange. Then just below that ‘(1202)’ is written which means the stock was last traded at Rs.1202/- at NSE (National Stock Exchange).

Beside “Pre.Cl.”, “Op” “Hi” “Lo” and “Cl” is written respectively which means “Op” is opening market price i.e. the market price at which the stock was first traded on that day. Then, “Hi” is the highest price i.e. the maximum price at which the stock was traded during that day and “Lo” means the lowest price at which the stock was traded on that day. Then, “Cl” is the market price at which the stock was last traded on that day.
Below "Op", "Hi", "Lo" and "Cl" "1210", "1210", "1183" and "1187" is written and "1209", "1210", "1182" and "1187" is given in the next line. This indicates that at Bombay Stock Exchange, the stock was first traded at Rs.1210/ (market price) and the highest price at which the stock was traded on that day was Rs.1210/-. The stock was also traded at Rs.1183/- which is the lowest market price the stock reached on that day and the last price at which it was traded on that day was Rs.1187/-. In case of NSE opening price was Rs.1209/- highest price was Rs.1210/-, lowest price was Rs.1182/- and the last traded price was Rs.1187/-.

Beside "Cl", "(Vol.,Tra.)" is mentioned which means "Volume" and "Trade". Here, "Volume" means the total number of shares traded on that day and "Trades" means number of persons or entities who transacted on that day. To be more precise if a person bought or sold 5000 shares of that stock, volume will added by 5000 shares while 1 will be added to "trades".

Just below "(Vol.,Tra.)", in the first line [224K, 7489] and in the next line [727K, 27191] is written which means at BSE total 224000 shares were traded by 7489 people or entities while at NSE total 727000 shares were traded by 27191 people or entities.

Beside "(Vol.,Tra.)", "P/E" is written.

P/E means price earnings ratio.
P/E ratio is the valuation ratio of a company's current share price compared to its earnings per share.

Calculated as: \[ \frac{\text{Market Value Per Share}}{\text{Earnings per share (EPS)}} \]

For example, if a company is currently trading at Rs.43/- a share and earnings over the last 12 months were Rs.1.95 per share, the P/E ratio for the stock would be Rs.22.05.

EPS is usually given for the last four quarters (trailing P/E), but at times it can be taken from the estimates of earnings expected in the next four quarters (projected or forward P/E). A third variation for the calculation of EPS uses the sum of the last two actual quarters and the estimates of the next two quarters.

Sometimes this is also called “price multiple” or “earning multiple”

In general, investors are expecting a higher growth in their earnings in the future from companies with a higher P/E compared to companies with a lower P/E. However, the P/E ratio does not denote all the facts by itself. It is usually more useful to compare the P/E ratios of one company to other companies in the same industry, to the market in general or against the company’s own past P/E. It would not be wise for investors using P/E ratios as a basis for their investments to compare the P/E of a technology company (high P/E) to a utility company (low P/E) as each industry has different growth prospects. The P/E is
sometimes referred to as the “multiple”, because it refers how much investors are willing to pay per rupee of earning. If a company was currently trading at a multiple (P/E) of 20, the interpretation is that an investor is willing to pay Rs.20/- for Re.1 of current earnings.

It is important that investors take a note of the serious risk that arises with using only the P/E measure for investments, and avoid basing their decisions on this measure alone. The denominator (earnings) is based on an accounting measure of earnings that is susceptible to forms of manipulation, making the quality of the P/E only as good as the quality of the underlying earnings figures.

Just below “P/E” “28” is written in both the lines which mean that the P/E of the stock is 28 in both in Bombay Stock Exchange and National Stock Exchange.

Beside “P/E”, “M-Cap” is written which means Market Capitalization. Just below Market Capitalization i.e. “M- Cap”, in the first line “5166” is written and in the second line “5165” is written, which means that market capitalization i.e. “M - Cap” of the stock for BSE is Rs.5166 cores and for NSE it is Rs.5165 cores.
Beside “M-Cap”, “52 - WK H/L” is written which means 52 week high / low i.e. what is the highest market price the stock has reached in the last one year and what is the lowest market price the stock has reached in the last one year.

Just below “52 -WK H/L”, in the first line “1680/367” is written and in the second line “1682/366” is written which means at Bombay Stock Exchange the stock achieved the highest market price of Rs.1680/- while it went down to Rs.367/- market price per share in the last one year at BSE. Similarly the highest and lowest market price that stock achieved in the last one year at NSE (National Stock Exchange) is highest Rs.1682/- and the lowest Rs.366/- per share.

Just, beside “52-WK H/L”, “Div % (Yr)” is written which means how much dividend the company had paid to its shareholders and in which year.

Here if just below “Div % (Yr)” “80 (09)” is written it means that the company paid 80% dividend in the year 2009.

Here, 80% dividend is on the face value of the share i.e. on the face value of the share which is Rs.2/- and if you have 1000 shares then you get Rs.2 x 1000 = Rs.2000, Rs.2000 x 80% = Rs.1600 as dividend.
Dividend yield is a financial ratio that shows how much a company pays out in dividends each year and is relevant to its share price. In the absence of any capital gains, the dividend yield is the only return on investment for a stock. Dividend yield is calculated as follows:

\[
\text{Dividend yield} = \frac{\text{Annual dividend per share}}{\text{Price per share}}
\]

Dividend yield is a way to measure how much cash flow investors are getting for each rupee invested in an equity position. Investors who require a minimum stream of cash flow from their investment portfolio can do so by investing in stocks with relatively high and steady dividend yields.

To better explain the concept, refer to this dividend yield example. If two companies both pay annual dividends of Re.1 per share, but ABC company is trading at Rs.20 while XYZ company's stock is trading at Rs.40/- per share, then ABC has a dividend yield of 5% while XYZ is only yielding 2.5%. Thus assuming all other factors are the same, an investor looking to supplement his or her income would likely prefer ABC's stock over that of XYZ.

There is whole lot of useful information other than those mentioned above about stock market in "Economic Times Newspaper" and information about Indian and world economy is also there. So, it creates awareness about stock market to a very great extent. It is very important to read this paper for...
investing in stock market. It also provides several guidelines about stock market investing and many recommendations are also given for purchasing and selling of particular stocks. But, here it should be noted that the recommendation should not be followed blindly and investment should be done only after due study on the stock.

(B) Magazine:

Though all the above information is compulsory and very useful for investing in stock market, they are not enough as one needs to go into the depth of the financials to some extent of a company that the person wants to buy or sell. To learn more about the companies, firstly what is definitely required is a magazine called "CAPITAL MARKET". It is a fortnightly magazine.

In this magazine one can find that the companies are divided in 109 categories. Categories are set in alphabetical order. The categories are:

1) ABRASIVES & GRINDING WHEEL
2) AIR – CONDITIONERS
3) ALUMINIUM & ALUMINIUM PRODUCTS
4) AQUACULTURE
5) AUTOMOBILES – LIGHT COMMERCIAL VEHICLES & HIGH COMMERCIAL VEHICLES
6) AUTOMOBILES – PASSENGER. CAR
7) AUTOMOBILES – TRACTORS
8) AUTOMOBILES - M CYCLE / MOPEDS
9) AUTOMOBILES - SCOTTER / 3WHEELERS
10) AUTOMOBILE ANCILLARIES
11) BANKS - PUBLIC SECTOR
12) BANKS - PRIVATE SECTOR
13) BEARINGS
14) BREWERIES & DISTILLERIES
15) CABLES – POWER
16) CABLES – TELEPHONE
17) CASTING & FORGING
18) CEMENT - NORTH INDIA
19) CEMENT – SOUTH INDIA
20) CEMENT PRODUCTS
21) CERAMIC TILES / SANITARYWARE
22) CHEMICALS
23) CHLORIDE ALKALINE / SODAS
24) CIGARETTES
25) COMPRESS / DRILLING EQUIPMENTS
26) COMPUTER – HARDWARE
27) COMPUTER - SOFTWARE – LARGE SCALE
28) COMPUTER – SOFTWARE – MEDIUM SCALE
29) COMPUTER - SOFTWARE - SMALL SCALE
30) COMPUTER - EDUCATION
31) CONSTRUCTION
32) COURIERS
33) CYCLES & ACCESSORIES
34) DETERGENT / INTERMEDIATES
35) DIAMOND CUTTING / JEWELLERY
36) DOMESTIC APPLIANCES
37) DRY CELLS
38) DYES & PIGMENTS
39) ELECTRIC EQUIPMENTS
40) ELECTRODES - GRAPHITES
41) ELECTRODES - WELDING EQUIPMENTS
42) ELECTRONICS - CONSUMER PRODUCTS
43) ELECTRONIC - COMPONENTS
44) ENGINEERING
45) ENGG - TURNKEY SERVICES
46) ENGINES
47) ENTERTAINMENT / ELECTRONIC MEDIA SOFTWARE
48) FASTENERS
49) FERTILIZERS
50) FINANCE & INVESTMENTS
51) FINANCE & HOUSING
52) FIN - TERM- LENDING INSTITUTIONS
53) FOOD - PROCESSING - INDIAN
54) FOOD - PROCESSING – MULTI NATIONAL COMPANIES
55) GLASS AND GLASS PRODUCTS
56) HEALTHCARE
57) HOTELS
58) LEATHER / LEATHER PRODUCTS.
59) MINING / MINERALS / METALS
60) MOULDED LUGGAGE
61) OIL DRILLING / ALLIED SERVICES
62) PACKAGING
63) PAINTS / VARNISHES
64) PAPER
65) PERSONAL CARE - INDIAN
66) PERSONAL CARE - MULTI NATIONAL COMPANIES
67) PESTICIDES / AGROCHEMICALS - INDIAN
68) PESTICIDES / AGROCHEMICAL - MULTI NATIONAL COMPANIES
69) PETROCHEMICALS
70) PHARMACEUTICALS – INDIAN – BULK DRUGS AND FORMULA
71) PHARMACEUTICALS - INDIAN – BULK DRUGS
72) PHARMACEUTICALS - INDIAN - FORMULATIONS
73) PHARMACEUTICALS - MULTI NATIONAL COMPANIES
74) PHOTOGRAPHY & ALLIED SERVICES
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<td>TEXTILE - PRODUCTS</td>
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98) TEXTILE - SILK
99) TEXTILE - SPINNING - SYNTHETIC / BLENDED
100) TEXTILE - JUTE - YARN / PRODUCTS
101) TRADING
102) TRANSMISSION LINE TOWERS / EQUIPMENT
103) TRANSPORT - AIRLINES
104) TRAVEL AGENCIES
105) TYRES
106) MISCELLANEOUS
107) DIVERSIFIED - MEGA
108) DIVERSIFIED - LARGE
109) DIVERSIFIED - MEDIUM / SMALL

The corporate scoreboard of each industry is divided into four portions - Full year, Latest Quarter (last three months), Trailing Twelve Months (TTM) and market data. Latest quarter and trailing twelve months both end in the same month. A sample is given below:

How to read a corporate scoreboard:
Now, explanation of how the above “corporate scoreboard” to be read is given below.

(1) **Company Name** - Here name of the company is stated

(2) **Equity** - Equity is the equity capital of the company. It is calculated as, number, of equity shares issued multiplied by its face value. Throughout the year equity is continuously adjusted for rights, bonus, conversion etc., in this magazine, to give the latest figures of the equity component as far as possible.

**Rights** - is right shares. Right shares are the shares which are offered by the company to the existing shareholders. Simply stated, the existing shareholders have a right to subscribe for the shares which are offered by the company after IPO (initial public offering).

After the expiry two years from the formation of a company or at any time after the expiry of one year from the allotment of shares in that company made for the first time after its formation, whichever is earlier, the company can propose to increase the subscribed capital by allotment of further shares.

A company can raise capital through rights issue. With the issued rights, the existing shareholders have the privilege to buy a specified number of new shares from the firm at a fixed price within a specified time.
For example, an investor: Mr. A had 100 shares of company X at a total investment of Rs.40,000/-, assuming that the he had purchased the shares at Rs.400/- per share. Assuming a 1:1 subscription rights had been declared by the company where the subscription for rights issue was at an offer price Rs.200/- per share, Mr. A will be notified by the company about this option to subscribe for an additional 100 shares of ordinary shares of the company at the offer price of Rs.200/-. Now, if he exercises his option, he would have to pay an additional Rs.20000/- in order to acquire the shares, thus effectively bringing his average cost of acquisition for the 200 shares to Rs.300 per share \(\frac{40000+20000}{200} = 300\).

Now the share price of the stock currently quoted on the stock exchange is Rs.400/-. The company X has 10,00,00,000 outstanding shares. Thus market capitalization of the stock would be Rs.4000 cores. If all the shareholders of the company chose to exercise their stock option, the company’s outstanding shares would increase to 20,00,00,000. The market capitalization of the stock would increase to Rs.8000 cores.

**Bonus Shares** - The term bonus means an extra dividend paid to shareholders in a joint stock company from the surplus profits. When a company has accumulated a large fund out of profits –more than its immediate financial requirements, the directors may decide to distribute a portion of the excess profit among the existing shareholders in the form of bonus shares. Bonus can be paid either in cash or in the form of shares. Cash bonus is paid by the company when it has large accumulated profits as well as cash to pay after
providing for dividends. Usually, a company is not in a position to pay cash bonus in spite of sufficient profits because such payments has adverse effects on the working capital of the company. In such a position, the company decides to reward the bonus to its shareholders in the form of shares, the free shares thus issued are known as bonus shares. Thus a bonus share is a free share of stock given to current / existing shareholders of a company, depending upon the number of shares that the shareholders already own at the time of announcement of the bonus. While the issue of bonus shares increases the total number of shares issued and owned, it does not increase the value of the company. Though the total number of issued shares increases, the ratio of number of shares held by each shareholder remains constant.

When a company declares dividends or issuance of bonus shares, there has to be a cut-off date for such benefits to be transferred to the shareholders. This date is termed as “Book Closure” date or “Record date”. It is the date after which the company will not handle any transfer of shares requests until these transactions are completed. Only shareholders marked in the company’s books at the book closure date or record date would be entitled to receive these benefits. If a company announces book closure as 1st January, shareholders who as on the last day i.e. 31st December of the previous year own the stock would be entitled to the dividend / bonus / split benefits. For example, if Mr. Y buys this stock from Mr. X on 2 January, the benefit of bonus issue or split or dividend will still be transferred to Mr. X by the company. A company
generally announces such a date along with the announcement of the bonus issue or splits or dividend, as the case may be. Bonus share is given in a fixed ratio to its shareholders. For example, Reliance Industry issues bonus share in 1:1 ratio and Rs.13/- as dividend per share i.e. for every share of Reliance Industry a shareholder owns, he/she will receive another free share, and a dividend of Rs.13/- per share, for every share of Reliance Industries.

Conversion - Sometimes a company will change the number of shares in issue by capitalizing its reserve. In other words, it can convert the retained profit into paid up shares and issue them to existing shareholders in proportion to their present shareholdings. Doing so will not bring any additional funds into the company, nor will it affect the rights of the shareholders because each individual will hold the same proportion of outstanding shares as before.

(3) FV - The face value of the stock of the company is stated.

(4) Promoters Stake - Promoter is someone who organizes the starting of new companies, bringing other accountants, lawyers and other specialists. Corporate promoter, also known as a projector, is not a specifically defined legal term, but it is understood to be a person or an entity who takes active steps in the formation, organization or financing of a corporation.
Promoter's stake is the percentage of shareholding of the promoters in the equity capital of the company that they are promoting. It includes governments' holdings in case of public sector undertakings.

(5) B.V. - B.V. is Book Value per share

\[
\text{Stockholders Equity} = \frac{\text{Preferred Stock} - \text{Average Outstanding Shares}}{\text{Preferred Stock}}
\]

Somewhat similar to the earnings per share, it relates to shareholders equity to the number of shares outstanding, giving the shares a raw value.

"Stockholders" equity is that part of the company's balance sheet that states the capital received from investors in exchange for stock (paid-in-capital), donated capital and retained earnings. Stockholders equity represents the equity stake currently held by the investors in the company's equity.

It is calculated either as the company's total assets less its total liabilities, or as share capital plus retained earnings less treasury shares.

Stockholders Equity = Total Assets - Total Liabilities

OR

Stockholders Equity = Share Capital + Retained Earnings — Treasury Shares
(Here treasury shares means the portion of shares that a company keeps in its own treasury).
Treasury stock may have come from a repurchase or buyback from shareholders; or it may have never been issued to the public in the first place. These shares do not pay dividends, investors have no voting rights, and is not be included while calculating the total number of shares outstanding of the company.

Treasury stock is often created when shares of a company are initially issued. In this case not all shares are issued to the public, as some are kept in the company's treasury to be used to create extra cash should need arise in future. Another reason can be to keep a controlling interest within the company to help ward off hostile takeovers.

Alternatively, treasury stock can be created when a company decides on a share buyback and purchases its shares from the open market. This can be advantageous to shareholders because it lowers the number of shares outstanding. However not all buybacks have positive effects. For example, if a company merely buys stock to improve financial ratios such as EPS or P/E, then the buyback is detrimental to the shareholders and it is done without looking into the best interests of the shareholders.

(6) Return on Net Worth - RONW (%)

- Return on net worth (RONW) is used in finance as a measure of a company's profitability.
It reveals how much profit a company generates with the money that the equity shareholders have invested.

Therefore it is also called "Return on Equity" (ROE)

This ratio is useful for comparing the profitability of a company to that of other firms in the same industry.

It is expressed as:

$$\text{RONW} = \frac{\text{Net Income}}{\text{Shareholder's Equity}} \times 100$$

- The numerator is equal to a fiscal year's net income (after payment of preference share dividends but before payment of equity share dividends).
- The denominator excludes preference shares and considers only the equity shareholding.

Example:

- A company's net income for the year was Rs.60000 and shareholder equity for the year was Rs.300000
- This gives us a Return on Net Worth of 20% (Rs.60000 net income /Rs.300000 shareholders' equity)
- This means that for each rupee invested by shareholders, 20% was returned in the form of earnings.
- So, RONW measures how much return the company management can generate for its equity shareholders.
Therefore:

- RONW is a measure for judging the returns that a shareholder gets on the investment.
- As a shareholder, equity represents your money and so it makes good sense to know how the management is managing it.
- Return on Capital employed (ROCE) is a way of assessing a company’s profitability from its overall operations.
- Let us now try to understand how RONW is a more accurate tool for decision making than ROCE.

Difference between Return on Capital Employed (ROCE) and Return on Net Worth (RONW):

Example of ROCE

- A and B both started a business by investing initial capital of Rs. 10000/- each.
- After one year, A had an after-tax profit of Rs. 4000/- while B made only Rs. 3000/-
- The return on capital employed for A was 40% (Rs. 4000/- / Rs. 10000/-) while for B it was 30% (Rs. 3000/- / Rs. 10000/-)
- On the face of it, it appears that A was the better manager since he earned more profit and therefore a higher return than B - though both started their businesses with the same amount of initial capital.

Therefore as an investor you are likely to feel encouraged to invest in A rather than B.
But, RONW says,

- Now assume that A’s business had shareholder equity of Rs.45000 and net income of Rs.4000/-
- While B’s business had shareholder equity of Rs.30000/- and net income of Rs.3000/-
- RONW of A is Rs.4000/- /Rs.45000/- = 8.88%
- RONW of B is Rs.3000/- /Rs.30000/- = 10%
- Now, with the measure of RONW, we find that B has done better than A.
  To Sum it up
- ROCE considers total capital which is in the form of both equity and long term debt such as loans and borrowings.
- RONW considers equity shareholding as the base for deciding efficiency of a company’s operations.
- So, for an equity investor, RONW is a better measure of efficiency than ROCE, since he is interested in knowing the return on his equity investment rather than return on the company’s total capital.

Hence, ROCE is a better indicator of the overall profitability of the company’s operations. But RONW is an appropriate measure for judging the returns that a shareholder gets on his investment.

Hence successful investors like Warren Buffet assign more importance to a company’s RONW to understand their investment growth potential.
(7) Sales – Total sales less excise duty.

(8) Sales Var % – Sales variance percentage – The percentage difference between the sales of the company of current year and last year.

(9) NP – Net Profit – Here is how one arrives at net profit in a P & L (Profit & Loss) account

1. Sales Revenue = Price (of product) X Quantity Sold
2. Gross Profit = Sales Revenue - Cost of sales and other direct costs.
3. Operating Profit (EBIT, earnings before interest and taxes) = Gross Profit - overheads and other indirect costs.
4. Pretax Profit (EBT, earnings before taxed) = Operating Profit - One off items and redundancy payments, staff restructuring - interest payable.
5. Net Profit = Pretax Profit - tax
6. Retained Earnings = Profit after tax - Dividends.

Here direct cost means a cost that can be directly traced to the production of specific goods or services.

For example, the cost of meat in hamburgers can be attributed directly to the cost of manufacturing that product. Other costs, such as depreciation or administrative expenses, are more difficult to assign to a specific product and are not considered as direct costs.
Overheads - In business, overhead / overhead cost / overhead expenses refers to the ongoing expenses for operating the business (also known as operating expenses - rent, gas / electricity, wages etc). The term overhead is usually used to group expenses that are necessary to the continued functioning of the business, but cannot be immediately associated with the products / services being offered.

Overhead expenses are all costs on the income statement except for direct labor, direct materials and direct expenses. Overhead expenses include accounting fees, advertising, depreciation, insurance, interest, legal fees, rent, repairs, supplies, taxes, telephone bills, travel and utilities cost.

Indirect Cost - Indirect costs are costs that are not directly accountable to a cost object (such as a particular function or product). Indirect costs may be either fixed or variable. Indirect costs include taxes, administration, personnel and security costs and are also known as overheads.

One off items - A happening that occurs only once and is not repeated.

Redundancy Payment - Employers must give you a lump sum payment if you are made redundant and if you have at least 2 years continuous service since the age of 18. If this has been agreed in your contract of Employment, you may be entitled to non-statutory payments (non-statutory means it is not laid down in law)
Operating Profit Margin - OPM (%) - A ratio used to measure a company’s pricing strategy and operating efficiency.

Calculated as: Operating Margin = \( \frac{\text{Operating Income}}{\text{Net Sales}} \)

Operating margin is a measure of what proportion of a company’s revenue is left after paying for variable costs of production such as wages, raw materials etc. A healthy operating margin is required for a company to be able to pay for its fixed costs, such as interest on debt.

Also known as “Operating profit margin” or “Net profit margin”

Operating margin gives analysts an idea of how much profit a company makes (before interest and taxes) on each rupee of sales. When looking at operating margin to determine the quality of a company, it is best to look at the changes in operating margins over time and to compare the company’s yearly or quarterly figures to those of its competitors. If a company’s margin is increasing, it is earning more per rupee of sales. The higher the margin, the better it is for the profits of the company.

For example, if a company has an operating margin of 12%, this means that it makes Re.0.12 (before interest and taxes) for every rupee of sales. Often, non-recurring cash flows, such as cash paid out in a law suit settlement, are excluded from the operating margin calculation because they don’t represent operating performance.
(11) NP Var % - Net Profit variance percentage - The percentage difference between the net profit of the company of current year and of last year. LP (Loss to profit) in the var (%) column means that the company which incurred a loss in the corresponding previous period has made a profit in the current period. P/L (Profit to Loss) in the Var (%) column means that the company which made a profit in the corresponding previous period has now incurred a loss. Nil (-) in the var (%) column indicates that either the figures for the corresponding previous period are not available or the variance is insignificant. A variance of 999 indicates that the variance is very large (more than three digits). This occurs mostly in the case of new companies.

(12) Div (%) - It shows the % of dividend that has been declared and paid during that year.

(13) EPS - Earning Per Share (Rs.) - The Portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.

Calculated As = \[
\frac{\text{Net Income} - \text{Dividend on preferred stock}}{\text{Average Outstanding Shares}}
\]

When calculating average outstanding shares, the number of shares outstanding at the end of the period is taken. But it is more accurate to use a weighted average of the number of shares outstanding over the reporting period, as the
number of shares outstanding can change over time. Earnings per share is considered to be the single most important variable in determining the price of a share. It is also a major component used to calculate the Price - to - Earnings valuation ratio.

For example, assume that a company has a net income of Rs.2500000. If the company pays out Rs.100000 in preferred dividends and has 1000000 shares for half of the year and 1500000 shares for other half, the EPS would be Rs.1.92 (24/12.5). First, the Rs.100000 is deducted from the net income to get Rs.2400000, then a weighted average is taken to find the number of shares outstanding (0.5 x 1000000+ 0.5 x 1500000 = 12500000).

An important aspect of EPS, that is often ignored is the capital that is required to generate the earnings (net income) in the calculation. Two companies can generate the same EPS figures but one could do so with no equity (investment) - that company would be more efficient at using its own capital to generate income and all other things being equal, would be a “better” company. Investors also need to be aware of manipulation in earnings by the companies which will affect the quality of the total earnings. It is important not to rely on any one financial measure, but to use it in conjunction with analysis of other financial statements and other measures.
Earning Manipulation - Earning manipulation means when managers manipulate financial statements to show what they wished to happen not what had actually happened.

Here, full year is a period of 12 months where in the very first column it is written 0903 which means the “12 month” period ends at 31st March 2009 so 01.04.08 to 31.03.09.

Then, latest quarter means the result of the last 3 months that ends on the same day as the full year ends. So, in case of above period the latest quarter will show the result of 3 months starting from 1.1.09 to 31.03.09.

TTM - Trailing twelve months (TTM) figures are the sum of the last 4 quarters.

Under market data Price of a certain date of that company i.e. Market price is given and beside that 52 week High / Low is given and lastly P/E ratio of the company is stated.

1.14 Risk and Uncertainty in Stock Market:

One hears the words risk and uncertainty more often in stock market, and whenever there is a panic in stock market these two words are used as if there are no other words in the dictionary. While both the risk and uncertainty are
used interchangeably they both have different meanings. Let’s look at both of them one by one.

Risk refers to the possibility of an event happening which one does not wish to happen. So, for example if one is buying a stock of a company whose earnings are dependent on the price of crude then there is a risk that crude price may fall and therefore stock earnings will also fall leading to a loss to that investor. Risk can be avoided by taking certain steps like one can short sell crude company’s stock and hedge against falling crude price, in the same way as one can take life insurance against the risk of death.

Uncertainty refers to lack of knowledge of the event happening - for example nobody can say where the indices of the stock market will be the after 2 years because stock markets are affected by so many factors. Therefore nobody can be certain about the movement in stock market and therefore one cannot insure against uncertainty unlike risk against which one can insure or hedge.

One must know all the above points before beginning to invest in stock markets. Once a person starts investing in stock market with the knowledge of the above basic concepts, the person will learn more and more about stock market with the practical knowledge that he or she will gain about the day to day operations in stock markets.