Stock and Commodity Markets

As per New Syllabus for Sixth Semester, BBM, Bangalore University w.e.f. 2012-13

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Himalaya Publishing House
Mumbai • New Delhi • Nagpur • Bengaluru • Hyderabad • Chennai • Pune • Lucknow
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Primary Market and Secondary Stock Market

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First Edition : 2015

Published by : Mrs. Meena Pandey for Himalaya Publishing House Pvt. Ltd., “Ramdoob”, Dr. Bhalerao Marg, Giraon, Mumbai - 400 004. Phone: 022-23860170/23863963, Fax: 022-23877178
E-mail: himpub@vsnl.com; Website: www.himpub.com

Branch Offices :
New Delhi : “Pooja Apartments”, 4-B, Murari Lal Street, Ansari Road, Darya Ganj, New Delhi - 110 002. Phone: 011-23270392, 23278631; Fax: 011-23256286
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DTP by : Sunanda
PREFACE

This book is a comprehensive study in stocks and commodities environment in India. Many changes have taken place since the new economic reforms in 1991. India is now working towards globalization, deregulation and liberalization. This book provides information of the latest developments in the markets in India and in other countries.

The book comprising of five units, Unit I incorporates the structure of the financial markets, commodities market and the difference between stock market and commodities market. Unit II discusses the history, membership and functions and organizations of stock markets including important stock markets like NSE and BSE. It also provides the role of SEBI in the securities markets and a brief description of derivatives in the market.

Unit III is an attempt to explain the method of trading that takes place in stock markets.

Unit IV and V are completely devoted to the commodities market. While Unit VI discusses the functions, types of transactions and differences between physical and futures markets. Unit VII discusses the pattern of trading that takes place in commodities market.

The book within the structure of the first edition is written in simple language for students and teachers of management, economics, chartered accountants and masters in finance and commerce graduates.

The chapters of the book begin with a chapter plan. It has many types of questions both objective type and long questions and every chapter has a summary in the form of points to remember at the end of each chapter.

Thanks are due to Brajendra Kumar for his untiring work in supporting me for library and data search and typing the manuscript of this book. I would also like to thank my publishers Himalaya Publishing House Pvt. Ltd. for their support and continuing relationship with me.

Preeti Singh
SYLLABUS

OBJECTIVE

The objective is to provide students with a conceptual framework of stock markets and commodity markets, functionaries in these markets and their mode of trading.

Unit 1: An Overview of Capital and Commodities Markets 10 Hrs


Unit 2: Stock Market 12 Hrs

History, Membership, Organization, Governing Body, Functions of Stock Exchange, Online Trading, Role of SEBI, Recognized Stock Exchanges in India (Brief Discussion of NSE, BSE and Nifty). Derivatives on Stocks: Meaning, Types (in Brief).

Unit 3: Trading in Stock Market 14 Hrs


Unit 4: Commodities Market 14 Hrs


Unit 5: Trading in Commodity Markets 10 Hrs


Skill Development

- Prepare the list of recognized stock exchanges in India.
- Prepare the process chart of online trading of share and debentures.
- Prepare the chart showing Governing Body of the Commodities Market.
- Prepare the list of commodities traded on commodity market.
- Enlist the role of NSDL and CSDL.
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AN OVERVIEW OF CAPITAL AND COMMODITIES MARKETS

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1.1 BACKGROUND OF FINANCIAL SYSTEM

The primary and secondary stock market forms the Indian securities market which is part of the financial system of a country. It consists of a network of financial markets, institutions, investors, services and regulators. A well fortified structure is able to encourage public and institutional support leading to an organized network of supporting financial markets. A vibrant and diversified system plays an important role in mobilizing the savings of different classes of people, whose investment objectives differ widely in terms of their expected returns, depending upon their ability to take risk.

The financial system deals with the finances of the people of the country. Its main product is money and credit and through these two variables it is able to bring about activity and in turn economic development of a country.

A financial system comprises of the following agencies:


2. **Financial Institutions**: Such as development banks, life insurance companies, general insurance companies, mutual funds, leasing companies, chit funds, post offices. These are also called financial intermediaries.

3. **Banks**: The central bank of a country is the apex bank. In India, it is the Reserve Bank of India. It regulates the monetary policy of a country and the supporting commercial banks engaged in money and creation of credit.

4. **Financial Instruments**: These are long-term and short-term in nature. These are shares, debentures, treasury bills, mutual fund schemes, commercial papers, treasury bills, units, post office schemes. These are in the nature of assets and claims.

5. **Market Regulators**: These are necessary to bring in discipline in the market by making certain laws, rules
and regulations and procedures. In India, some regulatory authorities are the Securities Exchange Board of India (SEBI), Reserve Bank of India (RBI), Insurance Regulatory Authority of India.

6. Market Participants: The market participants are individuals, corporate organizations, government, intermediaries and regulators.

The Indian securities market consists of the new issue market where securities are issued first and the stock market which trades in the securities after they have been placed through the new issue market.

1.2 PRIMARY/NEW ISSUE MARKET

The Primary Market is also called New Issue Market. In this market, securities are sold for the first time. In India, many developments have taken place in this market. The New Issue Market in the past issued fixed price shares. Currently, most of the shares are being issued through the book building method based on demand and supply of the security. Bids are made by people interested in the purchase of shares and then according to the price that is fixed shares are allotted within 30 days of the closing of the issue. The New Issue Market mobilizes the savings of the investors.

1.3 SECONDARY/STOCK MARKET

The Stock Market provides the sale and purchase of securities only after their allotment and listing with SEBI and Stock Market in which trading is desired. In India, there are 23 stock markets. The most important are National Stock Exchange (NSE) and Mumbai Stock Exchange (BSE). Two other well-known stock markets are the Over the Counter Exchange of India (OTCEI) and Inter-Connected Stock Exchange (ICSE). The stock market has an index. The most important index is the SENSEX. This is made up of 30 stocks traded most actively in the market. It gives the information as to whether the market is moving in an upward trend or is falling downwards. In India there is screen based trading through the depository system. The distinction between Primary Market and Secondary Market is given in Table 1.
Table 1: Primary Market and Secondary Market

<table>
<thead>
<tr>
<th>Primary Market</th>
<th>Secondary Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Market helps in mobilization of savings of individuals. Bankers, stock</td>
<td>It is market for purchase and sale of securities and is represented by share brokers. After the issue of securities in the primary market, they are listed on the stock exchange.</td>
</tr>
<tr>
<td>brokers, and merchant bankers operate for the success of the issue.</td>
<td></td>
</tr>
<tr>
<td>This market is called the New Issue Market. All securities are first issued</td>
<td>When the security has been registered in the New Issue Market all subsequent trades take place in the secondary market popularly called the Stock Exchange after listing of shares.</td>
</tr>
<tr>
<td>through this market. It is the market for IPOs or Initial Public offering.</td>
<td></td>
</tr>
<tr>
<td>This market helps in raising funds for industry or corporate organizations.</td>
<td>The stock market helps in lending liquidity and marketability to such securities.</td>
</tr>
</tbody>
</table>

1.4 PARTICIPANTS IN THE SECURITIES MARKET

The role of the participants in the financial markets is to create a flow of funds from savers to investors. They are the main link between the savings efficient to savings deficient organizations. The link consists of financial institutions and intermediaries, individuals, firms and corporate organizations, government and market regulators.

The following are identified as participants in the market:

1. **Individual.** Individual purchasers and sellers of securities. The trend in many countries has shown the increased participation of households and the popularity of stocks in the life of a general household.

2. **Corporate organization.** Corporate organizations help in the flow of funds in the market. Organizations raise their funds for expansion of their business or because they require funds for business activity. Surplus organizations lend funds to the deficit organizations.
3. **Government.** Government plays multiple roles in the market. It borrows funds or lends funds through its gilt edged securities. From the point of view of security, it is excellent as it is ‘near gold’ as the name gilt-edged suggests. Interest is, however, low and so investors do not look for it as a good investment. Government also plays the role of a regulator and controller by making a monetary policy and by appointing a regulator for making rules and regulations for protection of the investors. Many countries call it a Securities Exchange Commission. In India, it is called the Securities Exchange Board of India.

4. **Regulators.** Regulators may be appointed by Government in some countries but is usually an independent board which frames rules and regulations especially because trading has now become a household word and people are able to make money on stocks or lose money because of the high risk. Also market scams and frauds take place, so regulators become important in capital markets.

5. **Intermediaries.** The market intermediaries help in the process of transfer of funds from savers to investors. These intermediaries are brokers, underwriters, clearing houses, depositaries, mutual funds, investment companies, lead managers, portfolio managers, credit rating agencies, Reserve Bank of India.

Market intermediaries/participants operate in the securities market of a country. The objective of these intermediaries is to link the savers and the investors. In an economy, the financial intermediaries transform surplus wealth into productive outlets. The saving deficits are linked with the saving surplus units by offering different kinds of financial assets by the intermediaries. The chief intermediaries are given below and their role is discussed in detail in Chapter 2:

- Merchant banker
- Underwriters
• Lead managers
• Share brokers
• Depositories
• Portfolio managers
• Investment bankers
• Credit rating agencies
• Mutual funds
• Investment companies
• Registrar and share transfer agents

1.5 OTHER FINANCIAL MARKETS

The financial markets are classified into the following categories:

(a) Organized and Unorganized Market
(b) Money Market and Capital Market
(c) Primary Market and Secondary Market
(d) Foreign Exchange Market

The distinctive features of these markets are discussed below:

(a) Organized and Unorganized Market: An organized market is a formal financial market that operates under rules, regulations and guidelines set by regulatory authorities such as Securities Exchange Board of India, Reserve Bank of India, Insurance Regulatory Authority, Mutual Fund Regulations, and Central Government Policies.

Unorganized market is an informal market that operates without any standardization and control of any regulatory authority. In India, it is operated by moneylenders and traders. There are high rates of interest and it operates mainly in rural areas. Such informal markets also exist in urban areas and they are outside the purview of government control. Table 2 shows the distinction between organized and unorganized market.

<table>
<thead>
<tr>
<th>Table 2: Organized and unorganized market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Organized Market</strong></td>
</tr>
</tbody>
</table>

---
Primary Market and Secondary Stock Market

<table>
<thead>
<tr>
<th>A market operating with rules and regulations.</th>
<th>Non-standardized procedures. Variable rates of interest and transactions.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control of a recognized controller (example: SEC).</td>
<td>No control on transactions as no rules operate.</td>
</tr>
<tr>
<td>It is a formal recognized market like New Issue Market and Stock Exchange</td>
<td>It is operated by money lenders and traders. It is also called an informal market.</td>
</tr>
<tr>
<td>Institutions play an important role in collection of savings of people in the intermediation process.</td>
<td>There is no large institution but there are some chit funds and lotteries in operation in an informal manner. Rates of interest are exorbitant.</td>
</tr>
</tbody>
</table>

(b) Money Market and Capital Market: Money market consists of financial assets which have a maturity of less than 1 year. The assets can be converted into cash quickly and the transaction cost is low. They are considered to be a substitute for cash and bring about liquidity. The market deals with short-term funds between savers and investors that have a short-term requirement of funds due to deficit or surplus of funds especially for working capital needs. Some examples are commercial papers, bills, CDs and inter-corporate lending and borrowing. The participants in this market are large corporate organizations, mutual funds, life insurance companies and companies. The volume of transactions is very high.

The Call Money Market deals in loans, which have very short maturity and are highly liquid. The loans are payable on demand, at the option of either the tender or the borrower and the maturity period varies from one day to fourteen days. While in UK and USA, there are separate call money markets, in India, they are associated with the presence of the stock exchange. The call loans are given:

(a) To the bill market;
(b) For inter-bank uses;
(c) For dealing in stock exchanges and bullion markets; and
(d) To individuals for trade purposes to save interest on cash credits and overdrafts.

Capital market is a market for financial assets that have long-term maturities such as shares, debentures and mutual fund investments. The
capital market has two separate demarcations. These are the primary market/new issue market where shares are sold for the first time and secondary market/stock market where trading takes place. These are organized markets with SEBI as the main regulator.

### Table 3: Money Market and Capital Market

<table>
<thead>
<tr>
<th>Money Market</th>
<th>Capital Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is a market for financial assets of less than one year maturity.</td>
<td>It is a market for long-term financial investments.</td>
</tr>
<tr>
<td>It is a market for those assets, which can be converted into cash immediately at a small transaction cost. Examples inter-corporate deposits, treasury bonds, commercial papers and bills and CDs</td>
<td>It is a market for shares, debentures and mutual fund investments. There are 23 stock exchanges in India. NSE and BSE are the most popular. SENSEX is the most popular indicator.</td>
</tr>
<tr>
<td>It is a market whose participants are large institutional investors who deal in short-term instruments. There is no separate category for call money market like primary market and secondary market. All short-term transactions are executed.</td>
<td>Capital market is categorized as Primary Market or New Issue Market for first time issue of securities and Stock Exchange or Secondary Market for sale of second hand securities. Individual investors and institutions both operate in the market.</td>
</tr>
<tr>
<td>The volume of transaction is very high.</td>
<td>Volume of transactions is high but less than money market.</td>
</tr>
</tbody>
</table>

(c) **Inland and Foreign Exchange Market:** The Foreign Exchange Market is for transacting business between different countries. The different kinds of activities are inter-bank dealings between Authorized Dealers (ADs) exchange brokers and Central Bank. Business with banks abroad is part of Foreign Exchange Market. ADs open branches in the overseas market to carry out business abroad. Apart from ADs, the Central Bank also licenses hotels and other individuals as AMCs or Authorized Money Changers. The money changers are categorized as: (i) full-fledged money changers, and (ii) restricted money changers. The restricted money changers can purchase only foreign currency notes, coins and travellers’ cheques whereas the former category has a right to both purchase and sale to the public.

Foreign institutional investment has an important role to play in a country. These are pension funds, investment trusts, asset management companies and portfolio managers. They usually invest in developing
countries because they are able to get higher rates of interest than in their own developed infrastructure. Companies also raise funds through the floatation of their bonds and equities in the euro capital markets. The two instruments which are popularly floated by them are Global Depository Receipts and Foreign Currency Convertible Bonds.

Foreign capital has also come into India through trust companies which raise funds for investments in Indian securities. The first offshore fund was floated by the UTI in collaboration with Merrill Lynch International better known as India Fund; Morgan Stanley floated Indian Magnum Fund and India Investment Fund. Can Bank floated the Himalayan fund in collaboration with Indo-Suez Investment Management Asia. SBI Mutual Fund floated Asian convertibles. Jardinal Flemming floated the India Pacific Fund. Many more funds were also floated. These are Bombay Fund, India Opportunities Fund, India Liberalization Fund, and Lloyd George India Fund.

1.6 FINANCIAL INSTRUMENTS

Financial Investments consist of ownership securities debt securities and Mutual Fund units. They are:

Ownership securities consist of:
1. Equity shares
2. Preference shares

Debt securities are listed in the following way:
1. Non-convertible debentures
2. Convertible debentures
3. Deep discount bonds

Mutual Fund Securities are called units. They have:
1. Income schemes
2. Growth schemes
3. Equity schemes
4. Money market schemes

Financial instruments help in the process of intermediation. A choice of financial instruments to cater to the needs of the different
types of investors will provide dynamism in trade of the securities in the financial markets. An array of securities creates development in the financial system. As discussed in Chapter 1, an economy devoid of financial instruments is financially backward.

The following instruments are traded in the Indian capital market. Financial instrument consists of ownership securities, debt securities, mutual funds units and financial engineering securities.

Equity Shares

The shares are ownership securities. Investors find equity shares the best type of investment as the shares can be traded. The investor participates in the earnings of the company and receives dividends. The equity share value increases and during inflation it acts as a hedge, increasing the importance of such shares. The equity shares also have capital appreciation. They are, however, very risky shares as the prices can also fall and there can be losses.

Preference Shares

Preference shares are fixed dividend bearing instruments. They are called hybrid instruments because they have the features of both the equity shares and bonds. They have certain important features like cumulative dividends and are redeemable after some years.

Debentures/Bonds

There are many kinds of debentures/bonds in the Indian capital market. These are redeemable, perpetual, convertible, registered and bearer issues. They have a fixed interest called ‘coupon’ rate. These are debt securities and the holders do not have any right to attend the annual general meeting of the company. They are also not allowed to vote in any issues.

1.7 FINANCIAL ENGINEERING INSTRUMENTS

These are new type of securities which combine different features in one security. They are called innovative instruments. It is called a hybrid security as it creates different types of cash flows from one security. In India, for example, financial institutions like ICICI, IFCI, and IDBI had issued Deep Discount Bonds with different maturity
Primary Market and Secondary Stock Market

periods. These are redeemable at full value and issued at a discount in the face value. Interest is not paid. The total redeemable value is paid at the end of the period. Corporate organizations have also created securities through financial engineering. Reliance Petroleum gave investors different options for interest, redemption, right shares in their optionally convertible debentures. Unit Trust of India through its mutual fund operations issued an open-ended equity linked funds with a set of six equity linked funds to provide maximum returns and flexibility in switching between these funds.

Many companies have tried to innovate to give a choice to the investors. The financial institutions and development banks in India have also issued such securities. The following are some financial engineering securities issued in India.

Participating Debentures have been issued by companies. The investors are given a part of the excess profits that it has earned after giving a dividend to equity shareholders.

Convertible Debentures Redeemable at Premium: These securities are issued by a company at the par value but the holders have a ‘put option’. This enables the holders to sell the security at a premium.

Zero Interest Fully Convertible Debentures (FCDs): These debentures do not carry any interest but on the specified date they are converted into shares.

Floating Rate Bonds (FRBs): These bonds are issued by financial institutions by linking the interest on the bond to a benchmark interest rate. The benchmark may be the interest rate on treasury bills, prime lending rate or interest rate of term deposits. The floating rate may be either above or below the benchmark rate.

Zero Interest Coupon Bonds: Such bonds do not pay interest but are offered at a low price. The investors get returns from the difference he receives between the acquisition and redemption amount.

Deep Discount Bonds: Such bonds have a long-term maturity period between 20 to 25 years. They carry the feature of ‘call’ which means that the company can call back the bond after 5 or 10 years. It is sold at a discount but has no interest, for example, a 25 year bond is
issued at ` 10,000 but is redeemed at ` 1,00,000. The discount makes up for not receiving any interest during the waiting period.

**Regular Income Bonds:** These bonds have ‘call’ and ‘put’ options. They are for a fix period of kind and they pay interest after every 6 months. The period can also be monthly and the bond can be called monthly income bonds. It also carries a front-end discount.

**Retirement Bonds:** These bonds are useful for investors who are in the retirement stage. They are issued at a discount with the option of monthly income and for a specified fix term period. On the exit time of the bond, the investor gets a lump sum amount.

The most important component of the Industrial Securities Market comprising the New Issue and Stock Exchange market are the ‘Industrial Securities’ themselves. This is the physical or tangible asset through which the market functions.

The three types of securities through which the corporate sector raises their capital are: (a) Equity Shares or Ordinary Shares or Common Stock, (b) Preference Shares, and (c) Debenture or Bonds.

There are many new financial instruments brought through financial innovations of which the values depend on the prices of stocks. Some new instruments are exchange traded funds (ETFs), stock index and stock options, equity swaps, single-stock futures, and stock index futures. These can be traded on futures exchanges. Financial innovation and financial engineering has brought about a balanced and new form of instruments to suit different kinds of consumers.

**Derivatives**

Derivatives are also relatively new securities. They were introduced in India in 2001. These are financial instruments whose performance is derived, at least in part, from the performance of an underlying asset, security, or index. Even small market movements can dramatically affect their value, sometimes in unpredictable ways. In India, derivatives have become popular in recent years. The different derivatives are **forwards, options, futures and swaps**. Derivatives can be classified into commodity or financial instruments. They are basic and complex and exchange traded and OTC derivatives.
1.8 SECURITY MARKET INDICES

Stock Market Indices help in showing the stock market behavior. In fact, they represent the market by showing upward and downward trends in the stock market. Since it is not possible to see all the stocks everyday a price index and wealth index are Stock Market Indices which help in showing the stock market behavior. A price index is the authentic average of share prices with a base date and reflects general price movement of stock. A wealth index is prepared by giving weights through market capitalization. The base period values are adjusted for subsequent bonus and right issues. This index presents real wealth created for shareholders over a period of time.

Let us take an example of an index constructed with three scrips A, B and Z.

<table>
<thead>
<tr>
<th>Equity of Co. A</th>
<th>100 (Par Value ( \text{`} 1 ))</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity of Co. B</td>
<td>200 (Par Value ( \text{`} 1 ))</td>
</tr>
<tr>
<td>Equity of Co. Z</td>
<td>250 (Par Value ( \text{`} 1 ))</td>
</tr>
<tr>
<td>Market Price of scrip A ( \text{`} 2 )</td>
<td></td>
</tr>
<tr>
<td>Market Price of scrip B ( \text{`} 3 )</td>
<td></td>
</tr>
<tr>
<td>Market Price of scrip Z ( \text{`} 4 )</td>
<td></td>
</tr>
</tbody>
</table>

Market Capitalization (MC) = No. of Shares \( \times \) Prices of Shares

\[
\begin{align*}
A &= 100 \times 2 = 200 \\
B &= 200 \times 3 = 600 \\
Z &= 250 \times 4 = 1000 \\
\end{align*}
\]

**Market Capitalization** 1800

Index at period \( N = 100 \)

Market price at \( N + 1 \)

\[
\begin{align*}
&= A \text{ share price } \text{`} 2.2 \\
&= B \text{ share price } \text{`} 4.0 \\
&= Z \text{ share price } \text{`} 5.0 \\
\end{align*}
\]

**Market Capitalization**

\[
A = 100 \times 2.5 = 250
\]
B = 200 × 4.0 = 800
Z = 250 × 5.0 = 1250

Market Capitalization

\[
\text{Index at period } N + 1 = \frac{2300 \times 100}{1800} = 127.78
\]

Indices depend on: (a) the number of stocks in an index, (b) the composition of the stock, (c) the weights and (d) the base year. In India, SENSEX and BSE National index are very popular. However, BSE National index has 100 stocks and is stated to be more representative compared to SENSEX. NIFTY also provides a good index in the Indian Stock Market.

The SENSEX is like a barometer, which indicates the health, sentiment and mood of the market. It was named by Deepak Mohani

The BSE Sensex or Bombay Stock Exchange Sensitive Index. It is a value-weighted index composed of 30 stocks with the base April 1979 = 100. It consists of the 30 largest and most actively traded stocks, representative of various sectors, on the Bombay Stock Exchange. These companies account for around one-fifth of the market capitalization of the BSE. The base value of the Sensex is 100 on April 1, 1979 and the base year of BSE-SENSEX is 1978-79. It is constantly reviewed and modifications are made to make it reflect the current market conditions. The stock market has grown by over ten times from June 1990 to 2006.

S&P CNX Nifty is a well-diversified 50 stock index accounting for 25 sectors of the economy. It is used for benchmarking fund portfolios, index based derivatives and index funds.

S&P CNX Nifty is owned and managed by India Index Services and Products Ltd. (IISL), which is a joint venture between NSE and CRISIL. IISL is India's first specialized company focused upon the index as a core product. IISL have a consulting and licensing agreement with Standard & Poor's (S&P), who are the world leaders in index services.

<table>
<thead>
<tr>
<th>Major Stock Market Indices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Stock Market Indices</td>
</tr>
<tr>
<td>-----------------------------</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>Index/Market</th>
<th>Type</th>
<th>Value</th>
<th>Year(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic Times Index of Ordinary Share Prices</td>
<td>Unweighted</td>
<td>72</td>
<td>1984-85</td>
</tr>
<tr>
<td>BSE Sensex</td>
<td>Market Value</td>
<td>30</td>
<td>1978-79</td>
</tr>
<tr>
<td>BSE National Index</td>
<td>Market Value</td>
<td>100</td>
<td>1983-84</td>
</tr>
<tr>
<td>BSE-200</td>
<td>Market Value</td>
<td>200</td>
<td>1998-90</td>
</tr>
<tr>
<td>Dollex</td>
<td>Market Value</td>
<td>200</td>
<td>1998-90</td>
</tr>
<tr>
<td>S &amp; P CNX Nifty Junior (NSE)</td>
<td>Market Value</td>
<td>50</td>
<td>—</td>
</tr>
<tr>
<td>S &amp; P CNX -500</td>
<td>Market Value</td>
<td>500</td>
<td>1994</td>
</tr>
<tr>
<td>S &amp; P Midcap-200</td>
<td>Market Value</td>
<td>200</td>
<td>1994</td>
</tr>
<tr>
<td>CMIE</td>
<td>Market Value</td>
<td>72</td>
<td>June 1994</td>
</tr>
<tr>
<td>International Stock Indices</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dow Jones Industrial Average</td>
<td>Price Weighted</td>
<td>30</td>
<td>1928</td>
</tr>
<tr>
<td>Nikkei Dow Jones Average</td>
<td>Price Weighted</td>
<td>225</td>
<td>1949</td>
</tr>
<tr>
<td>S &amp; P Composite</td>
<td>Market Value</td>
<td>500</td>
<td>1941-42</td>
</tr>
</tbody>
</table>

1.9 SOURCES OF FINANCIAL INFORMATION

Fundamental analyst insists that the investor should also be aware of the sources of information that are available to him while evaluating a firm’s performance. This gives a fairly good idea of both the company’s internal management as well as the analyst’s opinion who makes projection of these firms without actually managing their funds. In India, the following sources of information are available to an investor for analyzing the records of the firm and ascertaining its past performances and an insight to its future projections:

(a) **Annual Report:** Annual report indicates: (a) the company’s name, (b) location of company’s factories, (c) number of shareholders, (d) company’s expansion programmes, (e) analysis of company’s operations in the current year, (f) analysis of previous year’s performance through consolidated balance sheets, (g) company’s prospects for the next year, (h) the economic and business
involvement of the firm, (i) dividend policies, (j) proposal for issue of right shares, bonus shares, debentures, etc.

(b) **Financial Dailies:** In India, the daily newspapers also give information about the financial news about the leading firms. These firms are generally quoted on the stock exchanges of the major centres in the country. Most important financial dailies in the country are ‘Economic Times’ and the ‘Financial Express’. These papers give an in-depth study of the share prices, quoted in the stock exchanges, and economic, business, commercial and industrial information about different firms from time to time. There are some investment magazines also and other corporate magazines, which give details about the economic and industrial performance of companies. These may be listed as: (a) Business World, (b) Business India, (c) Directors’ Digest, (d) Industrial Times, (e) India Today, (f) Economic and Political Weekly, (g) Investments Today, and (h) Investments India.

(c) **Directories:** Besides these sources of information, there are important directories available to give information and also indications of growth shares and income shares. They also give case studies and analyze the performance of different firms with projection of future.

Valuable guides which are sources of information also are listed below:

(d) **Stock Exchange Directory:** This is bound in eighteen volumes and gives information about all listed public limited companies and major public sector corporations.

(e) **Kothari’s Economic and Industrial Guide of India:** This gives relevant financial information and analysis of more than 3,000 companies. It is designed in a manner to make the investor aware of the problems of
investment and depicts the nature of investments available for current investment.

(f) **Times of India Directory:** Time of India has also a directory which gives full information about many industrial companies and groups. It makes an analysis of the different companies on stock exchange.

The buyer of share should be careful in making an analysis of company and he should generally buy shares which are listed on the stock exchange. Listed shares have some kind of predictions from the stock exchange brokers of the solvency, profitability investment value and price of the shares. Moreover, listed shares’ information is available, whereas the unlisted shares suffer from grave risk as no information is available on them. As a rule, the investor should also buy those investments which are actively traded on the stock exchange. An active share is one which is transacted in the stock exchange at least three times a week. While activity of a share price will depend on the depressed or prosperous conditions of the market, yet the trend can be gauged by the investor by following the rule number of times it is transacted on the stock exchange. Inactive shares are priced at a very low rate and it gives the investor a chance of investing his money at a cheap rate but these shares have no value and the investor will find that his capital becomes eroded if he purchases these shares. A share is inactive because there are no buyers and this is why the prices are quoted at very low rates. It also indicates that since there are no buyers in the market it is not a worthwhile investment. Active shares offer attractive investments for the future. They are priced at higher rates. Investor is sure of either capital appreciation or good dividend income. In India, the price of a share rises in relation to dividend that is declared on it. Active shares can be discerned from two categories of listed shares, cleared securities and non-cleared securities. These securities are usually known in the stock exchange as Group A shares and Group B shares. Group A shares are considered to be the most active shares. Group B shares are generally negative in nature. Group A shares are periodically analyzed by the stock exchange officials.

Fundamentalists, therefore, make a careful analysis of shares. According to them, there should be a preliminary screening of
investment, the economic and industrial analysis and analysis of the company to find out its profitability and efficiency and a study of the different kinds of company’s management.

1.10 THE RELATIONSHIP OF THE NEW ISSUE MARKET AND STOCK EXCHANGE

This chapter presented the broad features of the structure of the securities market in India. The New Issue Market and Stock Exchanges are the constituents of the industrial securities market in India. They are also called the capital market and their main function is to issue new shares through the new issue market and after following the statutory regulations to have active trading in the stock market in India.

The New Issue Market (NIM) deals with those securities which have been made available to the public for the first time; the Stock Exchanges in India provide a forum for free transferability of shares held by the public. The Stock Exchanges not only affect purchases and sales of securities but also make a continuous valuation of securities traded in the market.

The New Issue Market and Stock Exchange are interlinked and work in conjunction with each other. They cannot be described as two separate markets because of the kind of functions they perform. The NIM and stock exchange are connected to each other even at the time of the New Issue. The usual practice by the firms issuing securities is to register themselves on a stock exchange by applying for listing of shares. Listing of shares provides the firm with an added prestige and the investing public is encouraged with this service. The advantage of listing on a recognized stock exchange is that it widens the market for the investor. It provides the investor with the facility of sale of his shares thus offering him a ‘market’ for immediate liquidity of funds. Secondly, the working of the stock exchange and NIM provides a greater protection for the investing public as the companies applying for stock exchange registration are bound by the statutory rules and regulations of the market.

Further, the securities markets are closely connected to each other because of the sensitive nature of the movements of stock prices. Stock
prices are to a great extent affected by environmental conditions such as political stability, economic and social conditions, industrial pattern, monetary and fiscal policies of the government. The long-term and short-term changes in these factors have an effect on the day-to-day changes in prices of stocks. The NIM depends on the stock exchange to find out these price movements and the general economic outlook to forecast the climate for investing and the success of new issues floated in the NIM. Thus, the prices of shares in the NIM are sensitive to changes in the stock market and act and react accordingly and in the same direction and the general outlook in the market will show a “downswing” in trading activity of securities.

The next chapter discusses the issue mechanism in the new issue market.

1.11 POINTS TO REMEMBER

- The financial system of a country consists of a network of financial markets, institutions, investors, services and regulators.
- A financial system helps in effective collection of savings of the individuals and institutions and helps in transforming the funds into investment.
- Financial engineering is a new financial instrument, which is a hybrid of different securities. It has been created to suit the needs of an investor.
- Market intermediaries consist of lead managers, underwriters, clearing houses, mutual funds, investment companies, share brokers, credit rating agencies, depositories, and investment companies.
- The New Issue Market deals with those securities, which are issued to the public for the first time. The stock exchange is a place for secondary sale of securities.

1.12 QUESTIONS
1. Distinguish between New Issue Market and Stock Market. Is their role complementary or competitive?

2. What are the components of a financial system? Discuss the different financial markets in a country.

3. Give a list of the players and participants in financial markets.

4. What are the sources of financial information available in the new issue market and stock market?

5. What is a stock market index? How do you distinguish between Sensex and Nifty?

6. Distinguish between:
   (a) Capital market and money market;
   (b) New Issue Market and Stock Market
   (c) Inland and Foreign Market
   (d) Financial instruments and Financial engineering instruments.

1.13 OBJECTIVE TYPE QUESTIONS

State whether the statements are True or False.

1. A financial system is a network of financial markets, institutions, instruments and intermediaries.

2. Money market is for long-term investments.

3. Mutual Funds are market intermediaries.

4. The ownership securities consist of Deep Discount Bonds.

5. Financial engineering is the creation of new securities by combining different options.

6. Debt securities are mostly ownership based.

7. The role of a financial system is to establish a link between savers and investors.


1.14 MULTIPLE CHOICE QUESTIONS
1. The function of a financial system is to
   (a) establish a link between savers and investors
   (b) link commercial banks with the Central Bank of a
country
   (c) create regulators for influencing the intermediaries
   (d) help traders and moneylenders in the capital market
2. Financial engineering is a new term to
   (a) acquire a financial degree
   (b) become a market participant
   (c) be a credit rating agency
   (d) provide a combination of features in a security to
      suit an investor
3. The difference between a primary market and a
   secondary market is
   (a) primary market is the stock market and secondary
      market is the market for second hand sale of
      securities
   (b) a primary market helps in long-term credit and
      secondary market offers short-term credit
   (c) a primary market helps in the issue of new
      securities those which are offered for the first time
      and the secondary market is for second hand sale of
      securities listed on the stock exchange
   (d) a primary market is the unorganized sector and the
      secondary market is the organized sector for sale
      and purchase of securities.

**Answers:** 1. (a), 2. (d), 3. (c).