CHAPTER 1

INTRODUCTION
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1.0 Introduction

The determinants of share prices are frequently a topic of debate both in academics and industry. The economists and investors hold different views as far as the pricing of a share is concerned. In an efficient market, share prices would be determined primarily by fundamental factors, such as dividend per share, earnings per share, dividend payout ratio, dividend yield, net worth, size of the firm, etc. To estimate the future share prices, fundamental analysts use stock valuation ratios to derive a share's current fair value and estimate future value. If fair value is not equal to the current share price, fundamental analysts believe that the stock is either over or under valued and the market price will ultimately drop towards fair value. Fundamental analysts do not pay attention to the advice of the random walkers and believe that markets are weak form efficient. As a result of believing that prices do not accurately reflect all available information, fundamental analysts look to capitalize on perceived price discrepancies.

The various researchers have found important internal factors that determine the share prices for different markets, viz., dividend, retained earnings, size, and earnings per share, dividend yield, leverage, payout ratio, and book value per share. The understanding of the impact of various fundamental variables on share price is very much helpful to investors, as it helps them in taking profitable investment decisions.
In the present study, an attempt has been made to study the impact of selected accounting variables, like book value, dividend per share, earnings per share, size of the firm, dividend payout ratio, dividend yield, return on net worth and P/E ratio on the equity prices of listed companies in Bombay Stock Exchange.

1.1 Concept of Stock Market

The Securities Contracts (Regulation) Act, 1956, has defined stock exchange as an "association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in securities". As an organized security market, it provides marketability and price continuity of shares and helps in a fair valuation of securities in terms of their intrinsic value. Thus, it helps orderly flow and distribution of savings between different types of investments. It performs an important part in the economic life of any nation, acting as a free market for securities, where prices are determined by the supply and demand forces. Apart from the above basic function, it also assists in mobilizing funds for the government and the industry and to supply a channel for the investment of savings in the performance of its functions.

The Stock Exchanges in India as elsewhere have a vital role to play in the development of the country in general and industrial growth of companies in the private sector in particular and helps the government to raise internal resources for the implementation of various development programs in the public sector. As a segment of the
capital market it performs an important function in mobilizing and channelizing resources which remain otherwise scattered. Thus, the stock exchanges tap the new resources and stimulate a broad based investment in the capital structure of industries.

A well developed and healthy stock exchange can be and should be an important institution in building up a property base along with a socialism in India with broader distribution of wealth and income. Thus, the stock exchange is a vital organ in a modern corporate business world. Without the stock exchange a modern corporate economy cannot exist. The system of joint stock companies financed through the public investment as emerged has put the vast means of finances almost to entrepreneur’s needs.

Finance from external sources, mainly from the investing public, can become possible only when an institute like the Stock Exchange provides opportunities for the conversion of scattered savings into profitable investments with the promise of a reasonable yield and minimum element of risk. Such a mechanism as provided by Stock Exchanges is not merely a source of capital but also a conduit which channelizes the savings into investment along with a free movement of capital.

With the probable exception of a totalitarian state no government will be able to mobilize resources from the public, if the money market in the form of stock exchange does not exist. The Stock Exchange benefits the entire community in a variety of ways. It enables the producers to raise capital which directly and indirectly gives gainful employment to millions of people on the one hand, and helps consumers to get a variety of goods needed by them on the other. It provides opportunities to savers to store the value
either as temporary abode of purchasing power or as a permanent abode of purchasing power in the form of financial assets. It also helps the segments of the savers who put their savings in commercial firms and non-banking financial intermediaries because these institutions avail themselves of the services of Stock Exchange to invest the money thus collected.

The stock exchange comes close enough to a perfectly competitive market allowing the forces of demand and supply a reasonable degree of freedom to operate as compared to other markets specially the commodity markets. This segment of the factor market can be considered as a perfect or a nearly perfect market. Apart from providing a mechanism for transacting business in stock and shares it generates genuine potential for a new entrepreneur to take up initiative in the private sector enterprises and allows the expansion of investing community by offering gainful development of their otherwise sluggish or shy capital. The stock exchange must assume the responsibility of protecting the rights of investors specially the small investors in the Joint stock companies.
1.2 Features of Stock Exchange:

(i) **Organized Market:** Stock exchange is an organized market of securities (shares, debentures, bonds, etc.) where the securities are bought and sold on the floor of a stock exchange. All transactions are regulated by the rules and bye-laws of the concerned stock exchange.

(ii) **Formation & Membership:** A stock exchange is generally registered as an association or a society or a company. The membership of the stock exchange is restricted
to a certain number, and new members are admitted only when there are vacancies. Every member has to pay the prescribed membership fee.

(iii) Members only Can Trade: Stock exchange is only open to the members of exchange also known as brokers. Brokers act as an agent of the buyers and sellers of shares, debentures and bonds. In a stock exchange, transactions take place between members or their authorized agents on behalf of the investors.

(iv) Listed Securities: To be able to trade a security on a certain stock exchange, it must be listed on the respective stock exchange as per the guidelines issued by the exchange. The stock exchanges do not allow trading in each and every company's securities. Companies which want their securities to be traded on the floor of a stock exchange have to fulfill certain conditions. The stock exchange satisfies itself about the genuineness and soundness of the company to protect the investors from being cheated. Exchanges maintain records at a central location of such securities but now the trade is increasingly moving from physical places to electronic networks enabling speed and reducing cost.

1.3 Secondary Market

The purpose of a stock exchange or secondary securities market, like any other organized market is to enable buyers and sellers to affect their transactions more quickly and cheaply than they could otherwise. However, since a stock exchange typically deals in existing securities rather than in new issues, its economic significance may be
misunderstood. As it is noted above, the primary function of the capital market relates to the channeling of savings into capital formation; hence the capital market’s economic significance stems from its impact on the allocation of capital resources among alternative uses.

But an increase in the volume of securities trading in the stock market does not represent an increase in the economy’s aggregate savings, every purchase of an existing security being exactly offset by the sale of the same security. To place the capital market in proper perspective it is useful to distinguish between the “primary” and “secondary” securities markets. For the economy as a whole, an increase in savings in the form of securities, ownership is measured by the volume of net new issues of securities, while transactions in existing securities represent shifts among owners, which always cancel out in the aggregate. Similarly, transactions in existing securities do not provide additional funds to finance capital formation; here again it is the volume of net new issues which provides additional financing to business enterprises.

An analogy can readily be drawn from the automobile market. The sales of new Maruti cars (new issues) by the Maruti Udyog (issuing firm) provide revenue (investment funds) to the company; transactions in older models of Maruti cars (existing securities) in the used car market (stock exchange) do not. But just as the existence of a resale market for cars affects the willingness of consumers to purchase new Marutis, the availability of an efficient secondary market for securities is one of the more important factors inducing investors to acquire new issues of securities. And the connection between the primary and
secondary markets is even stronger in the case of the securities market, since new issues are often close, or even perfect, substitutes for outstanding securities.

The basic economic function of a stock exchange is to provide marketability for long-term investments, thereby reducing the personal risk incurred by investors and broadening the supply of equity and long-term debt capital for the financing of business enterprise. For example, even though the investment in equity shares is fixed for the life of the firm, the ability to shift ownership to others during the course of this period permits more individuals to participate in the long-term financing of companies.

In an economy with a well-developed secondary securities market, the fixed investment of firms is provided by a changing group of individuals, none of whom may have been willing to commit his personal resources for the entire or even a substantial part of the life of the enterprise. Thus, in an efficient stock exchange the supply of credit, which from the private investor’s viewpoint is often inherently short-term, is transformed into a supply of long-term investment fund for the financing of capital formation.

The ability to transfer the risks of investment, forges a link between the stock exchange and the new issues market, and this greatly enhances the ability of business enterprises to mobilize additional long-term capital to finance the creation of new, or the expansion of existing production facilities. To effectively fulfill its functions as an allocator of capital, the securities market should be influenced solely by economic considerations; the prices of the various securities should reflect their expected returns and risk characteristics. In an efficient market, current prices for a company’s securities will reflect
the investors’ best estimates of the firm’s anticipated profitability and of the risks attaching to these profits.

And since—other things being equal—rising stock prices attract investors; the allocation of capital will be biased in favor of firms with relatively high levels of risk-adjusted profits. On the other hand, firms with low profitability or excessive riskiness will find it difficult, expensive, or on occasion even impossible to raise additional capital for expansion. The prerequisites for such an efficient securities market are roughly the same as those of any ‘perfect’ or purely competitive market: (a) the products traded in the market must be homogeneous; (b) the market must comprise many relatively small buyers and sellers; and (e) there must be free entry and exit into and out of the market.

Although a securities market is made up of many types of securities of a large number of companies, each class of securities is homogeneous in the sense that the risk-adjusted rates of return of the various classes of securities comprise homogeneous commodities. One share of a given risk class is as good as any other and therefore they must sell at the same price. In addition, a modern securities market is made up of a large number of relatively small buyers and sellers so that it is difficult for any individual to influence prices. This rather sanguine view of the stock market and its impact on the allocation of capital is not universally held. To some the Stock Exchange is a den of iniquity; to other, more sophisticated, observer’s stock market prices reflect mass psychology with little if any connection to underlying economic values. The case against the stock exchange was most forcibly expressed during the 1930s by the most famous
economist of the time, John Maynard Keynes. In a characteristically brilliant passage which goes a long way towards explaining his own success as an investor, Keynes described the stock exchange as a place where most investors attempt to guess what average opinion thinks. Average opinion will be like one month hence, while others practice the “fourth, fifth and higher degrees” of this art.’

It should be recalled that Keynes was writing at a time when a worldwide financial crisis had so undermined public confidence that stock prices did often appear to be unconnected with any underlying economic values. Taking a somewhat longer view, however, there is really no inherent contradiction between the kind of speculative behavior which Keynes described and the thesis that stock prices, in the long run, reflect economic values. For this purpose it is sufficient that some investors become conditioned to the fact that stock prices rise when profits and dividends increase, so that it “pays” to exploit all available information in an attempt to anticipate such possibilities. The available statistical evidence suggests that Keynes notwithstanding, the pure speculator does not rule the roost, and therefore the quest for quick capital gains has not divorced the trend in the price of a company’s stock from the expectation of future profits.

1.4 Importance of Investor in Stock Markets:

Investor is the backbone of the stock markets and therefore protection of his interests is paramount to the National Stock Exchange. In prolongation of his interests, the NSE has put in place systems to ensure obtainability of passable, up-to-date and correct information to investors to empower them to take cognizant decisions. It guarantees that
precarious and price-sensitive evidence reaching the exchange is made accessible to all classes of investors at the identical point of time. Such price-sensitive information as bonus announcements, mergers, new line of business, etc. received from the companies is disseminated to all the market participants through the network of NSE terminals all over India.

Action is initiated by the Exchange, where any kind of price-sensitive information is not provided to the Exchange at the prescribed time. It ascertains the veracity of rumors and disseminates facts in the interest of investors. In an attempt to ease the existing system of information dissemination by the listed companies, NSE launched the electronic interface for listed companies in August 2004. Under the new system, all corporate announcements including that of Board meetings which needs to be disclosed to the market is handled electronically in a straight through and hands free manner.

It also conducts various seminars and programs for the investors all over the country with a view to educate them on their rights and obligations. They are also made aware of the precautions they need to take while dealing in the securities market. It makes an audit trail available on request for all transactions executed on the NSE to enable investors to counter-check trade details for the trades executed on his behalf by the member. It has also prescribed and makes effort to ensure the implementation of various safeguards like time schedules for issuing contract notes, for receiving funds and securities purchased by investors, segregation of client funds and securities from those of members, etc. The exchange has also launched a facility to verify trades on the NSE website.
Using this facility, an investor who had received a contract note from the trading member of the Exchange can check whether the trade has been executed. The NSE has put in place a system for redressal of investor grievances for matters/issues related to/against trading members/companies. The Investor Grievance Cell of NSE is manned by a team of professionals possessing relevant experience in the areas of securities markets, company and legal affairs, and specially trained to identify problems faced by the investor and to find and effect a solution quickly. It takes up complaints in respect of trades executed on the NSE through its NEAT terminal and routed through the NSE trading member or SEBI registered sub-broker of NSE trading member and trades pertaining to companies traded on NSE.

1.5 Stock Exchanges in India

Any attempt at raising the standard of living of the masses must address itself to the task of producing the right quantity of the right types of goods and have them available for consumption at the right time. This requires large-scale production through coordination of activities of hundreds of people under the same roof even when the product is the simplest to make. This, however, calls for raising vast amounts of financial resources for the purpose of acquiring land, buildings and equipment, besides purchasing raw materials and employing labor. No one individual or a small group of individuals is rich enough to provide all the capital required by modern business enterprise and savings of hundreds, if not thousands, of people must be mobilized. The corporate form of organization is well adapted to the task of raising capital from many people. This is done
by issuing or offering for sale at cash, different types of securities, that is, shares and bonds, which offer to individual investors a means of productively employing capital/savings suited to his/her needs and temperament.

The need for offering for sale different types of securities is obvious. Some people may desire safety of the amount they have invested and a regular income from their investment. To them the corporation or company may offer debenture bonds- a certificate issued under the seal of the company promising a refund of the loan on a specified date and payment of interest at prescribed intervals. Other investors may be willing to commit their savings for an indefinite period of time and to assume greater risk while still desiring safety of capital and stability of income. To them the corporation will sell preference shares. Still other investors may be willing to shoulder the business risk that goes along with the ownership of the business in the hope that the profit realized would be large enough to compensate the greater risk they are assuming.

But no one will buy these securities unless there exists an organized market where the holders can dispose them of, should the need arise, and new investors can purchase them. Over the years, such organized markets have come into existence in all democratic and capitalistic countries including India. Such a market is called stock market or a stock exchange in English speaking countries and a 'brouse' in continental Europe. There is, obviously, no need for stock exchange in Communist countries since in such countries all the productive organizations are owned by the government. Organized stock exchanges in India are of recent origin. As late as 1933 there were only three stock
exchanges – one each at Ahmedabad, Bombay and Calcutta, but trading in securities was in vogue much prior to that year. Of course, no one can tell when the first transaction took place, however, it is generally agreed that business in securities had begun as early as the concluding years of the 18th century, that is, between the years 1790 and 1800 A.D.

The stock exchange or market is a place where stocks, shares and other long-term commitments or investments are bought and sold. The economic significance of a stock market results from the increased marketability resulting from a stock exchange share quotation. The stock exchange is an essential institution for the existence of the capitalist system of the economy and for the smooth functioning of the corporate form of organization.

The Securities Contracts (Regulation) Act of 1956 defines, a stock exchange as “an association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling, business in buying, selling and dealing in securities.” Stock Exchanges are noted as “an essential concomitant of the Capitalistic System of economy. It is indispensable for the proper functioning of corporate enterprise. It brings together large amounts of capital necessary for the economic progress of a country. It is a citadel of capital and pivot of money market. It provides necessary mobility to capital and directs the flow of capital into profitable and successful enterprises. It is the barometer of general economic progress in a country and exerts a powerful and significant influence as a depressant or stimulant of business activity.” The first organized stock exchange in India was started in 1875 at Bombay and it is stated to be the oldest in
Asia. In 1894 the Ahmedabad Stock Exchange was started to facilitate dealings in the shares of textile mills there. The Calcutta stock exchange was started in 1908 to provide a market for shares of plantations and jute mills. Then the Madras stock exchange was started in 1920. At present there are 24 stock exchanges in the country, 21 of them being regional ones with allotted areas. They are located at Ahmedabad, Vadodara, Bangalore, Bhubaneswar, Mumbai, Kolkata, Kochi, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Chennai, Mangalore, Meerut, Patna, Pune and Rajkot. Two others set up in the reform era, viz., the National Stock Exchange (NSE) and Over the Counter Exchange of India (OICEI), have mandate to have nation-wise trading. The Stock Exchanges are being administered by their governing boards and executive chiefs. Policies relating to their regulation and control are laid down by the Ministry of Finance. Government also Constituted Securities and Exchange Board of India (SEBI) in April 1988 for orderly development and regulation of securities industry and stock exchanges.

1.5.1 Structure of Stock Exchanges in India

The Act recognizes stock exchanges with different legal structure. Presently the stock exchanges which are recognized under the Securities Contracts (Regulation) Act in India, could be segregated into two broad groups – 20 stock exchanges which were set up as companies, either limited by guarantees or by shares, and the 3 stock exchanges which are functioning as associations of persons (AOP) viz. BSE, Ahmedabad Stock Exchange and Indore Stock Exchange. The 20 stock exchanges which are companies are: the stock exchanges of Bangalore, Bhubaneswar, Calcutta, Cochin, Coimbatore, Delhi, Guwahati and
Hyderabad, Interconnected SE, Jaipur, Ludhiana, Madras, Magadh, Managalore, NSE, Pune, OTCEI, Saurashtra-Kutch, Uttar Pradesh, and Vadodara. Of these, the stock exchanges of Ahmedabad, Bangalore, BSE, Calcutta, Delhi, Hyderabad, Madhya Pradesh, Madras and Gauhati were given permanent recognition by the Central Government at the time of setting up of these stock exchanges. Apart from NSE, all stock exchanges whether established as corporate bodies or Association of Persons (AOPs), are non-profit making organizations.

1.5.2 Powers of Stock Exchanges:

The powers of the stock exchange are to be implemented as per provisions in its bye-law. As per SCRA Act any acknowledged stock exchange may, subject to the preceding authorization of the Securities and Exchange Board of India, make bye-laws for the regulation and control of contracts.

The bye-laws can be responsible for the exercise of the subsequent powers by the stock exchange.

(a) The opening and closing of markets and the regulation of the hours of trade;

Set up a clearing house for the periodical settlement of contracts and differences thereunder, the delivery of and payment for securities, the passing on of delivery orders and the regulation and maintenance of such clearing house;

(b) The regulation or prohibition of blank transfers;

(c) The regulation, or prohibition of badlas or carry-over facilities;
(d) The fixing, altering or postponing of days for settlements;

(e) The determination and declaration of market rates, including the opening, closing, highest and lowest rates for securities;

(f) The terms, conditions and incidents of contracts, including the prescription of margin requirements, if any, and conditions relating thereto, and the forms of contracts in writing;

(g) The regulation of the entering into, making, performance, rescission and termination, of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts;

(h) The regulation of taravani business including the placing of limitations thereon;

(i) The listing of securities on the stock exchange, the inclusion of any security for the purpose of dealings and the suspension or withdrawal of any such securities, and the suspension or prohibition of trading in any specified securities;

(j) The method and procedure for the settlement of claims or disputes, including settlement by arbitration;

(k) The levy and recovery of fees, fines and penalties.

(l) The regulation of the course of business between parties to contracts in any capacity;
(m) The exercise of powers in emergencies in trade (which may arise, whether as a result of pool or syndicated operations or cornering or otherwise) including the power to fix maximum and minimum prices for securities;

(n) The regulation of dealings by members for their own account;

(o) The separation of the functions of jobbers and brokers;

(p) The limitations on the volume of trade done by any individual member in exceptional circumstances; Fixing the obligation of members to supply such information or explanation and to produce such documents relating to the business as the governing body may require.

1.5.3 Functions of Stock Exchanges

Stock exchange is one of the most important financial intermediaries that plays a very important role in the capital formation and economic development of the country. Given below are some important functions of stock exchanges from the economic point of view:

(i) Marketability of Securities: The stock exchange provides for easy marketability of securities as securities can be bought and sold conveniently on the floor of the stock exchange. The Stock Exchange provides companies with the facility to raise capital for expansion through selling shares to the investing public and on the other hand provides investors with a platform to trade these shares.

(ii) Price Determination & Continuity: Since transactions take place regularly on a stock exchange there is continuity in the dealings. Supply and demand in stock markets are driven
by various factors and this balance of supply and demand affects the price of stocks. These prices get duly recorded and reported in the newspapers for the benefit of investing public. Besides, stock exchanges have defined rules and regulations to moderate price fluctuations to ensure continuity in buying and selling.

(iii) Mobilizing Surplus Savings: Stock exchange is an integral part of the capital market of a country. When people draw their savings and invest in shares (through an IPO or the issuance of new company shares of an already listed company), this leads to mobilization of funds to help companies finance their organizations. They facilitate the process by which the savings from all parts of the country gets channelized as investment into industrial and commercial undertakings financing their capital requirements. This promotes business activity resulting in stronger economic growth and higher productivity levels of firms.

(iv) Barometer of the Economy: The share prices fluctuate on stock exchanges as a result of underlying market forces. The intensity of buying and selling of securities and the corresponding rise or fall in the prices of securities reflects the investors' assessment of the economic and business conditions. Share prices tend to rise or remain stable when companies and the economy show signs of stability and growth whereas they might fall sharply at the time of an economic recession, stagnation, depression, or financial crisis. Change in security prices are known to be highly sensitive to changing economic, social and political conditions and hence act as a barometer of economic and business conditions.

(v) Mobility of Capital: Investing in other businesses requires huge capital outlay whereas investing in shares is open to both the large and small stock investors. Stock exchanges
furnish an open and continuous market for small investors and their savings that are invested in securities are converted into cash for reinvestment in other securities. Thus, stock exchanges provide mobility to capital and facilitate sound investment. Savings are encouraged when people come to invest in stock exchange.

(vi) **Profit Sharing & Resource Allocation:** As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises. All types of stock investors, whether they are individuals, professional stock investors, institutional investors, earn capital gains through dividends and stock price increases. This enables them to share in the wealth of profitable businesses. Industries which have potentials of growth are able to attract the savings of people towards their ventures relatively more than those which have no such prospects. Thus, financial resources of the economy are allocated on a reasonable basis. Unprofitable and troubled businesses may result in capital losses for shareholders.

(vii) **Speculation:** The stock exchanges are also fashionable places for speculation and bring equilibrium in the prices of securities which are bought and sold by speculators. In a financial context, the terms "speculation" and "investment" are actually quite inter-related because "investment" means the act of placing money in a financial vehicle with the intent of producing returns over a period of time. Speculators generally buy securities in anticipation of rise in the prices. As a result of their buying, prices do not decline as low as might have been the case without their buying and vice versa hence regulating excessive price fluctuations.
(viii) Liquidity: This is the most important function provided by the stock exchanges. The capital investments are generally long term and if shareholders want their investment back, in a physical scenario, it will result in winding up the company and selling its assets to discharge the money. Investors usually prefer liquidity of their investment. The stock markets facilitate and provide that assurance to investors. These are markets which facilitate buying and selling of securities assuring liquidity of investments which goes to serve the investor's need.

(ix) Corporate Governance: As stock exchanges facilitate ownership of companies to be helped by a wide and varied scope of owners, companies generally tend to improve management standards and efficiency to satisfy the demands of these shareholders. To safeguard the interest of investors more stringent rules are imposed by public stock exchanges and the government on public corporations when compared to privately owned enterprises. Every stock exchange defined its own rules and regulations for the control of operations of the exchange. Only members are allowed to deal in securities and make transactions. As the members have to transact their business strictly according to the rules, the investors' interests are safeguarded against dishonesty or malpractices. Traded public companies tend to have better management records than privately held companies.

(x) Pricing of Securities: The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The valuation of securities is useful for all investors, government and creditors. The investors can know the value of the
investment they have done, the creditors can value the creditworthiness and government can impose taxes on value of securities.

(xi) Safety of Transactions: In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

(xii) Contributes to Economic Growth: In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

(xiii) Spreading of Equity Cult: Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

(xiv) Providing Scope for Speculation: To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

(xv) Better Allocation of Capital: The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor’s fund to profitable channels.
(xvi) **Promotes the Habits of Savings and Investment:** The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

(xvii) **Facilitate Company Growth:** Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase its market share, or acquire other necessary business assets. A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways to company growing by acquisition of fusion.

(xviii) **Redistribution of Wealth:** By giving a wide spectrum of people a chance to buy shares and therefore become part owners (shareholders) of profitable enterprises, the stock market helps to reduce large income inequalities. Both casual and professional stock investors through stock price rise and dividends get a chance to share in the profits of promising business that were set up by other people.

(xix) **Creates Investment Opportunities for Small Investors:** As opposed to other business that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys only the number of shares he can afford. Therefore the Stock Exchange provides an extra source of income to small savers.
(xx) **Government Raises Capital for Development Projects:** Governments at various levels may decide to borrow money in order to finance infrastructure projects such as sewage and water treatment works, or housing estates by selling another category of securities known as bonds. These bonds can be raised through the Stock Exchange whereby members of the public buy them, thus loaning money to the government.

The issuance of such principal bonds can obviate the need to directly tax the citizens in order to finance development, although by securing such bonds with full faith and credit of the government instead of with collateral, the result is that the government must tax the citizens or otherwise raise additional funds to make any regular coupon payments and refunds the principal when the bonds mature.

**1.5.4 Management of Stock Exchanges in India**

(i). **Governing Body:**

The stock exchanges in India are managed by a governing board or executive committee or council of management. The governing board consists of 16 members of the exchange elected on general election basis by the members of the exchange, three persons appointed by the Central Government as its representatives, one representative of the Reserve Bank of India appointed by the Central Government, three persons nominated as public representatives and a chairman or executive director. The executive members elect from among themselves the president or chairman of the stock exchange. In day-to-day management, the governing board is assisted by a number of committees such as listing
committee, arbitration committee, defaulters committee, admission committee, etc. The
governing board is empowered to make rules and regulations in consultation with the
Government and the members of the stock exchange.

(ii). Membership:

The members only enter into trading of stock exchange and carry on business. A non-
member can buy or sell securities through a member. Every stock exchange has its own
rules and regulations for the admission of members. Member of a stock exchange are
allowed to appoint certain agents to do business on their behalf.

The non-members who can carry on business on the floor of a stock exchange on
behalf of the members are of three types:

(a) Remisiers: They are agents of full-fledged members of a stock exchange. They are
appointed to secure business for the members. They cannot carry business in their own
name. They are paid commission out of the brokerage collected by members on the
business procured by the remisiers. They are also known as half-commission men or sub-
brokers.

(b) Authorized Clerks: A member of the stock exchange can appoint authorized clerks or
assistants to assist him. The authorized clerks are merely employees of the members, and
cannot do business in their own name.
(c) **Brokers and Jobbers:** A broker is a commission agent who buys and sells securities on behalf of non-members. He executes the order of his clients and earns commission from them. A Jobber is an independent dealer in securities who buys and sells securities in his own name. He cannot enter into contract with non-members. He derives his income from the profit made through difference in prices.

1.5.5 **Trading Procedure in Stock Exchanges:**

The trading procedure involves the following steps:

(i) **Selection of a Broker:** The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator.

(ii) **Opening De-mat Account with Depository:** Demat (Dematerialized) account refers to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account. The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (e.g. Shares, Debentures, Bonds, Mutual (Funds, etc.)

At present in India there are two depositories: NSDL (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.) There is no direct contact between depository and investor.
Depository interacts with investors through depository participants only. Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

(iii) **Placing the Order:** After opening the De-mat Account, the investor can place the order. The order can be placed with the broker either (DP) personally or through phone, email, etc. The investor must place the order very clearly specifying the range of price at which securities can be bought or sold. e.g. “Buy 100 equity shares of Reliance for not more than Rs 500 per share.”

(iv) **Executing the Order:** As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

(v) **Settlement:** This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There can be two types of settlement.

   (a) On the spot settlement: It means settlement is done immediately and on spot settlement follows. T + 2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday.

   (b) Forward settlement: It means settlement will take place on some future date. It can be T + 5 or T + 7, etc. All trading in stock exchange takes place between the timing 9.55 am and 3.30 pm. from Monday to Friday every week.
1.5.6 Entities of the Clearing Process:

The transactions in secondary market are processed through three distinct phases, viz. trading, clearing and settlement. While the stock exchange provides the platform for trading to its trading members, the clearing corporation determines the funds and securities obligations of the trading members and ensures that trading members meet their obligations. The clearing banks and depositories provide the necessary interface between the custodians/clearing members (who clear for the trading members or their own transactions) for settlement of funds and securities obligations of trading members.

The clearing process involves determination of what counter-parties owe, and what counter-parties are due to receive on the settlement date. It is essentially the process of determination of obligations, after which the obligations are discharged by settlement. To illustrate, the clearing and settlement process for transactions in securities on NSE is presented. Several entities, like clearing corporation, clearing members, custodians, clearing banks, depositories, are involved in the process of clearing. The roles of each of these entities are explained below:

(i) Clearing Corporation:

The clearing corporation is responsible for post-trade activities of a stock exchange. Clearing and settlement of trades and risk management are the central functions for a clearing corporation.
(ii) Clearing Members:

Clearing members can be of two types:

(i) those who are trading as well as clearing members; these members trade as well as take the responsibility to settle their trades, and

(ii) those who act only as clearing members; these members do not trade but take on the responsibility to settle the trades of other trading members. They are responsible for settling their obligations as determined by the clearing corporation. They have to make available funds and/or securities in the clearing account or pool account, as the case may be, to meet their obligations on the settlement day.

(iii) Custodians:

The custodians are clearing members but not trading members. They settle trades on behalf of other trading members. A trading member may assign a particular trade to a custodian for settlement. The custodian is required to confirm whether he is going to settle that trade or not. If it confirms to settle that trade, then clearing corporation assigns that particular obligation to that custodian and the custodian is required to settle it on the settlement day.

(iv) Clearing Banks:

The clearing banks are a key link between the clearing members as well as clearing
corporation for funds settlement. Every clearing member is required to open a dedicated clearing account with one of the clearing banks. Based on the clearing member’s obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a pay-out.

(v) Depositories:

Depository helps in the settlement of the dematerialized securities. It holds dematerialized securities of the investors in the beneficiary accounts. Each clearing member is required to maintain a clearing pool account with all the depositories. Separate accounts are required to be opened for the settlement of trades on different stock exchanges. The clearing members are required to provide the securities as per their obligations in the clearing pool account on settlement day. At a pre-determined time, the depository sends the information about the availability of securities in the clearing pool accounts of the clearing member to the clearing corporation.

1.5.7 Types of Indian Stock Market

The Indian stock market has many stock exchanges, but prominently the two big ones are: National Stock Exchange also known as NSE, and the other one is Bombay Stock Exchange also known as BSE, located at the Dalal Street in Mumbai. There are many different types of indexes. First is the broad-base index and this index reflects how the whole stock market is doing and how investors currently feel about the economy. The index that is used the most is the broad-base index. It shows blue chip stocks and big stock
exchanges around the world, such as, NIFTY (index from NSE) and SENSEX (index from BSE). These are India Stock Exchanges.

1.5.8 Determinants of Stock Price Movements

In the present economic scenario, the role of financial system is pivotal to the economic planning and development of a country. The economic growth of any country largely depends on the growth of its financial sector. Stock market is a key player of financial sector and provides a platform to the users and suppliers of the financial resources for investment purpose. A stock market is where shares or securities are issued and traded through exchanges or over-the-counter markets. It is also known as the equity market and is one of the important areas of a market economy, as it provides access to capital to companies, ownership in the company for primary investors and the potential of gains based on the firm’s future performance for secondary investors.

Stock market performance is generally considered to be the reflector of financial and economic conditions of a country. Investment in equity shares is one of the major avenues of investment that yields considerable returns to investors. It is also a source of finance for the capital requirements of firms. Returns from such equity investments are subject to vary owing to the movement of share prices, which depend on various macroeconomic and industry related factors that potentially affect the stock returns of the companies. People invest in stock market to get return which is based on various factors. The precise number of these factors is not identified so far. There is a long history about the determinants of stock returns in the empirical capital market research literature.
The literature suggests that different variables are potentially important in explaining the variations in stock returns beyond a single market factor. Factors which could be internal or firm-specific such as earnings per share, dividends and book value or external factors such as interest rate, GDP, inflation, government regulations and Foreign Exchange Rate (FOREX). Share price is used as a benchmark to gauge performance of a firm and its variations as an indicator of the economic health or otherwise of a firm, hence the need to be conversant with the factors that could adversely affect share prices.

Having knowledge of such factors and their possible impact on share prices is very important on the part of both firms and investors. Since share prices convey information to the outside world about the current and future performance of firms, it is imperative for the managers of the firms to pay due attention to the factors that influence share prices as this could help them enhance firm value in the market. Consideration of such factors by investors is also warranted while investing their funds since this would aid them in making wise investment decisions and invest in stocks that yield good returns. Most investors are attracted to active counters at the stock exchange as this denotes the ever-changing perceptions and dealings on a firm’s securities which gives share price greater importance as a measure of stock performance.

The primary purpose of this study is to examine the impact of internal factors especially accounting variables that cause changes in stock market returns by applying multi-factor model. The model consists of accounting variables including Market Price of a Share (MPS), Book Value per Share (BV), Dividend per Share (DPS), Dividend Payout
Ratio (DP), Dividend Yield (DY), Earnings per Share (EPS), Price to Earnings ratio and Return on Net worth (RONW). The study attempts to determine which, if any, of the accounting variables are of use in explaining the variability of Market Price of a Share of Indian Industries. The firms relating to four different sectors are selected for this study on the basis of data availability, profitability and performance on the Bombay Stock Exchange. These sectors are Agri-Chemical, Cement, Hotel and Steel. The stock prices data for the selected firms are obtained for the maximum period of 10 years.

1.6 Growth and Working of Bombay Stock Exchange:

The first and largest securities market in India, the Bombay Stock Exchange (BSE) was established in 1875 as the Native Share and Stock Brokers' Association. Based in Mumbai, India, the BSE lists over 6,000 companies and is one of the largest exchanges in the world. The BSE has helped develop the country's capital markets, including the retail debt market, and helped the Indian corporate sector to grow.

Over the past 137 years, BSE has facilitated the growth of the Indian corporate sector by providing it an efficient capital-raising platform. Popularly known as BSE, the bourse was established as "The Native Share & Stock Brokers' Association" in 1875. BSE is a corporatized and demutualized entity, with a broad shareholder-base which includes two leading global exchanges, Deutsche Bourse and Singapore Exchange as strategic partners. BSE provides an efficient and transparent market for trading in equity, debt instruments, derivatives, mutual funds. It also has a platform for trading in equities of
small-and-medium enterprises (SME). More than 5000 companies are listed on BSE making it world's No. 1 exchange in terms of listed members.

The companies listed on BSE Ltd command a total market capitalization of USD 1.32 Trillion as of January 2013. It is also one of the world’s leading exchanges (3rd largest in December 2012) for Index options trading. BSE also provides a host of other services to capital market participants including risk management, clearing, settlement, market data services and education. It has a global reach with customers around the world and a nationwide presence.

BSE systems and processes are designed to safeguard market integrity, drive the growth of the Indian capital market and stimulate innovation and competition across all market segments. BSE is the first exchange in India and second in the world to obtain an ISO 9001:2000 certification. It is also the first Exchange in the country and second in the world to receive Information Security Management System Standard BS 7799-2-2002 certification for its On-Line trading System (BOLT). It operates one of the most respected capital market educational institutes in the country (the BSE Institute Ltd.). BSE also provides depository services through its Central Depository Services Ltd. (CDSL) arm.

BSE’s popular equity index - the S&P BSE SENSEX - is India's most widely tracked stock market benchmark index. It is traded internationally on the EUREX as well as leading exchanges of the BRICS nations (Brazil, Russia, China and South Africa). BSE has won several awards and recognitions that acknowledge the work done and progress made like The Golden Peacock Global CSR Award for its initiatives in Corporate Social
Responsibility, NASSCOM - CNBC-TV18’s IT User Awards, 2010 in Financial Services category, Skoch Virtual Corporation 2010 Award in the BSE STAR MF category and Responsibility Award (CSR) by the World Council of Corporate Governance. Its recent milestones include the launching of BRICSMART indices derivatives, BSE-SME Exchange platform, S&P BSE GREENEX to promote investments in Green India. BSE also has a wide range of services to empower investors and facilitate smooth transactions:

(i). **Investor Services**: The Department of Investor Services redresses grievances of investors. BSE was the first exchange in the country to provide an amount of Rs. 1 million towards the investor protection fund; it is an amount higher than that of any exchange in the country. BSE launched a nationwide investor awareness program- ‘Safe Investing in the Stock Market’ under which 264 programs were held in more than 200 cities.

(ii). **BSE On-line Trading (BOLT)**: BSE On-line Trading (BOLT) facilitates on-line screen based trading in securities. BOLT is currently operating in 25,000 Trader Workstations located across over 359 cities in India.

(iii). **BSEWEBX.com**: In February 2001, BSE introduced the world's first centralized exchange-based Internet trading system, BSEWEBX.com. This initiative enables investors anywhere in the world to trade on the BSE platform.

(iv). **Surveillance**: BSE’s On-Line Surveillance System (BOSS) monitors on a real-time basis the price movements, volume positions and members' positions and real-time measurement of default risk, market reconstruction and generation of cross market alerts.
(v). **BSE Training Institute:** BTI imparts capital market training and certification, in collaboration with reputed management institutes and universities. It offers over 40 courses on various aspects of the capital market and financial sector. More than 20,000 people have attended the BTI programs.

1.6.1 Achievements:

At par with international standards, BSE Ltd. has been a pioneer in several areas over the decades and has many firsts and key achievements to its credit. BSE is the first exchange in India to

a) Launch a special platform for trading in SME securities

b) Introduce Equity Derivatives
c) Launch a Free Float Index - S&P BSE SENSEX
d) Launch Exchange Enabled Internet Trading Platform
e) Obtain ISO certification for a stock exchange
f) Exclusive facility for financial training – BSE Institute Ltd.
g) Launch its website in Hindi and regional languages
h) Host the popular opening-bell ceremony in Indian capital markets
i) Launch mobile-based trading in India in Sept 2010
j) Become securities market infrastructure member of SWIFT in India and provide corporate actions to custodians in ISO 15022 format
Besides the above, BSE has taken large strides in product and service innovation for the benefit of its members and investors, notable ones being:

(i). Launch of a reporting platform for corporate bonds
(ii). Launch of the S&P BSE IPO index and S&P BSE PSU website
(iii). Revamp of its website with wide range of new investor-friendly features
(iv). Launch of trading in S&P BSE SENSEX futures on EUREX and leading exchanges of the BRICS nation bloc
(v). Launched Smart Order Routing for members and investors
(vi). Introduced SACT (SMS alert & Complaint Tracking system)
(vii). Launched co-location facility at BSE premises in November 2010
(viii). Reduction in membership fees to Rs. 10 lakh for new memberships to promote financial access and inclusion
(ix). Launch of web-based mutual fund trading platform for investors

Corporate Social Responsibility (CSR) in BSE is aligned with its tradition of creating wealth in the community with a three pronged focus on Education, Health and the Environment. Besides funding charitable causes for the elderly and the physically challenged, BSE has been supporting the rehabilitation and restoration efforts in earthquake-hit communities of Gujarat. BSE has been awarded the Golden Peacock Global - CSR Award for its initiatives in Corporate Social Responsibility (CSR) by the World Council of Corporate Governance.
1.6.2 Brand Identity:

Bombay Stock Exchange has now adopted only its initials as the new name (BSE), positioning itself better as a national multi-asset financial infrastructure institution. BSE’s strategic shift in approach, attitude and business focus is reflected in its new tag line - Experience the New. With renewed zeal and focus on new business opportunities, product and service innovation, upgrades in technology, increased investor and member focus, BSE is always pushing the envelope on all fronts. The ambition is to continually improve and adopt new and better ways of conducting their business.

As the first stock exchange in Asia and the pioneer of securities transaction business, BSE prides itself on being at the forefront of bringing innovations to the Indian capital markets while creating diverse investment opportunities for the investor community in India throughout its long history. BSE continues to undertake several initiatives to build on its strong brand, legacy and market position to create value.

1.7 Financial Ratios:

In the present study, the dependent and independent accounting variables are measured with the help of ratio analysis:

1.7.1 Market Price (MPS):

The market price of the share is mainly determined by the forces of demand and supply of a specific security in the market. The market price replicates the collective
wisdom and knowledge of the market. The price of a share at a particular moment represents the balance struck between the buyers and sellers. Daily price fluctuations arise because of changes in the buying and selling compression. Due to these fluctuations it becomes difficult to decide as to which market price should be regressed as a measure of dependent variable. In the present study, arithmetic means of high and low market price of share during the financial year of the firm has been taken. Mathematically it is calculated as:

\[
    p = \frac{P_H + P_L}{2}
\]

Where, \(P_H\) is the greatest market price, \(P_L\) is the lowest market price during the year which relates to the ‘t’ period.

1.7.2 Dividend Per Share (DPS):

Dividend is the percentage of the profit after taxes which are distributed to the shareholders for their investment and bearing risk in the company. The amount of dividend paid to the shareholders depends upon the dividend policy pursued by a company. The stable dividend policy helps in resolving uncertainty from the minds of the investors and also plays an important role in generating a healthy investment climate. The dividend rate of a company has a significant effect on the market price of a share. The dividends generally influence the share price in a positive direction as portrayed in earlier empirical works.

The dividend per share is attained as follows:
DPS = \frac{\text{Total amount of dividend paid to equity shareholders}}{\text{Number of equity shares outstanding}}

1.7.3 Earnings Per Share (EPS):

The equity shareholders are the sole claimant to the net earnings of the corporation after making payment of dividend to the preference share-holders. The earnings per share is one of the best measures of profitability. It also helps in projecting the value of security, which depends upon the probable future benefit and risk associated with it. Higher the magnitude of expected future benefits, higher will be value of a security and vice-versa. The increasing earnings per share generally indicates the growth of a company and resulting in high market price. The earning per share is arrived at as follows.

\[
\text{EPS} = \frac{\text{Net Profits after Tax} - \text{Preference Dividend}}{\text{Number of Equity Shares Outstanding}}
\]

The earnings per share has a positive relationship with market price, i.e., the higher the earning per share, the higher the market price.

1.7.4 Book Value (BV):

It is also known as net asset value per share because it measures the amount of assets, which the corporation has on behalf of each equity share. BV shows the investment per share made in the business by the shareholders. A high book value usually indicates that the company has a good record of past performances, i.e. high reserves therefore high
market price. Various studies have considered this ratio as a determinant of share price. It is calculated as follows:

\[
\text{Book Value per Share} = \frac{\text{Equity Share Capital + Shareholders Reserves}}{\text{Total Number of Equity Shares Outstanding}}
\]

1.7.5 Dividend Payout Ratio (DP):

Dividend payout shows the percentage share of the net profits after taxes and preference dividend paid out as dividend to equity shareholders. It can be calculated by dividing the total dividend paid to the equity shareholders by the total profits/earnings available for them. Alternatively, it can be found out by DPS by EPS. Linter (1956) linked dividend changes to earning while Shapiro valuation model (1962) showed dividend streams discounted by the difference in discount rate and growth in dividend should be equal to share price. This predicts direct relation between payout ratio and the Price-Earnings multiple. Conversely it means that there is an inverse relation between payout ratio and share price changes.

\[
\text{Dividend Payout} = \frac{\text{Total Dividend paid to Equity Shareholders}}{\text{Total Net Profit Belonging to Equity Shareholders}} \times 100
\]

Or

\[
\text{Dividend Payout} = \frac{\text{Dividend per Share}}{\text{Earning Per Share}} \times 100
\]
1.7.6 Return on Net worth (RONW):

The return on net worth ratio states the return that shareholders could receive on their investment in a company, if all of the profit earned were to be passed directly to them. Thus, the ratio is developed from the perspective of the shareholder, not the company, and is used to analyze investor returns. The formula is:

\[
\text{RONW} = \frac{\text{Net Profit after Tax}}{\text{Shareholder Capital + Retained Earnings}}
\]

1.7.7 Price Earnings Ratio (P/E):

The Price Earnings ratio expresses the relationship between the market price of a company’s share and its earnings per share. The ratio is a conventional measure of stock values because it gives an indication of share prices measured against the earning power of the stock. It is measured as follows:

\[
P/E = \frac{\text{Market Price of Share}}{\text{Earnings Per Share}}
\]

1.7.8 Size:

Size of the firm plays an important role in an investment criterion. Large companies generally offer better investment opportunities to investors than the smaller ones. The companies by virtue of their higher production generally occupy a stronger and dominant position in the stock market. The shares of large companies are actively traded in the stock exchange; they provide more liquidity and marketability to the investors. Thus
the temptation to buy shares of large companies leads to increase its market price of share.

The size of the firm can be measured in many ways, e.g. through turnover, paid-up-capital, capital employed, total assets, net sales, etc. The measure to be selected precisely depends upon the nature of the problem at hand. In the present study size is measured with the help of total sales.

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