CHAPTER-V
FINANCIAL MARKETS IN INDIA

Financial markets in India comprise the money market Government securities market, capital market, insurance market, and the foreign exchange market. Recently, the derivatives market has also emerged\(^1\). With banks having already been allowed to undertake insurance business, bane assurance market has also emerged in a big way.

Till the early 1990s most of the financial markets were characterized by controls over the pricing of financial assets, restrictions on flows or transactions, barrier to entry, low liquidity and high transaction costs. These characteristics came in the way of development of the markets and allocative efficiently of resources channeled through them. From 1991 onward, financial market reforms have emphasized the strengthening of the price discovery process easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity.

5.1 Classification of Financial Markets\(^2\)

Financial markets are classified in different ways, which are given below:


2. On the Basis of Maturity of the claims.

3. On the basis of Existing claim or New Claim.


A. On the Basis of Claim on financial Assets: The claims traded in a financial market may be for either a fixed amount or a residual amount. Based on claim on financial assets, financial markets are following two types: Equity market and Debt Market.

**Equity Market**\(^3\): Securities are conventionally divided into equities and debt securities. Financial markets in which equity instruments are traded are

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\(^1\) Dr Benson and Dr. s. Mohan, “Financial Market and Financial services in India”, July 2012, p.1

\(^2\) Ibid.

\(^3\) Ibid.
known as equity market. This market is also referred as the stock market. Two types of securities are traded in an equity market namely equity shares and preference shares. Preferred stock represents an equity claim that entitles the investor to receive a fixed amount of dividend. An important distinction between these two forms of equity securities lies in the degree to which they may participate in any distribution of earnings and capital and the priority given to each in the distribution of earnings.

**Debt Market:** Financial markets in which debt instruments are traded are referred as debt market. Debt instruments represent contracts whereby one party lends money to another on pre-determined terms and based on rate of interest to be paid by the borrower to the lender, the periodicity of such interest payment and the repayment of the principal amount borrowed. Debt securities are normally issued for a fixed term and are redeemable by the issuer at the end of that term. Debt securities include debentures, bonds, deposits, notes or commercial papers. Debt market is also called fixed income market. Generally, debt securities and preferred stock are classified as part of the fixed income market. That sector of the stock market which does not include preferred stock is called the common stock market.

**B. On the Basis of Maturity of the Claims:** Another way of classifying financial markets is on the basis of maturity/period of the claims. Based on this, financial markets are following two types: Money market and Capital market.

(a) **Money Market:** A financial market for short-term financial assets is called the money market. It is a market for dealing in monetary assets of short-term nature. The traditional cut off period for short term and long term claim is one year. Financial asset with a maturity of one year or less than one year is considered short term and therefore part of the money market. It is the central wholesale market for short-term debt securities, or for the temporary investment of large amount of short-term funds. Money market is a collective name given to various firms and institutions that deal with various grades of

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3 Ibid.
4 Ibid.
near-money. It includes trade bills, promissory notes and government securities. Money market instruments have the characteristics of quick liquidity and minimum transaction cost.

The instruments in money markets are relatively risk-free and the relationship between the lender and borrower is largely impersonal. Borrowers in the money market are the central government, state governments, local bodies, traders industrialists, farmers, exporters, importers and the public. The money market comprises several sub-markets, which are following:

(i) Call Money Market: Call money means the amount borrowed and lent by commercial banks for a very short period i.e. for one day to a maximum of two weeks. It is also called as inter bank call money market, because the participants in the call money market are mostly commercial banks. Call money market is the core of the Indian money market, which supply short-term funds. Call money market plays an important role in removing the routine fluctuations in the reserve position of the individual banks and improving the functioning of the banking system in the country.

(ii) Treasury Bill Market: For meeting its short-term financial commitments government issues these bills. The treasury bills market is a market, which deals in treasury bills issued by the Central Government for a short period of not more than 365 days. It is a permanent source of funds for the government. Regular treasury bills are sold to the banks and public, which are freely transferable.

(iii) Commercial Bill Market: Commercial bills are important device for providing short-term finance to the trade and industry. Commercial bill market deals in commercial bills issued by the firms engaged in business. These bills are generally issued for a period of three months. After acceptance, the bill becomes a legal document. Such bills can be transferred from one person to another by endorsement. The holder of the bill can discount the bills in a commercial bank for cash.

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5 Ibid.
(iv) Certificate of Deposit Market: Certificate of deposit market deals with the certificate of deposits issued by commercial banks. A certificate of deposit is a document of title to a time deposit. The minimum amount of investment should not be less than Rs. one lakh and in the multiples of 1 lakh thereafter. The maturity period of CDs issued by banks should not be less than seven days and not more than one year. They are freely transferable by endorsement and delivery. Certificate of deposits provide greater flexibility to an investor in the deployment of their short-term funds.

(v) Commercial Paper Market: Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short-term basis. Commercial papers will be issued in denominations of 5 lakh or multiples thereof. They are transferable by endorsement and delivery. Maturity period of commercial paper lies between 7 days and 365 days.

(vi) Collateral Loan Market: This market deals with loans, which are backed by collateral securities. Commercial banks provide short-term loan against government securities, share and debentures of the government etc.

Capital Market: Capital market is a market that specializes in trading long-term and relatively high-risk securities. A financial asset with a maturity of more than one year is part of the capital market. It is a market for long-term capital. The capital market provides long-term debt and equity finance for the government and the corporate sector. Capital market comprises two segments namely the new issue market and secondary market. The various constituents of capital market are viz. equity market, dept market, government securities market, mutual funds etc.

D. On the Basis of Domicile\(^6\): Another way of classifying financial markets is on the basis of domicile. Based on domicile way of classifying financial markets is on the basis of domicile. Based on domicile financial markets can be divided into two viz. International Market and Domestic Market.

\(^6\) Ibid.
(a) International Market\(^7\): International market is the markets where the issuances of securities are offered simultaneously to investors of a number of globalization, deregulation and liberalization of financial markets the companies and the investors in any country seeking to raise funds are not limited to the financial assets issued in their domestic market.

(b) Domestic Market\(^8\): Domestic market is that part of a nation’s internal market representing the mechanisms for issuing and trading securities of entities domiciled within that nation. It is a market where issuers who are domiciled in the country issue securities and where those securities are subsequently traded. It is otherwise called national or internal market. Domestic financial markets can be divided into different sub types like.

(i) Gilt-edged Market: It is a market for government and semi government securities, which carries fixed interest rates. Major players in the gilt-edged securities market in India are the Reserve Bank of India, State Bank of India, private and public sector commercial banks, co-operative banks and financial institutions.

(ii) Housing Finance Market: Housing finance market is characterized as a mortgage market, which facilitates the extent of credit, to the housing sector. National housing bank is an apex bank in the field of housing finance in India. It is a wholly owned subsidiary of the RBI. The primary responsibility of the bank is to promote and develop specialized housing finance institutions to mobilize resources and extent credit for house building.

(iii) Foreign Exchange Market: Foreign exchange market or Forex-market facilities the trading of foreign exchange. RBI is the regulatory authority for foreign exchange business in India. The foreign exchange market in India prior to the 1990s was characterized by strict regulations, restrictions on external transactions, barriers to entry, low liquidity and high transaction costs. Foreign exchange transactions were strictly regulated and controlled by the Foreign Exchange Regulations Act (FERA), 1973. With the rupee

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\(^8\) Ibid.
becoming fully convertible on all current account transactions in August 1994, the risk-bearing capacity of banks increased and foreign exchange trading volumes started rising.

This was supplemented by wide-ranging reforms undertaken by the Reserve Bank of India (RBI) in conjunction with the reforms by the Government to remove market distortions and strengthen the foreign exchange market. The reform phase ensured with the Sodhani Committee (1994) which, in its report submitted in 1995, made several recommendations to relax the regulations with a view to vitalizing the foreign exchange market. Foreign Exchange Regulation Act (FERA) was replaced by the Foreign Exchange Management Act (FEMA), 1999, in which the Reserve Bank of India delegated its powers to authorized dealers to release foreign exchange for a variety of purposes. Capital account transactions were also liberalized in a systematic manner.

(iv) Futures Market: Futures markets provide a way for business to manage price risks. A futures contract is an agreement that requires a party to the agreement to either buy or sell something at a designated future date at a predetermined price. The basic economic function of futures market is to provide an opportunity for market participants to hedge against the risk of adverse price movements. Buyers can obtain protection against rising prices and sellers can obtain protection against declining prices through futures contracts. Futures contract can be either commodity futures or financial futures. Commodity futures contract based on financial instruments or a financial index are known as financial futures. Financial futures can be classified as follows:

1. Stock index futures,
2. Interest rate futures,
3. Currency futures, and

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9 www.vakilno.1.com visited on 26th April 2013 at 2 o clock
10 www.businessindia.com visited on 25th March 2014 at 2 o clock
11 Benson Kunjukunju and S. Mohan, ’’ Financial Market and Financial services in India” July 2010 p-6
4. Commodity futures etc.

5.2 Factors Affecting Financial Markets

1. Actions of Investors: Actions of individuals, institutions and mutual funds investors will instantly affect the prices of stocks, bonds, and futures in the securities market.

2. Business Conditions: Business conditions also affect the financial Market. Profits earned, volume of sales and even the time of year all will determine how much an investor wants to invest in stock.

3. Government Actions: The government makes all kinds of decisions that affect both how much an individual stock may be worth (new regulations on a business) and what sort of instruments people want to buy. The government’s interest rates, tax rates, trade policy and budget deficits all have an impact on prices.

4. Economic Indicators: General trends that signal changes in the economy are watched closely by investors to predict what is going to happen next. Such indicators include the Gross National Product (GNP), the inflation rate, the budget deficit and the unemployment rate. These indicators point to changes in the way ordinary people spend their money and how the economy is likely to perform.

5. International Events: Events around the world, such as changed in currency values, trade barriers, wars, natural disasters, and changes in governments will affect the price of securities, which ultimately influence the amount of investment.

The capital market is represented by investment bankers, over the counter market, SEBI etc.

5.3 Primary Market

Capital market consists of primary and secondary market. Primary market is that part of the capital market that deals with the issuance of new securities. Primary market is otherwise called as New Issue Market (NIM). In

\[12\] Ibid.
the primary market the securities are purchased directly from the issuer. This is the market for new long-term or permanent capital. In other words, the money raised from the primary market provides long-term capital to the companies.

Primary market is a market which accelerates the process of capital formation in a country’s economy. Primary market provides opportunity to corporate and the government to raise resources to meet their investment requirements and to discharge their obligations. The companies use these funds either for setting up of new businesses or to expand the existing ones. At the same time, the funds collected through the primary capital market, are also used for modernization of business. The securities are issued in the primary market either at face value, or at a discount or premium. Companies will issue the securities either in domestic market or in the international market through American Depository Receipt (ADR) or Global Depository Receipt (GDR) or External Commercial Borrowings (ECB) route.

5.3.1 Characteristics of Primary Market

Primary capital markets are those security market where the equity and debt securities of corporations are offered to the investors for the first time. Important features of primary market are the following.

1. Primary market is the market for new long term capital.
2. In a primary market, the securities are issued for the first time by the company to investors.
3. In primary market securities are issued by the company directly to the investors.
4. In primary market the company receives the money and issues new security certificates to the investors.
5. In primary market it is difficult to accurately gauge the investor demand for a new security until several days of trading have occurred.
6. Primary market does not include certain other sources of new long-term external finance, such as loans from commercial banks and other financial institutions.
7. Primary issues are used by companies for setting up new business for expanding or modernizing the existing business or for providing permanent working capital.

5.4 Kinds of Issues

There are different ways for offering new issues in the primary capital market. Primary issues made by Indian companies can be classified as follows:

1. Public Issue.
2. Rights Issue.
4. Private Placement.

Public and rights issues involve a detailed procedure whereas private placements or preferential issues and bonus issues are relatively simple.

5.4.1 Public Issue\(^{13}\)

This is one of the important and commonly used methods for issuing new issues in the primary capital market. When an existing company offers its shares in the primary market, it is called public issue. It involves direct sale of securities to the public for a fixed price. In this kind of issue, securities are offered to the new investors for becoming part of shareholders family of the issuer. If everybody can subscribe to the securities issued by a company, such an issue is termed as a public issue. In terms of the Companies Act of 1956, an issue becomes public if it is allotted to more than 50 persons. SEBI defined public issue as “an invitation by a company to public to subscribe to the securities offered through a prospectus”. Public issue can be further classified into two:

1. Initial Public Offer (IPO).
2. Further Public Offer (FPO).

5.4.1.1 Initial Public Offer (IPO)

An IPO is referred simply an offering or flotation of issue of shares to the public for the first time. Initial Public Offer is the selling of securities to

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the public in the primary market. When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an Initial Public Offer (IPO).

The sale of securities can either be through book building or through normal public issue. IPOs are made by companies going through a transitory growth period or by privately owned companies looking to become publicly traded. IPO paves the way for listing and trading of the issuer’s securities in the stock exchanges. Initial public offering can be risky investment. For the individual investor, it is tough to predict the value of the shares on its initial day of trading and in the near future since there is often little historical data with which to analyze the company.

5.4.1.2 Further Public Offer (FPO)

When an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public it if called FPO Further Public Offer (FPO) is otherwise called as Follow on Offer.

5.4.1.3 Rights Issue

When a listed company which proposes to issue fresh securities to its existing shareholders existing as on a particular dated fixed by the issuer (i.e. record date), it is called as rights issue. The rights are offered in a particular ratio to the number of securities held as on the record date. The route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.

5.4.1.4 Bonus Issue

When an issuer makes an issue of shares to its existing shareholders as on a record date, without any consideration from them, it is called a bonus issue. The shares are issued to the existing shareholders out of company’s free reserves or share premium account in a particular ratio to the number of securities held on a record date.

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14 Ibid.
5.4.1.5 Private Placement

When a company offers its shares to a select group of persons not exceeding 49, and which is neither a rights issue nor a public issue, it is called a private placement. Often a combination of public issue and private placement can be used by the companies for the issue of securities in the primary market. Privately placed securities are often not publicly tradable and may only be bought and sold by sophisticated qualified investors. As a result, the secondary market is not liquid as in the case of a private issue. There are SEBI guidelines, which regulate the private placement of securities by a company.

Private placement is the fastest way for a company to raise equity capital. Private placement can of two types viz. preferential allotment and qualified institutional placement.

5.4.1.6 Issue of shares in the Primary Market

In India, the primary market is governed mainly by the provisions of The Companies Act, 2013, which deals with issues, listing and allotment of various types of securities. The Securities and Exchange Board of India (SEBI) protect the interests of investors in securities, promote the development of securities markets as well as regulate them.

SEBI issued the guidelines on primary issue of securities under Section 11 of the Securities and Exchange Board of India Act of 1992. In addition to the specific functions under the SEBI Act, the functions vested in the government as per Securities Contracts Regulations Act (SCRA) of 1956 have also been delegated to the SEBI. The SEBI now enjoy full powers to regulate the new issue market.


The SEBI guidelines shall be applicable to all public issues by listed and unlisted companies, all offers for sale and rights issues by listed
companies whose equity share capital is listed, except in case of rights issues where the aggregate value of securities offered does not exceed Rs 50 lakh. Since 1992, in order to streamline the public issue process by the Indian companies, SEBI has been issuing clarifications and amendments to these guidelines as and when required.

5.5 Prospectus

A prospectus is an invitation to the public to subscribe to the shares and debentures offered by a company. A public company can issue shares and debentures through a prospectus. As per Section 2(70) of The Companies Act, 2013 a prospectus means 'any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate'.

Prospectus is a document that must accompany the application forms of all public issues of shares and debentures. Every prospectus has to comply with the requirements of The Companies Act, 2013 (Section 26 to 30). A prospectus is a legal document that institutions and businesses use to describe the securities they are offering for participants and buyers. If any prospectus is issued in contravention of Section 26 to 30 the company, and every person, who is knowingly a party to the issue thereof, shall be punishable with fine which may extend up to five thousand rupees.

Typically, a prospectus contains the terms and conditions of the issue, along with the specific feature of the security, the purpose for which the issue is made, the company's track record, the risk inherent in the project for which the capital is being raised and so on.

5.5.1 Red Herring Prospectus (Section 32 of The Companies Act, 2013)

It is a draft prospectus, which is used in book building issues. A prospectus which does not have details of either price or number of shares being offered or the amount of issue is called red herring prospectus. It contains all disclosures except the price and the number of shares offered. Red
herring prospectus is used for testing the market reaction to the proposed issue. Only on completion of the bidding process, the details of the final price are included in the offer document. The document filed thereafter with the Registrar of Company is called a prospectus.

5.5.2 Abridged Prospectus

According to Section 26 of The Companies Act, 2013, abridged prospectus means a memorandum containing the salient features of fee prospectus. The lead merchant banker shall ensure that a copy of the abridged prospectus containing the salient features of the prospectus accompanies every application form distributed by the issuer company or anyone else. The application form may be stapled to form part of the abridged prospectus. Alternatively, it may be a perforated part of the abridged prospectus. The abridged prospectus shall not contain matters, which are extraneous to the contents of the prospectus. Enough space shall be provided in the application form to enable the investors to file in various details like name, address etc. There are exceptions to Section 26 The Companies Act, 2013, which are given below:

1. Where the offer is made in connection with the bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures.

2. Where me snares or debentures are not differed to the public.

3. Where the offer is made only to the existing members or debenture holders of the company with or without a right to renounce.

4. Where the shares and debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognized stock exchange.

5.6 Book Building

Book building is a process of price discovery mechanism used by corporate issuing securities. It is a mechanism used to discover the price of their securities. Book building is a common practice in developed countries and has recently been making inroads into emerging market as well, including India. As
per the recommendations of Malegan Committee, SEBI introduced the option of book building in public issue in October 1995. The option of book building was initially available only to those companies when their proposed public issue exceeded Rs. 100 crore. With effect from November 1996, the minimum size of the issue has been removed and any company can make a public issue through the book building process. However, issue of securities to the public through a prospectus for 100 percent book building process shall be available to a company only if their issue of capital shall be Rs. 25 crore and above.

Book building is a price discovery mechanism based on the bids received at various prices from the investors, for which demand is assessed and then the prices of the securities are discovered. In the case of normal public issue, the price is known in advance to the investors and the demand is known at the close of the issue. In the case of public issue through book building, demand can be known at the end of everyday but price is known only at the close of issue. Book building works on the assumption that the underwriting syndicate estimates demand and takes the allocation on their books, before the sale to the investor who is a retail one.

Securities and Exchange Board of India defined Book building as "a process undertaken prior to filing of prospectus with the Registrar of Companies by which a demand for the securities proposed to be issued by a body corporate is elicited and built up and the price for which such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document", the objective of book building is to find the highest market clearing price.

The issuer company shall have an option of either reserving the securities for firm allotment or issuing the securities through book building process. The issue of securities through book building process shall be separately identified as "placement portion category" in the prospectus. The securities available to the public shall be separately identified as "net offer to the public".
5.7 Stock Invest Scheme

'Stock invest', a legal and non-negotiable instrument like a cheque, is used to ensure that investors' fund continue to earn interest till such time the allotment is made by companies and they should not make undue advantage at the cost of investors' savings. Their money is not blocked while anticipating the primary market issue. The Department of Company Affairs of Government of India and RBI have recognized the 'stock invest' as on one of the instruments by which the application money for subscription to shares, debentures etc. may be paid.

5.8 Issue of Sweat Equity

Sweat equity means equity shares issued by the company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions. The SEBI (Issue of Sweat Equity) Regulations, 2002 have been framed and the main provisions laid down for issue of sweat equity are the following:

1. The issue of sweat equity shares is authorized by a special resolution passed by the company in the general meeting. The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.

2. The sweat equity shares should be locked in for a period of three years.

3. The pricing of the sweat equity shares should be as per the formula prescribed for that of preferential allotment.

4. Not less than one year has elapsed at the date of the issue since the date on which the company was entitled to commence business.

5. The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.
5.9 Employees Stock Option Scheme

Employee Stock Option Scheme (ESOS) means a scheme under which company grants option to its employees to apply for shares of the company at a predetermined price. It is a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company. Employee's stock option scheme is governed by SEBI (Employees stock option scheme and employees stock purchase scheme) Guidelines of 1999.

5.10 Secondary Market

Capital market is a place that provides facilities for buying and selling of financial assets such as shares and debentures. Capital market comprises both primary and secondary market. The market for newly issued securities is called primary market. Secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. The secondary market refers to the market where the securities issued in the primary market are traded. In secondary market, the investor purchases an asset from another investor rather than from the issuing company. In secondary market previously issued securities and instruments are only bought and sold and hence secondary market is otherwise called as aftermarket. Once a newly issued share is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock.

The key distinction between a primary market and a secondary market is that in the primary market, the issuer of those securities receives money directly from the investors. Rather, the existing issue changes hands in the secondary market, and funds flow from the buyer of the asset to the seller\textsuperscript{15}. In the primary market, long term securities are offered to public for subscription for the purpose of raising capital or fund. Whereas in secondary market, the long term financial instruments which are used for raising capital are traded."

The primary as well as the secondary markets is dependent on each other and changes in one market affect changes in the other. Compared to

\textsuperscript{15} Ibid
primary market majority of the trading is done in the secondary market. More the number of companies make new issues in the primary market; the greater will be the volume of trade in secondary market.

In the secondary market securities are sold by and transferred from one investor or speculate to another. For a general investor, the secondary market provides an efficient platform for trading of his securities. Since secondary market provides it efficient platform for trading in securities, it ensures high liquidity to the general investors. For the management of the company, secondary market serves as a monitoring and controlling conduit by facilitating value enhancing control activities and aggregating information through price discovery that guides management decisions.

Secondary market is vital to an efficient and modern capital market. The stock exchange along with a host of other intermediaries provides the necessary platform for trading in secondary market and for clearing and settlement. Secondary market comprises equity markets and the debt markets. Secondary market could be either auction or dealer market. While stock exchange is part of an auction market, Over-the-Counter (OTC) is a part of the dealer market. Only listed securities can be traded in secondary market.

5.10.1 Securities Dealt in the Secondary Market

Following are the main financial instruments which are dealt in the secondary market:

1. Equity Shares.
2. Preferred Stock/Preference shares.
4. Debentures.
5. Commercial papers.
6. Coupons.
7. Dated securities.

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8. Treasury Bills.


5.11 Listing of Securities

Listing means formal admission of a security into a public trading system of a stock exchange. A security is said to be listed when they have been included in the official list of the stock exchange for the purpose of trading. The prime objective of admission to dealings on the stock exchange is to provide liquidity and marketability to securities and also to provide a mechanism for effective management of trading. The securities listed in stock exchanges may be of any public limited company, central or state government, quasi-government and other corporations or financial institutions. To make a security eligible to be listed in a stock exchange, the company shall be obligatory to fulfil all the listing requirements specified in the Companies Act of 1956. Besides the company is also compulsorily to discharge the listing norms issued by SEBI from time to time and such other conditions, requirements and norms that may in force from time to time and the bye-laws and regulations of the exchange to make the security eligible to be listed and for continuous listing on the exchange.

5.11.1 Acts and Regulations Governing Listing of Companies

A company intending to list its securities in stock exchange shall fulfil all the basic requirements of listing stated in The Companies Act, 2013 and the Securities Contracts (regulations) Act of 1956. The issuer company shall also comply with all the conditions of listing stated both by SEBI and the concerned stock exchange. The securities listed on the exchange at its discretion, as the stock exchange has the right to include, suspend or remove from the list the said securities at any time and for any reason, which it considers appropriate. The companies desire to list their securities shall comply with all the relevant provisions of listing stated in the following Acts, Rules, Regulations and Guidelines.

- Indian Companies Act, 2013.
- Securities Contracts (Regulations) Act, 1956.
- Securities Contacts (Regulations) Rule, 1957.
- Rules, bye-laws and regulations of the stock exchange made by time to time.

5.12 Listing Agreement\(^\text{17}\)

The company should execute a listing agreement, in the prescribed form with the stock exchange, prior to approval of the listing application of the company. Listing agreement is of great importance and is executed under the common seal of the company. Under this agreement, the company must give an undertaking to the exchange that they will provide facilities for prompt transfer, registration, sub-division and consolidation of securities and giving proper notice of closure of transfer books and record dates.

The listing agreement specifies the terms and conditions of listing and the disclosures that shall be made by a company on a continuous basis to the exchange for dissemination of information to the market. Any addition or amendment to the provisions of the listing agreement, as may be prescribed by SEBI and the stock exchange shall become applicable to the company as if such addition or amendment was part of the listing agreement. In other words, for listing of securities, companies are called upon to keep the stock exchange fully informed of all corporate developments having a bearing on the market price of shares like dividend, rights, bonus shares etc.

5.12.1 Trading Permission

As per SEBI Guidelines, an issuer company should complete the formalities for trading at all the stock exchanges where the securities are to be listed within 7 working days of finalization of the basis of allotment.” A company should scrupulously adhere to the time limit specified in SEBI (Disclosure and investor Protection) Guideline 2000 for allotment of all securities and dispatch of allotment letters/share certificates/credit in depository accounts and refund orders and for obtaining the listing permissions of all the exchanges whose names are stated in its prospectus or offer document, [n the event of

\(^\text{17}\) www.Sebi.com visited on 26\(^\text{th}\) Oct. 2013 at 3 P.M
listing permission being denied to a company by any stock exchange where it had applied for listing of its securities, the company cannot proceed with the allotment of shares. However, the company may file an appeal before SEBI under Section 22 of the Securities Contracts (Regulation) Act, 1956

**5.12.2 Central Listing Authority**

The Central Listing Authority (CLA) is set up to address the issue of multiple listing of the same security and to bring about uniformity in the due diligence exercise in scrutinizing all listing applications on any stock exchanges. SEBI or any authority constitutes the Central Listing Authority under the relevant law relation to listing or delisting and trading or suspension of trading in securities of companies on a stock exchange.

The Central Listing Authority is constituted by SEBI and consists of a President and not more than ten members, out of which at least four members are representatives of the stock exchanges.

SEBI appoints the President and the members of central listing authority. Persons having integrity, outstanding ability and drawn from judiciary, lawyers, academicians and financial experts are generally appointed as members.

The functions of Central Listing Authority as enumerated in SEBI (Central Listing Authority) Regulations of 2003 include the following:

1. Processing the application submitted by any body corporate, mutual fund or collective investment scheme for the letter of recommendation to get listed at the stock exchange.

Before making an application for listing to any stock exchange, a body corporate, mutual fund or collective investment scheme should obtain a letter of recommendation for listing from the Central Listing Authority on an application made on that behalf.

2. Making recommendations as to listing conditions.

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18  [www.vakilno.1.com](http://www.vakilno.1.com) visited on 27th Sept 2013 at 2 P.M
3. Any other functions that may be specified from time to time by the SEBI. Where the Central Listing Authority refuses to issue letter of recommendation in accordance with the procedure laid down in the Regulations, the aggrieved party may approach SEBI with in 10 days of receipt of such refusal and if satisfied, SEBI may direct Central Listing Authority to issue a letter of recommendation within 15 days of receipt of such representation.

If the exchange refuses listing to the body corporate, mutual fund or collective Investment scheme, it may prefer an appeal to the Securities Appellate Tribunal as provided in the Securities Contracts (Regulations) Act, 1956.

The provisions, guidelines, norms and procedures governing the listing or delisting and trading or suspension of trading in securities may be stipulated by the Central Listing Authority and should be incorporated in the bye-laws of the exchange and should be made applicable to the exchange.

Central Listing Authority should also set up a fund called the Central Listing Authority Fund for any processing fees charged and received by the authority

5.13 Delisting of Securities

Delisting indicates removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange. In the interest of orderly market in securities or in the interest of trade or in the public interest, the Governing Board or Managing Director or Relevant Authority has absolute discretion to impose restrictions on trading in any security admitted to dealings on the exchange. During the operation of such restrictions, no trading member shall, either on his own account or on account of his sub-brokers or clients, enter into any transaction in contravention of such restrictions. SEBI Guidelines (Delisting of Securities), 2003 deals with the delisting of companies securities.


20 Dr. C.S. Bansal, Corporate Governance Law Practice & Practice (Taxmann Allied Services P.Ltd. 2005)
A company may be allowed to get its securities de-listed from the exchange, provided the provisions, guidelines, norms and procedures governing the delisting and suspension of trading in securities that may be stipulated by the SEBI or Central Listing Authority are duly complied with. SEBI guidelines on delisting of securities from stock exchanges are applicable only in the following three situations.

1. Voluntary delisting of securities.
2. Compulsory delisting of securities.
3. Liquidation or Merger.

Voluntary Delisting of Securities: Any promoter or acquirer desirous of voluntarily delisting of securities of a company from all or some of the exchanges shall fulfil the following conditions under the provisions of the SEBI guidelines.

1. Prior approval of shareholders of the company by a special resolution passed at its general body meeting.
2. Make a public announcement in the manner as provided in the guidelines.
3. Make an application to the delisting exchange in the form specified by the exchange.
4. Comply with such other additional conditions as may be specified by the concerned stock exchanges from where securities are to be de-listed.

The SEBI guidelines (Delisting of Securities, 2003) provide the overall framework for voluntary delisting by a promoter or acquirer through a process referred to as "Reverse Book Building".

Under reverse book building process the promoter shall appoint trading members for placing bids on the online electronic system. Investors may approach trading members for placing offers on the on-line electronic system. The shareholders desirous of availing the exit opportunity shall deposit the shares offered with the trading members prior to placement of orders. Alternately, they may mark a pledge for the same to the trading member.
The offer price has a floor price, which is average of 26 weeks average of traded price quoted on the stock exchange where the shares of the company are most frequently traded preceding 26 weeks from the date the public announcement is made. There is no ceiling on the maximum price. For occasionally traded securities, the offer price is as per Regulation 20 (5) of SEBI (Substantial Acquisition and Takeover) Regulations.

The final offer price shall be determined as the price at which the maximum number of shares has been offered. The promoter or acquirer shall have the choice to accept the price. If the price is accepted, the acquirer shall be required to accept all offers up to and including the final price. If the quantity eligible for acquiring securities at the final price offered does not result in public-shareholding falling below the required level of public holding for continuous listing, the company shall remain listed. At the end of the book building period, the merchant banker to the book building exercise shall announce the final price and the acceptance (or not) of the price by the promoter/acquirer.

The stock exchanges shall provide the infrastructure facility for display of the price at the terminal of the trading members to enable the investors to access the price on the screen to bring transparency to the delisting process. The stock exchange shall also monitor the possibility of price manipulation and keep under special watch the securities for which announcement for delisting has been made.

5.13.1 Compulsory Delisting of Securities

Permanent removal of securities of a listed company from a stock exchange as a penalizing measure at the behest of the stock exchange for not making submissions or complying with various requirements set out in the listing agreement within the time frames prescribed. In connection with compulsory de-listing of securities the stock exchanges have to adopt the following criteria.

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The stock exchanges may delist companies which have been suspended for a minimum period of six months for non-compliance with the listing agreement.

The stock exchanges have to give adequate and wide public notice through newspapers and also give a show cause notice to the company. The exchange shall provide a period of 15 days within which representation may be made to the exchange by any person who may be aggrieved by the proposed delisting.

Where the securities of the company are delisted by an exchange, the promoter of the company should be liable to compensate the security holders of the company by paying them the fair value of the securities held by them and acquiring their securities, subject to their option to remain holders of the company.

**Liquidation or Merger:** If any issuer whose securities have been granted admission to dealings on the exchange, be placed in final provisional liquidation or is about to be merged into or amalgamated with another company, the Governing Board or Managing Director or Relevant Authority may withdraw the admission to dealings on the exchange granted to its securities. The Relevant Authority may accept such evidence as it deems sufficient as to such liquidation, merger or amalgamation. If the merger or amalgamation fails to take place or if any company placed in provisional liquidation be reinstated and an application be made by such company for readmission of its securities to dealings on the exchange, the competent authority shall have the power of considering and of approving, refusing or deferring such application.

**5.13.2 Re-admission to Dealings on the Exchange**

The Governing Board or Managing Director or Relevant Authority may readmit to dealings on the exchange the security of a company whose admission to dealings had been previously withdrawn, on the fulfilment of conditions, norms, guidelines or requirements as may be prescribed by the Governing Board or Managing Director or Relevant Authority and or SEBI.
from time to time. At the expiration of the period of suspension, the Governing Board or Managing Director or Relevant Authority may reinstate the dealings in such security subject to such conditions, as it deems fit.

5.13.3 Advantages to Companies

- Listing of securities on a stock exchange offers many opportunities to the companies. Following are the important advantages of listing:
  - Listing enables companies to enjoy the confidence of the investing public.
  - It helps the company to raise future finance easily for financing new projects, expansions, diversifications and for acquisitions.
  - Listing increases a company's ability to raise capital through various other routes like preferential issue, qualified institutional placement, ADRs, GDRs, FCCBs etc,
  - Listing improves the image or status of the company and thus it provides value addition.
  - Listing raises a company's public profile with customers, suppliers, investors, financial institutions and the media. A listed company is typically covered in analyst reports and may also be included in one or more of indices of the stock exchanges.
  - Listing facilitates nation-wide trading facility for a company's securities.
  - It facilitates companies to ascertain the market value of their shares.
  - Listing provides price continuity for securities.
  - Listed companies enjoy certain confessional rates of income tax.

5.13.4 Advantages to the Investors

- Listing provides ready marketability of securities.
- It ensures considerable liquidity to the investors.
- Listing ensures continuous liquidity to the investors.
• Listing provides fair, efficient and transparent securities market to the investors.

• Listing of securities on stock exchanges improves investor's awareness and confidence on securities.

• Listing leads to better and timely disclosures and thus protects the interest of the investors.

• It also provides a mechanism for effective management of trading

5.13.5 Disadvantages of Listing

• Once the securities are listed, the company is obligatory to discharge various regulatory measures, bye-laws, circulars and other guidelines as may be prescribed by the stock exchange and SEBI from time to time.

• Listing involves huge expenditure to the company.

• Companies have to fulfill a number of formalities for listing of securities.

• Listed companies are required to submit and disclose vital information to the stock exchanges from time to time.

5.13.6 Classification of Listed Securities

Listed securities are classified into two categories:

1. Cleared securities, and

2. Non-cleared securities.

Cleared Securities: Securities traded on carry over or forward trading basis are called cleared securities. In these types of securities forward trading facility is allowed through the clearing house of the stock exchange.

Non-cleared Securities: Those shares which are traded on cash basis are called non-cleared securities. In these types of securities carry forward facility is not provided. These securities are not included in cleared list of the stock exchange. Non-cleared securities are called non-specified or cash securities or Group B shares.
5.14 Stock Broker

A broker is an agent of the investor. A stockbroker is a member of a recognized stock exchange who transacts in securities. Stockbrokers are not allowed to buy, sell, or deal in securities, unless they hold a certificate granted by SEBI. The stockbrokers and sub brokers regulations were issued by the SEBI through a notification in October 1992 and it had the prior approval of the Central Government.

The Securities and Exchange Board of India (Stock brokers and sub brokers) Rules, 1992 defined a stockbroker simply as "a member of a recognized stock exchange" Therefore, a registered stockbroker is a member of at least one of the recognized Indian stock exchanges. The application of a stockbroker for grant of certificate is made through a stock exchange/s, of which he is a member. The stock exchange on receipt of application from a broker forwards it to the SEBI as early as possible i.e. not later than thirty days from the date of its receipt. SEBI considers it and on being satisfied that the stockbroker is eligible, it shall grant a certificate to the stockbroker and this will be intimated to the stock exchange.

5.15 Sub-Broker

The Securities and Exchange Board of India (Stock brokers and sub-brokers) Rules, 1992 defines a sub-broker as "any person, not being a member of a stock exchange, who acts on behalf of a stockbroker as an agent, or otherwise, to assist the investors in buying, selling, or dealing in securities through such a stockbroker". Based on this definition, the sub-broker is either a stockbroker's agent or an arranger for the investor. Thus, legally speaking, the stockbroker as a principal will be responsible directly to the investor for conduct of a sub-broker who acts as his or her agent. However, the market practice is entirely different from this legally defined relationship. No sub-broker is supposed to buy, sell, or deal in securities, without a certificate granted by the SEBI. However, majority of the sub-brokers in India are not registered with SEBI.
5.16 Types of Members in Stock Exchange

There are different types of members in a stock exchange, which are given below:

5.16.1 Brokers

Brokers are commission agents or floor agents, who act as intermediaries between buyers and sellers of securities. Brokers do not purchase or sell securities on their behalf. They bring together the buyers and sellers and help them in making a deal. Brokers charge a commission from both the parties for their service. Brokers are experts in estimating trends of price and can effectively advice their clients in getting a fruitful gain. Stockbrokers are not allowed to buy, sell, or deal in securities, unless they hold a certificate granted by SEBI.

5.16.2 Jobbers

Jobbers are also members of the stock exchange who do business only for themselves. Jobbers as members of the stock exchange, deal in shares and debentures as independent operators. A jobber is a market maker who gives two-way quotes for a security at any point of time, a lower quotation for buying and a higher quotation for selling of securities. The difference between the two prices is termed as jobber's profit. Jobbers cannot deal on behalf of public and are barred from taking commission. In India, there is no clear-cut distinction between jobbers and brokers. Here a member can act as both a broker and a jobber at the same time. Jobbers acted as market makers in the London Stock Exchange. In India jobbers are also called taravaniwalas.

5.16.3 Market Makers

Market maker is the one who gives two way quotes for a security at any point of time. Market maker provides liquidity to scrip. A market maker would offer to do transaction on either side as chosen by the counter party at the prices indicated by the market maker for the quantities offered. The market maker assumes the price risk, the liquidity risk and the time risk. Price risk

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means that the market maker may not be able to cover his position at the same or better price than the price at which he did the original transaction. Liquidity risk means that he may not be able to liquidate his purchase position and may have to take deliveries and vice versa. Time risk means that the market maker may have to hold the inventory for an unknown period of time and lose the interest on his investments.

5.16.4 Taravaniwala

They are a special category of members of the Bombay Stock Exchange. The taravaniwala may be a jobber who specializes in stocks located at the same trading post. When a jobber gives two way quotes and does the transaction, the difference he gets between these two ways spread is called Tarvani and the trader is called Tarvanivala. They make transactions on their own behalf and may act as brokers on behalf of the public.

5.16.5 Badliwalas

Badliwalas are financiers in the stock exchange. They usually give fully secured loans to the buyers and sellers for a short term period, say two or three weeks. For granting credit facilities they charge a fee known as 'cantago' or 'undabadala' or 'seedhabadala'.

5.17 Classification of Buyers and Sellers in a Stock Exchange

The buyers and sellers in a stock exchange can be classified into two broad categories:

1. Investors.
2. Speculators.

5.17.1 Investors

The investors buy the securities with a view to invest their savings in profitable income earning securities. An Investor is interested in safety of his investment. They generally retain the securities for a considerable length of time with the objective of earning profit. They are assured of a profit in cash.

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5.17.2 Speculators

A speculator may buy securities in expectation of an immediate rise in price of the securities. Speculation refers to the buying and selling of securities with a hope to sell them at a profit, in future. Those who engage in such activity are known as 'speculators'. Speculative transactions are made with the purpose of earning quick money. They do not retain their holdings for a long period. They buy the securities with the aim of selling them and not to retain them. They are interested only in price difference. They are not genuine investors.

If the expectation of speculator comes true, he sells the securities for a higher price and makes a profit. Similarly, a speculator may expect a price to fail and sell securities at the current high price to buy again when prices decline. He will make a profit if prices decline as expected. In reality, there is no pure Speculator or an investor. Each investor is a speculator to some extent. Similarly, every speculator is an investor, to some other extent. Hence, the difference between the two is a matter of degree only.

5.17.2.1 Types of Speculators

There are four types of speculators who are active on the stock exchanges in India. They are known as Bull, Bear, Stag, and Lame Duck. These names have been derived from the animal world to bring out the nature and working of speculators. Bull and bear are the two classic market types used to characterize the general direction of the market.

5.17.2.2 Bull

Bull is a speculator who expects a rise in prices of securities in the future. In anticipation of price rise, he makes purchases of shares and other securities with the intention to sell at higher prices in future. He makes money when the share prices are rising. The speculator is called bull because the behaviour of the speculator is very much similar to a bull. A bull tends to throw his sufferer; up in the air. The bull speculator stimulates the price to rise, lie is an optimistic speculator. A bull also called as Tejiwala.
A bull market indicates generally rising stock prices, high economic growth, and strong investor confidence in the economy. The bull market tends to be associated with rising investor confidence and expectations of further gains. A key to successful investing during a bull market is to take advantage of the rising prices. When the prices of shares rise, it is called a bullish trend.

5.17.2.3 Bear

A bear market is a market condition that occurs when the prices of shares decline or are about to decline. A bear is a speculator who expects a fall in the prices of shares in future and sells securities at present with a view to purchase them at lower prices in future. A bear does not have securities at present but sells them at higher prices in anticipation that he will supply them by purchasing at lower prices in future. A bear speculator tends to force down the price of securities. A bear is a pessimistic speculator. If an investor is bearish, they are referred to as bear because they believe a particular company, industry, sector, or market in general is going to go down. A bear is also known as a Mandiwala.

A bear market indicates falling stock prices, bad economic news, and low investor confidence in the economy. The economy goes into recession coupled with a rise in unemployment and inflation. However, if the period of declining prices is not long and is immediately followed by a period where stock prices are on the increase, the trend is no longer considered as a bear market but labelled, in financial terms, as a 'correction'. Trading in a bear market is extremely difficult and risky for shareholders.

5.17.2.4 Stag

A stag is a cautious speculator in the stock exchange. A stag is an investor who neither buys nor sells but applies for subscription to the new issues, expecting that he can sell them at a premium. Stag is an investor who buys the shares in the primary market from public issue in anticipation of a rise in prices on the listing of the shares on stock exchange. He selects those
companies whose shares are in more demand and are likely to carry a premium. He is also called as 'premium hunter'.

5.17.2.5 Lame Duck

When a bear speculator finds it difficult to fulfil his commitment, he is said to be struggling like a lame duck. A bear speculator contracts to sell securities at a later date. On the appointed time, he is not able to get the securities, as the holders are not willing to part with them. In such situations, he feels concerned. Moreover, the buyer is not willing to carry over the transactions.

5.18 Clearing and Settlement Systems

Until the early 1990s, the trading and settlement infrastructure of the Indian capital market was poor. Trading on all stock exchanges was through open outcry, settlement systems were paper-based, and market intermediaries were largely unregulated. By late 1990s the clearing and settlement mechanism in Indian secondary market has witnessed significant changes and several innovations. The notable changes include use of the state-of-art information technology, emergence of a clearing corporation to assume counterparty risk, shorter settlement cycle, dematerialization and electronic transfer of securities, fine-tuned risk management system etc. Trading +2 rolling settlement has now been introduced for all securities. The regulators have also prescribed elaborate margining and capital adequacy standards to secure market integrity and protect the interests of investors.

Stock exchange is an entity which facilitates a platform for trading in securities to its registered members called brokers. They transact business primarily on behalf of their clients or investors. Clearing and settlement activity constitutes the core part of the trading cycle. After the conformation of a security deal, the broker who is involved in the transaction issues a contract note to the investor which contains all the information about the transactions in detail, at the end of the trade day. In response to the contract note issued by broker, the investor has to settle his obligation by either paying money or deliver the shares.
The transactions in stock exchanges pass through three distinct phases, viz. Trading, Clearing.

Settlement Financial market in India consist of Money Market, Government securities market, capital market, insurance market and foreign exchange market. The derivatives market has also emerged. Now a days Banks are also allowed to undertake insurance business . Till the early 1990s most of the financial markets were characterized by control over the financial assets, restrictions on flows or transactions, barriers to entry, low liquidity and high transaction costs. These characteristics came in the way of development of markets and allocative efficiency resources channeled through them. From 1991 financial market reforms have emphasized the strengthening of the price discovery process, easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity.

5.19 Classes if Buyers

The securities of a corporation must be marketed so that fund raising may be facilitated. There are various classes of security buyer? who purchase different types of securities. They may be classified as follows:

5.19.1 Institutional or Professional Buyers

They are familiar with the character of the securities they buy. These include banks, investment trusts, insurance companies, special investment buyers and others. These are in some way related to sellers of securities and are obviously a little cautious about taking risks.

5.19.2 Bankers

Savings banks invest funds in Government and semi-Government securities., whereas commercial banks invest in debentures, notes or any other securities. They do not invest in speculative securities, for several restrictions have been placed upon their methods of investment. The practice governing the relations between corporations and bankers is the designation of a particular banking house as the latter's fiscal agent. Through which all the offerings of the company are made. The fiscal agent, in return for this preferential treatment, assumes a certain moral responsibility to finance the corporation,
both in good and bad times. Company officials favour this method rather than the method of competitive bidding because of the feeling of security for new finances and refunding which this relationship gives them. They know that they are ordinarily safe, and that the fiscal agent will take care of them to the limit of his ability. At times, they may sell bonds at better prices by "shopping around" among bankers; but the difference is small, and in bad weather, they have often to pay through the nose.

5.19.3 Investment Bankers

The primary distribution of securities is generally performed by the investment banker who is the middleman between the issuing corporation and the investors seeking a return on their investment. An adequate investment banking system is just as important to the health of the private enterprise economy as an essential cog in the whole machinery of national economy. Investment bankers may participate in the formation of capital for new and established corporations by different methods,

*Outright Purchase and Sale of Securities Offered by Issuing Corporation.* This outright purchase of securities is often known as *underwriting.* An investment banker's profit is the difference between the price he pays for the securities and the price for which he sells them, less the selling commission and other expenses. The purchase price is either negotiated with the issuing corporation or established by competitive bidding. An investment banker assures the issuing corporation a definite price upon signing the purchase contract or underwriting agreement, and bears the risk of distributing the securities to his clients for profit. By dealing through investment bankers, the corporation is relieved of the risk of discouraging buyers for the entire issue offered. Moreover, the highly specialized function of securities distribution is entrusted to a specialized agency like the investment banker.

5.19.4 Life Insurance Corporation

The Life Insurance Corporation is owned by policy-holders. They collect annual premiums on insurance contracts. The sum total of the reserves of life insurance contracts issued by the Life Insurance Corporation of India
constitutes the source of funds available to the industry. The size of the funds which are constantly available for investment makes the Life Insurance Corporation an important factor in the securities investment market. The investments are obviously regulated by certain laws.

5.19.5 General Insurance Companies

They do not have a large investment element in their contracts to accelerate the expansion of their activities- Nevertheless, their assets, which are substantial, are mainly in the form of investments.

5.19.6 Other Institutions

These include universities, hospitals, charitable trusts and philanthropic organisations which have large amounts of funds which they have to invest for long periods of time.

5.19.6.1 Investors

Individual investors include buyers of securities who invest their own funds. They depend on investment income and do not want to incur any risk. They desire to conserve their capital and appreciate it, if possible, and aspire to a regular income on it. Their interest lies in the marketability of securities, an assurance of a definite rate of income, and the safety of the principal. They assume the minimum risk. Such investors buy debentures and preferred stock. Securities are issued by the company having an established business with an efficient management, assured profits and a conservative distribution of profits to stockholders. If any of these characteristics are absent from a business, its securities are not entitled to investment ranking, because there is no guarantee to the investor that the income, on the basis of which he buys the stock or a bond, will be permanent.

5.19.6.2 Speculators

Speculators may be professional traders. They do not depend on investment income, but expect a substantial capital appreciation. They prefer to buy equity stock with a desire to benefit by trading on equity. A company whose securities they select need not have an established record. Investors desire to take advantage of growing market for the company's products. They
do not mind accepting some losses even if their judgment goes wrong. They believe in capital appreciation and accept oscillations in the prices of securities. They prefer newly organised companies with good prospects. If they successfully analyse the investment potential of their securities, they stand to gain handsomely. However, if their analysis proves to be totally wrong, they suffer disastrously and take heavy losses for their errors of judgment. The characteristics of a speculative security are the exact opposite of an investment. If a company is new, or if the efficiency of its management is doubtful, or if it has not yet achieved profitable operations, or if, as happens in rare instances, it has made profits and has, by the manipulation of its accounts, segregated its large earnings from stockholders, or, finally, if it has paid out a large percentage of profits so that it has to suspend dividends when earnings decline, its stock must be recorded as speculative. The characteristic of speculation is the fact that its value depends upon circumstances which cannot be known because only the future can reveal them. An investment, on the other hand, contains no "ifs" or "provides" or "beliefs." Its value is founded upon certainty. The value of a speculative security is built upon the shifting sands of probabilities and suppositions.

The stocks and bonds of established companies, where success is certain, are purchased by investors; but speculative securities are bought by speculators. The investor will not buy a security whose value is doubtful. He demands the quality of safety in a stock or bond, before anything else. He must be reasonably certain that his principal is safe, that he can, at any time in the future, disregarding the occasional fluctuations in the market, sell his stocks or bonds at or near the price he paid for them. If this assurance of safety of principal and certainty of income can be given to him, he is satisfied with a moderate return.

5.19.6.3 The Public

If the securities of a new corporation cannot be sold to a banker in resale to the investors, they must be sold to the public. This is composed of persons of moderate or small means who are willing to buy the shares of new companies at low prices, trusting in the representatives of those who have
stock to sell, that these stocks will pay large dividends and eventually increase in value. The buyer has usually no knowledge of finance. He does not understand the nature of an investment judgment. He has no skill in offsetting advantages against disadvantages. For him a security is either good or bad. There is no half-way point. Great care must, therefore, be exercised to give him only the most simple and favourable information concerning a stock. The public asks few questions except those on the standing of the officers and directors of a new company, for naturally does not want to be robbed of the amount of dividends which is promised to the stockholders,

5.19.6.4 Trader Buyers

Trader buyers dispose of securities on a retail scale. They correspond to floor traders on the stock exchange. Trader buyers purchase such securities as readily appeal to them. They include individuals whose tastes differ from one person to another. There is, therefore, a considerable fluidity in security purchase preferences so far as individual buyers are concerned. Few individuals act on simple reasoning. Others act on their own prejudices and are often reluctant to change their investment preference because of their unfamiliarity with the scrip.

5.19.6.5 General Investment Buyers

This is a group of general investment buyers, including typical individuals and business establishments. The individuals are typical because they have accumulated funds which they do not like to use as a basis for income. The list of securities for sale widens the market for all securities and such individuals are stock-minded and pay their attention more to market quotations than to any other considerations. Ordinarily, a sound, significant background must be created to inspire their confidence. General investment buyers also include business establishments which regard securities as corporate investment.
5.19.6.6 Promoters

Security may be sold by the promoter to his friends and relatives. If securities have a large sales potential, they may well be sold directly in the open market.

5.19.6.7 Employees

Corporations may encourage their employees to buy their stock on instalment basis under favourable conditions. The basic idea of selling stock to employees is, that of fostering properly interest in the well-being. Some managements have a real interest in the welfare of employees and wish them to share in the fortunes of the company. There are two ways of selling stock to employees. In the first case, employees are allowed to switch their holding, if they so desire, to realise a profit. In another case, the companies sell the employees a special issue whereby employees are prevented from switching their holdings and will have to offer them back to the company for re-purchase in case they wish to dispose of them. This method has been criticized on the ground that it violates an elementary principle of diversification of risks, for in a period of depression, the employee is likely to suffer both ways. There may be a depreciation in the value of his stock. At the same time, he may have to lose his job.

5.19.6.8 Customers

Customer ownership is a new device which is employed by public utilities and industrial companies. Customers are allied with their concern by making them stockholders. The idea of such involvement is to encourage the customers to buy the products of the company and to boost its sales. Customer owners have a property interest in the company, and are less likely to agitate for lower rates and severe restrictions on the quality of the product. The risk is that, if securities prove to be low grade ones, there is a possibility that they will lose both the consumers' goodwill was well as the investment market.
5.19.6.9 Existing Stockholders

The corporation may sell its securities to the existing stockholders. It does so particularly at the time of its expansion.

5.19.6.10 Business Corporation

Business corporations, which can spare large sums of money, invest funds in short-term securities. Some corporations have investments in securities of subsidiary or affiliated companies with a view to acquiring control. Often, they invest in the securities of their supplier or creditor companies, and investments are made by marketing the securities of related companies. The above groups of investors range from uninformed investors to expert investors. The latter know the merits of their investments, whereas the former may be ignorant about them. The public is often gullible and succumbs to the false promises and gimmicks of the issuing corporations. There is, therefore, a need for protective measures for innocent investors. If the issuing corporation is guilty of fraudulent misrepresentation or concealment of material facts from the investors, the investors have a right to sue it and recover the damage caused to them. However, it is difficult to prove the false representations of the corporations, and investors can ill-afford to bear the expenses of litigation.

5.19.6.11 Intermediaries

It is possible for a reputed corporation to distribute directly its issue of securities. Although this is economical, there are several considerations which force it to present its securities in the market through intermediaries.

(i) A corporation may not be acquainted with the investment market and is likely to be duped in the process of selling its securities.

(ii) When a corporation issues its securities directly, investors may possibly feel that it lacks the support of institutional agencies, and cannot, therefore, be 'rustled.'

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(iii) The securities sold through reputed agencies attract investors easily. Established agencies may be able to sell securities to a class of purchasers who do not have any hope of getting a quick return. On the contrary, if the corporation were to sell directly to investors, the latter may hope for quick returns; and, if these hopes are belied, they may sell back the securities.

5.20 Derivatives Markets

Derivatives are innovations that have redefined the financial services industry and they have attained a very significant place in the capital markets. The primary objectives of all investors are to maximize their returns and minimize their risks. The Derivatives are contracts which originated from the need to minimize risk. The word ‘derivative’ originated from mathematics and refers to a variable, which in turn has been derived from another variable. Derivatives are so called because they have no value of their own.

Financial markets are, by nature, extremely volatile and hence the risk factor is an important concern of financial agents. To reduce this risk, the concept of derivatives was introduced. The term “Derivative” indicates that it has no independent value, i.e. its value is entirely “derived” from the value of an underlying asset. Values of derivatives are determined by the fluctuations in the underlying assets. Derivatives are an alternative to investing directly in assets without buying and holding to the asset itself. They also allow investments in underlying and risks which cannot be purchased directly. A derivatives is basically a bet.

Derivatives are specialized contracts which signify an agreement or an option to buy or sell the underlying asset up to a certain time in the in the future at a prearranged price. The contract also has a fixed expiry period mostly in the range of 3 to 12 months from the date of commencement of the contract. The value of the contract depends on the expiry period and also in the price of the underlying asset.

A derivative is defined as “a contract between a buyer and a seller entered into today regarding a transaction to be fulfilled at a future point in

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time”. Derivative is defined in another way as “a contract embodied with a right and or an obligation to make an exchange of financial asset from one party to another party.” The term Derivative has been defined in the securities Contracts (Regulations) Act of 1956. As per the Act derivative includes:

1. A security derived from a debt instrument share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security.

2. A contract which derives its value form the prices, or index of prices, of underlying securities.

- Derivatives are financial products.
- Derivative is derived from another financial instrument/contract called the underlying.
- Derivative derives its value from the underlying assets.

5.20.1 Development of Derivatives Markets in India

Derivatives have had a long presence in India. The commodity derivative market has been functioning in India since the nineteenth century with organized trading in cotton through the establishment of Cotton Trade Association in 1857. Since then contracts on various other commodities have also been introduced. Indian securities markets have indeed been waiting for too long for derivatives trading to emerge. Derivative products initially emerged as hedging devices against fluctuations in commodity prices and commodity-linked derivatives remained the sole form of such products for almost three hundred years.

While derivatives markets flourished in the developed world, Indian markets remain deprived for financial derivatives up to the beginning of this millennium. While the rest of the world progressed by leaps and bounds on the derivatives front, Indian markets lagged behind. Financial derivatives came to the spotlight in the post 1970 period due to the growing instability of the financial markets.

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The first step towards introduction of derivatives trading in India was the promulgation for the Securities Laws (Amendment) Ordinance, 1995, which withdrew the prohibition on options in securities. The market for derivatives, however, did not take off, as there was no regulatory framework to govern trading of derivatives.

SEBI set up a 24 member committee under the Chairmanship of Dr. L.C. Gupta on November 18, 1996 to develop an appropriate regulation framework for derivations trading and to recommend a bye-law for Regulation and Control of Trading and Settlement of Derivatives Contracts in India. The committee submitted its report on March 17, 1998 prescribing necessary pre-conditions for introduction of derivatives trading in India. It recommended that derivatives should be declared as ‘securities’ so that regulatory framework applicable to trading of securities could also apply to trading of derivatives. The Board of SEBI in its meeting held on May 11, 1998 accepted the recommendations of the Gupta committee and introduced derivatives trading in India with Stock Index Futures.

SEBI also appointed another group in June 1998 under the Chairmanship of Prof. J.R. Varma, to recommend measures for risk containment, in derivatives market in India. The report, which was submitted in October 1998, worked out the-operational details of margining system, methodology for charging initial margins, broker net worth, deposit requirement and real-time monitoring requirements.

However the Securities Contracts (Regulation) Act, 1956 (SCRA) needed amendment to include "derivatives" in the’ definition of securities to enable SEBI to introduce trading in derivatives. Thus the Securities Contract Regulation Act was amended in December 1999 to include derivatives within the ambit of securities’ and the regulatory framework was developed for governing derivatives trading. The act also made it clear that derivatives shall be legal and valid only if such contracts are traded on a recognized stock exchange, thus —precluding-QTC derivatives; The ban imposed on trading in derivatives way back in 1969 under a notification issued by the Central Government has been revoked.
Thereafter, SEBI formulated the necessary regulations/bye-laws and intimated the same to stock exchanges in the year 2000, and derivative trading started in India at NSE in the same year and at BSE in the year 2001. Derivative products were introduced in a phased manner starting "With Index Futures Contracts in June 2000. SEBI permitted the derivative segments of two stock "exchanges, NSE and BSE, and their clearing house/corporation to commence trading-and-settlement in approved derivatives contracts. The derivatives trading on NSE commenced with S&P CNX Nifty Index futures on June 12, 2000. The index futures and options contract on NSE are based on S&P CNX Trading and settlement in derivative contracts is done in accordance with the rules, byelaws, and regulations of "the respective exchanges and their clearing house/corporation and are duly approved by SEBI and notified in the official gazette.

Index Options and Stock Options were introduced in June 2001 .and July 2001 followed by Stock Futures in November 2001. Sectoral indices were permitted for derivatives trading in December 2002. Interest Rate Futures on notional bond and T-bill were introduced in June 2003. Exchange traded interest rate futures on notional bond priced off on a basket of Government Securities was permitted for trading in January 2004. Mini derivative (F&O) contract on Index (SENSEX and Nifty) were permitted by SEBI in December 2007. Longer tenure Index Options contracts and Volatility Index commenced in January 2008. Further, Bond Index was introduced in April 2008.

In addition to the above, during August 2008, SEBI Permitted Exchange traded Currency Derivatives. Foreign Institutional Investors (FIIs) are permitted to trade in all exchange traded derivative products. National Commodity & Derivatives Exchange Limited (NCDEX) started its operations in December 2003, to provide a platform for commodities trading.

In recent years, markets for financial derivatives have grown tremendously in terms of instruments available, their complexity and their turnover. In the class of equity derivatives, futures and options on stock indices have gained more popularity than on stocks, especially among
institutional investors, who are major users of index-linked derivatives. Even small investors find these instruments useful due to the high correlation of popular indexes with various portfolios and ease of use. In terms of volume and turnover, NSE is the largest derivatives exchange in India. Currently, the derivatives contracts have a maximum of three-months expiration cycles. Three contracts are available for trading, with one month, 2 months and 3 months expiry.

5.20.2 Functions of Derivatives Markets\textsuperscript{27}

1. They help in transferring risks from risk averse people to risk oriented people.

2. Derivatives help in the discovery of future as well as current prices.

3. An important incidental benefit that flows from derivatives trading is that it acts as catalyst for new entrepreneurial activity. Derivatives attracted many bright, creative, well-educated people with an entrepreneurial attitude. They often energize others to create new businesses, new products and new employment opportunities, the benefit of which are immense.

4. The underlying market witness higher trading volumes because of participation by more players who would not otherwise participate for lack of an arrangement of transfer risk.

5. They increase savings and investment in the long run.

6. In the absence of an organized derivatives market, speculators trade in the activities of various participants become extremely difficult in this kind of mixed market.

5.20.3 Types of Derivatives Markets\textsuperscript{28}

There are two competing segments in the derivatives market, which are given below:

1. Exchange Trade Derivatives Market

\textsuperscript{27} Ibid.
\textsuperscript{28} Ibid.
2. Over the Counter Derivatives Market

5.20.3.1 Exchange Traded Derivatives Markets

Exchange traded derivatives (ETD) are those derivatives products that are via specialized derivatives exchanges or other exchanges. A derivatives exchange acts as an intermediary to all related transactions, and takes initial margin from both sides of the trade to act as a guarantee. Exchange traded derivatives are standardized contracts traded on the stock exchange. In the Exchange Traded Derivatives Market (on-exchange) or Future Market, exchange acts as the main party and by trading of derivatives, risk is actually traded between two parties. One party who purchases future contract is said to go "long" and the person who sells the future contract is said to go "short". The holder of the "long" position owns the future contract and earns profit from it if the price of the underlying security goes up in the future. On the contrary, holder of the "short" position is in a profitable position if the price of the underlying security goes down, as he has already sold the future contract. Therefore, when a new future contract is introduced, the total position in the contract is zero as no one is holding that for short or long periods.

5.20.3.2 Over the Counter Derivative Markets

Privately negotiated derivative contracts are called over-the-counter (OTC) derivatives. Over-the-counter (OTC) derivatives are contracts that are traded directly between two parties, without going through an exchange or other intermediary. OTC derivatives are created by an agreement between two individual counterparties. OTC derivatives cover a range from highly standardized to tailor-made contracts with individualized terms regarding underlying, contract size, maturity and other features. Products such as swaps, forward rate agreements, and exotic options are usually traded in this way. Both exchange-traded and OTC derivative contracts offer many benefits, the former have rigid structures compared to others. The OTC derivative market is the largest market for derivatives, and is unregulated.
Most derivatives products are initially developed as OTC derivatives. Once a product matures, exchanges "industrialize" it, creating a liquid market for a standardized and refined form of the new derivatives product. The OTC and exchange-traded derivatives then coexist side by side. The number of OTC-traded derivatives is unlimited in principle as they are customized and new contracts are created continuously.

Swaps, Options and Forward Contracts are traded in Over the Counter Derivatives Market or OTC market. The main participants of OTC market are the Investment Banks, Commercial Banks, Govt. Sponsored Enterprises and Hedge 'Funds. The investment banks markets the derivatives through traders to the clients like hedge funds and the rest.

**5.20.3.3 Features of OTC Derivatives Markets**

The OTC derivatives market has the following features compared to exchange-trade derivatives:

1. There are no formal rules for risk and burden sharing.
2. There are no formal limits on individual positions, leverage or margining.
3. There are no formal rules or mechanisms for ensuring market stability and integrity and for safeguarding the collective interests of market participants.
4. The management of counter-party credit risk is decentralized and located within individual institutions.
5. The OTC contracts are generally not regulated by a regulatory authority and the exchange’s self-regulatory organization.

**5.21 Government Securities**

It is a tradable instrument issued by central government and state government. It acknowledges the government’s debt obligation. Such

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29 Ibid
30 Ibid at p. 294.
securities are short term (less than one year) or long term (more than one Year)

According to Public Debt Act of 1994, government securities means a security created and issued by the government for raising a public loan or any other purpose as notified by the government.

Advantages of Government Securities

- Government Securities offer maximum safety. No default risk as the Government Securities carry sovereign guarantee for payment of interest and repayment of principal.
- Government Securities are available in a wide maturities from 91 days to as long as 30 years to suit the requirement of investors.
- Government securities provide ample liquidity to the investors. It can be easily sold in secondary market to meet cash requirement.
- The settlement system for trading in Government Securities, which is based on Delivery Versus Payment (DvP), is a very simple, safe and efficient system of settlement. The DvP mechanism ensures transfer of securities by the seller of securities simultaneously with transfer of funds from the buyer of the securities, mitigating the settlement risk.
- Lower volatility as compared to corporate bonds.

These are various type of securities dealt in financial market in India. The various law regulating the financial market is-

- The Companies Act 2013.
- Securities Contract Regulation Act
- Security Exchange Board of India Act, 1992
- Government Securities Act 2006
- Reserve Bank of India Act, 1935.

Every person is eligible to invest in Government securities. The biggest investors of both central and state Government Securities are commercial banks.

Financial market in India plays an important role for development of the country. Through Financial Market companies raise finance for its activities by issuance of prospectus. Only public company can raise finance from public. Till the early 1990s most of the financial markets were characterized by controls over the pricing of financial assets, restrictions on flows or transactions, barrier to entry, low liquidity and high transaction costs. These characteristics came in the way of development of the markets and allocative efficiently of resources channeled through them. From 1991 onward, financial market reforms have emphasized the strengthening of the price discovery process easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity, Free pricing of financial assets, greater transparency, regulatory and legal challenge, building of institutional infrastructure , improvement in trading, clearing and settlement practices.

The money market has witnessed the emergence of a number of new instruments such as commercial paper and certificate of deposit and derivative products including forward rate agreements and interest rate swaps. Repo operations, which were introduced in the early 1990s and later refined into a liquidity adjustment facility, allow the RBI to modulate liquidity and transmit interest rate signals to market on a daily basis.

The process of financial market development was buttressed by the evolution of an active Government securities market after the government borrowing programme was put through the auction process in 1992-93. The development of a market for Government paper enabled the RBI to modulate the monetization of the fiscal deficit.

The corporate debt market is not yet large to have a significant impact on systematic stability. The Indian financial system is predominated by Bank intermediation. Corporate in India have traditionally relied on borrowing from bank and financial institutions. Equity financing has also been used during periods of surging equity prices. The Corporate Bond markets, which was reasonably vibrant in mid eighties has shrunk with respect to its alternative sources of funding. The Lack of binding interest, low transparency and absence of pricing of spreads against the benchmark are some of the other
reasons. The opening up of capital account could see the growth of corporate bond markets as there are may be demand from foreign investors seeking exposure to high quality corporate debt.

The foreign exchange market deepened with the opening up of the economy and the institutions of a market based exchange rates regime in the early 1990s. Although there are occasional episodes of volatility in foreign exchange market, these are swiftly controlled by appropriate policy measures.

Financial instruments fall into two broad groups – (1) Direct instrument and (2) derivatives Instruments. Direct Instrument in Capital market includes the following:

1. Equity shares.
2. Preference shares
3. Debentures

The capital market consists of primary market and secondary market in which trading in shares and other debentures are done. In term of trading and settlement practices, risk management and infrastructure, capital market in India is now comparable to the developed markets. Although stock market have undergone a number of shocks and irregularities over the past decade, they have over time, developed sophisticated institutional mechanisms by harnessing modern technology. Even though the market design on the stock markets have made major progress, there are continuing concern about the speed and effectiveness with which fraudulent activities can be detected and focused.

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