INVESTMENT AND SECURITIES MARKETS IN INDIA
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In the Indian Economy since 2014, when the new Government took over at the Centre, there was marked change in political and economic conditions. The GDP growth rate was higher at around 7% to 8%. The inflation rate was kept low at 4% FDI and FII were encouraged to flow in more freely. A number of new schemes were initiated via the Make in India in vibrant economy. Public sector banks were allowed to tap the market for additional funds and to consolidate themselves to make banking sector more strong with lower NPAs and higher lending. The scheme of 'Make in India' and other similar schemes were tuned to longer production and higher productivity in the manufacturing and service sectors.

The tenor of monetary policy is to further tighten the interest rate structure but encourage greater inflow of FDI into banking and insurance and service industries. The policy was made to reduce the liquidity in the banking system and longer productivity.

During the period after 2009, there was however a revival and stock and capital markets saw recovery, due to strong fundamentals of the corporate sector, expected higher growth rates of GDP and control on inflation in the Eleventh Plan Period. The foreign inflows were also considerably boosted due to depressed dollar and uncertain prospects of the U.S. economy. The FIIs and FDI flows reached new peaks during 2007-08, due to optimistic expectations of the Indian economy.

It is in the above background that this revision of the book was undertaken. Many chapters have been drastically changed. The basic structure of the book has been, however, kept in tact. But the usefulness of the book to the students has been enhanced by removing the errors, and bringing the facts and figures up-to-date to the extent possible. This is our constant endeavour to make this book more popular among the student community. Some repetitions and restatements are unavoidable to make each chapter self-contained, and are student-friendly.

A separate chapter is added in this edition on the Problems in Hire Purchase and Leasing. This is in addition to case studies and examples in the chapters, where they are needed.

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PART I

SECURITIES MARKETS IN INDIA
Introduction

The issue of securities by corporate units in India is as old as the introduction of joint-stock enterprises by the British Government. The 18th and 19th centuries saw the emergence of cotton and jute textiles, tea and plantation industries in India. Many companies were set up as joint-stock enterprises with liability limited by shares. A vast number of businessmen in major cities purchased these shares and trading started in them early in the 19th century, thanks to their enterprising spirit. In those days, although many of these companies were financed by the issue of shares to the public, they mainly depended on the joint-stock British banks in India and borrowals from abroad. British enterprise and the British Government have thus helped the emergence of the securities markets in India. The corporate securities have come to have a market first. So far as the Government securities are concerned, the British India Government borrowed mostly in London by issue of Sterling consols. Only later in the 19th century, the Government issued treasury bills and Government securities in rupees. This led to the emergence of the Government securities market also in India.

What is Securities Market?

Securities markets are markets in financial assets or instruments and these are represented as IOUs (I owe you) in financial form. These are issued by business organisations, corporate units and the Governments, Central or State. Public sector undertakings also issued these securities. These securities are used to finance their investment and current expenditure. These are thus sources of funds to the issuers.
There are different types of business organisations in India, namely, partnership firms, co-operative societies, private and public limited companies and joint sector organisations etc. The more frequently organised method is the company, registered under the Indian Companies Act 1956. Under this Act, there are three types of companies: (a) companies limited by guarantee; (b) companies which are private limited companies — limited by shares paid up; and (c) companies which are public limited companies - limited by shares paid up. Under the Act, the private limited companies can have 50 members and their shares are not transferable freely. These companies reserve the right to refuse any transfer of shares and as such trading in them is restricted. Due to these inhibitive features, private limited companies do not have easy access to the securities markets. Only public limited companies are largely popular as they can raise funds from the public through the issue of shares. The methods of raising funds used by the corporate sector are to issue securities, either in the form of ownership instruments or debt instruments.

What are Securities?

Securities are claims on money and are like promissory notes or IOU. Securities are a source of funds for companies, government, etc.

The external sources of funds of the companies are as follows:

(A) Long-term Funds
   (i) Ownership capital — equity and preference capital and variants of them.
   (ii) Debt Capital — debentures or bonds and long-term borrowings in the form of deposits from public or loans and advances from banks and financial institutions, etc.

(B) Short-term Funds
   (i) Borrowings from banks.
   (ii) Trade credits and suppliers’ credits, etc.

Of the above sources, the most popular are those which are tradable and transferable. They have a market and their liquidity is ensured, as in the case of equity shares, preference shares, debentures and bonds. Of these the ownership instruments, particularly the equity shares, are generally the most liquid as they are not only tradable in the securities markets but also enjoy the prospects of capital appreciation, in addition to dividends. The market for these has thus grown much faster than for others.

Mobilisation of Savings for Investment

The issue of securities can be looked at from various angles. These may be set out as follows:

(i) From the point of view of issuers, these are the sources of finance for long-term capital investment and for working capital. They can thus invest more than their own resources;
(ii) From the point of view of investors, these are IOUs or promissory notes, giving an income or a return to their investment. They provide a channel to their savings and cater to the asset preferences of the public with varying characteristics of risk, income, maturity, etc.;
(iii) From the point of view of the nation, these issues mobilise the savings for investment and capital formation in the country. They promote the growth of output and income by a multiplier leading to a rise in the output by a multiple of the original investment over a period of time;
(iv) From the point of view of the financial intermediaries like banks, financial institutions, etc., these issues are a source of income to them for the management of these issues, placing them with the public, providing liquidity and marketability to them.
Thus, the securities markets comprise all the above players, namely, issuers, savers, investors, intermediaries, etc. and the major activity is the mobilisation of funds from saving and their channelisation into investment.

**IOUs as Securities**

In the securities markets, the securities dealt with are equity shares, preference shares, debentures and bonds. These securities being financial claims are issued as IOUs or Promissory Notes. In the primary market, the issues are made to the primary or original savers. The other forms of holding debt or borrowings such as public deposits or bank owned IOUs are not securitised and hence not tradable. In certain cases like the P.O. Certificates, bank deposits, LIC policy certificates etc., they are not transferable by endorsement, but they have a primary market as these primary issues are IOUs, used to mobilise the savings of the public. The market for such primary securities is limited to one stage and there is no secondary market for them. The UTI units and the instruments of many mutual funds in India belong to a hybrid category, as these are not securities according to the strict definition of the term under the Indian Companies Act. But as they can be sold back to the issuing institution or sold in the market if they are quoted on the Stock Exchange, they enjoy liquidity. These are deemed securities under the SC(R) Act. Thus, UTI units under the 1964 scheme for example can be repurchased by the UTI, which provides liquidity to these instruments. The master shares of UTI and the stocks of many of the mutual funds like Kotak Gold can also be traded as they are quoted on the Stock Exchanges. These are called exchange traded funds.

The securities markets emerge out of the two characteristics of financial instruments: (a) mobilising primary savings from the public to serve as sources of funds for the issuing authority; and (b) providing liquidity to these instruments through regular quotations in the financial markets and thus traded. The primary markets exist only if the first condition is satisfied. The secondary market also operates if both the conditions are satisfied.

The pattern of corporate financing and the extent of their dependence on the external sources of funds, as opposed to the internally generated cash flows, would thus determine the creation of new securities. The retained earnings are the internally generated funds which have an opportunity cost but whose issue costs are zero. There are, however, issue costs for equity and preference shares, convertible and non-convertible debentures etc. The capital market and stock market do provide the facilities for new issues and conversion of issues into money and vice versa, so that investors are assured of liquidity for their investments so as to induce them to enter these markets.

**Characteristics of Securities**

The major characteristics of securities are their transferability and marketability. These help the process of trading and investment in them.

Under the Indian Companies Act, Sections 82 and 111 deal with the transfer of shares. In the case of public limited companies, the objective of the Companies Act as also of the Listing Agreement with the Stock Exchanges is to ensure free and unfettered transfer of shares. Under Section 82 of the Companies Act, shares are treated as any movable property. As any right to property, these are freely transferable. By one amendment in 1985, Section 22(A) of the Securities Contracts (Regulation) Act has denied the right to refuse to transfer shares by a listed public limited company except on technical grounds. The other grounds on which the transfer can be refused are specifically laid down under the Act and the company has to specify the reasons for such refusal to transfer and reference has to be made to the Company Law Board whose decision to refuse or not to refuse the transfer of shares will
be final. Thus, the essential characteristic of transferability of shares is well preserved which gives them the market which in turn extends liquidity to these shares. This has led to the emergence of securities markets in India.

**Primary Issues and Derivative Securities**

Primary issues are those issued by the companies, Governments and financial institutions. Derivative issues are those which are based on the original primary issues. There are a number of derivative instruments which are used to generate a market for the primary issues. Thus, in many developed markets abroad, there are warrants, options, futures, index linked instruments etc. which have well-established markets and they are based on some primary instruments. In India, options were not permitted but some form of futures trading exists in Group A securities on the stock exchanges as they are permitted to be carried forward from settlement to settlement without taking delivery of shares. Since January 1995, options and futures and other derivative tradings have been permitted.

More recently, new instruments have been developed in India, namely, warrants, Zero coupon bonds, conversion options, rights options etc. But in many cases these are not well developed and secondary markets for these instruments do not exist and trading does not take place as in the case of listed shares and particularly those on the specified group (Group A) of stock exchanges.

Reference is made in the subsequent chapters to many new instruments which are introduced both in the capital market and the money market in India. Besides, the RBI has also recently permitted the securitisation of bank debts in the sense that the debit balances on companies’ accounts can be transferred to other banks and financial institutions which are willing to discount them or purchase them at a price but the market in many new instruments of corporate debt is yet to be developed in India.

**Schematic Presentation of Emergence of Markets**

A schematic presentation of the emergence of markets through the flow of cash, credit and savings of the public is made in Charts 1.1 to 1.5. It will be seen from Chart 1.1 that money flows lead to claims on financial assets and physical assets and financial assets in turn when issued as securities result in trading in markets. The money and capital markets are shown separately as short-term and long-term wings of the markets. The components of capital market are shown as primary and secondary markets whose details are explained in terms of instruments traded, institutions involved and operations undertaken in Charts 1.3 and 1.4 respectively. Chart 1.2 explains the savings flows of the household sector into physical assets invested by the household sector, namely, currency, deposits of banks, etc. Chart 1.5 presents the interrelations of the various institutions and markets, namely, the stock exchange, brokers, banks, financial institutions, etc. Finally, the investor clients and corporate clients and the various services rendered to them by these markets are briefly depicted in this chart as constituting the totality of the markets.
Chart 1.1 Broad Contours of Money Flows

BROAD CONTOURS OF MONEY FLOWS

MONEY
CASH + CREDIT

CREATED BY
R.B.I. CASH

CREATED BY
BANKS — CREDIT

INCOME MINUS
EXPENDITURE = SAVINGS

INVESTMENTS

FUTURE CLAIMS
ON MONEY

PHYSICAL
ASSETS

FINANCIAL ASSETS = INSTRUMENTS

A. SHORT-TERM — DDS, MTS, CHEQUES, TBs, etc.

B. LONG-TERM — SECURITIES, SHARES, DEBENTURES
(CAPITAL MARKET) — DEPOSITS, BORROWINGS, ETC.

PRIMARY MARKET

INSTRUMENTS
NEW ISSUES,
ALLOTMENT LETTERS,
RIGHTS BONDS,
VOUCHERS,
RENUNCIATIONS, etc.

SECONDARY MARKET
OR STOCK MARKET
TRADING IN OLD SHARES
OR SECURITIES

ASSETS TRADED
GOVERNMENT SECURITIES,
CORPORATE SHARES,
DEBENTURES, UNITS, etc.
### SAVINGS PROFILE 2012-13

<table>
<thead>
<tr>
<th>Form of Assets</th>
<th>2012-13</th>
<th>Percentage of Gross Financial Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Currency</td>
<td>10.2</td>
<td>12.5</td>
</tr>
<tr>
<td>2. Deposits of Banks</td>
<td>51.3</td>
<td>54.9</td>
</tr>
<tr>
<td>3. Deposits of Non-Bank Companies</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>4. LIC, Insurance, PF and Pension Funds</td>
<td>31.0</td>
<td>29.5</td>
</tr>
<tr>
<td>5. Claims on Govt. (Postal Savings, Government Securities, etc.)</td>
<td>−0.6</td>
<td>−3.1</td>
</tr>
<tr>
<td>6. Shares and Debentures &amp; MFs</td>
<td>3.1</td>
<td>2.6</td>
</tr>
<tr>
<td>7. Others</td>
<td>3.4</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Chart 1.2 Saving Profile of Macro Household

*Source: RBI Annual Reports, 2013*
Securities and Securities Markets

CORPORATE SHARES, DEBENTURES, RIGHTS, ETC. ARE THE INSTRUMENTS.

BASIS:

1. ENABLING LEGISLATION, PRACTICES, PROCEDURES
2. PATTERN OF CORPORATE FINANCING - STRUCTURE

A. INTERNAL FINANCE, RETAINED INCOME
B. EXTERNAL SOURCES — METHODS

3. PRIMARY MARKET OPERATIONS

PROJECT PLANNING, FINANCE PLANNING, CONSULTANCY, FINANCIAL MANAGEMENT, TAX PLANNING, GOVT. REGULATIONS, DEALINGS IN THE PRIMARY MARKET – ISSUES TO THE HOUSEHOLDS, ETC.
PROSPECTUS, ALLOTMENT, LISTING, ETC.

Chart 1.3 Primary Market
SECONDARY MARKET PROFILE

SEBI-Securities Appellate Tribunal (Securities and Exchange Board of India)

GOVT. COMPANIES — PSUs

STOCK EXCHANGES

BROKER JOBBER

DEPTS FUNCTIONS

OWN BUSINESS (WHOLESALE) — JOBBER
CLIENT BUSINESS (RETAIL) — BROKERS

CUSTOMERS

INDIVIDUALS, COMPANIES, FI's, MUTUAL FUNDS ETC.

TRADING

BID-OFFER/PURCHASE & SALE

SPECIFIED SHARES

NON-SPECIFIED SHARES, ETC.

O.T.C. OPTIONS AND DERIVATIVES

PASSING OF SOUDAS — VANDAS ETC

CLEARING HOUSE
SETTLEMENT, DELIVERY PAYMENT ETC.

GOVT. SECTOR FINANCING — CENTRAL — STATE
LOCAL BODIES AND SEMI-GOVT. ORGANISATIONS

GILT - EDGED MARKET, RBI AS UNDERWRITER, PRIMARY DEALERS,
JOBBER, DEALERS, BANKS, PF, FI's — BROKERS ETC.

CORPORATE SECTOR FINANCING —
EQUITIES, PREFERENCE SHARES, DEBENTURES, BONDS ETC.

REGISTRATION, CONSOLIDATION, SUB-DIVISION
FLOW OF INFORMATION ON COMPANY AFFAIRS ETC.

Chart 1.4 Secondary Market
Chart 1.5 Inter-relations