INVESTMENT MANAGEMENT

Dr. V. A. Avadhani

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Dr. V. A. AVADHANI
M.A. Ph. D., (USA), M.A., LLB., CAIIB.
(Retired Adviser in RBI & Former Director of Training Institute in Bombay Stock Exchange, Former Advisor to HSE.)

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The theory and principles of Investment Management remain unaltered but the backdrop of the operations of investment and the practices and procedures of investment management change from time to time. The financial markets in which most of the operations take place are a reflection of the economy and its performance. The economic and financial reforms in India are a continuing process and these affect the operations in the financial markets. The changes are to be incorporated in any revision of a book of this nature, which is being used by students of finance whether in MBA or M.com. or any other professional course. This is the rationale of the present revision, which hopefully helps the student update the information relevant to the area.

During the recent past and in the present decade from 1999 to 2009, the GDP growth was at a rate of about 8% higher than ever before, with the latest year 2006-7 showing a growth of 9.2%. Nearly 60% of this growth is due to services sector which includes the financial services like banking, insurance, stock broking etc. The financial structure and institutional framework is being strengthened and banking and e-commerce are the highlights of the recent past. Stock and capital markets are booming reflecting the strong economic fundamentals and good corporate performance. Foreign funds inflow is increasing particularly during the period 2004 to 2008 when the BSE Sensex has reached a peak of 21,207 in January 2008 and after a low of 7,697 in October 2008, firmed up again to a high of 18,048 in April 2010 and is around 17,000 in May 2010. Globalization trends are perceptible in all spheres of the economy and particularly in the financial markets. These trends along with privatization of the enterprise gave a new boost to the economy and financial markets. The global recession 2008-09 had its impact along with the financial turmoil in Euro-markets due to debt crisis in Greece on the Indian markets.

The strong points in the economy are the good monsoons and rapid growth of the manufacturing sector, control of inflation and larger inflow foreign direct and portfolio investments and good buffer of forex reserves. Although the inflation rate reached a level of 10% at one stage, it is being controlled through monetary and fiscal measures. While equity market is bullish, the corporate debt market is being developed by the SEBI and the Government Debt market by the RBI. FDI inflows are being encouraged through the policy changes reducing the red tape and Govt. regulations, increase in limits for Foreign investments in selected sectors and rise in the ECB limits.

The Eleventh Plan aims at accelerating the growth of agriculture to 4% and increasing the GDP growth rate to 10% for which all necessary inputs are being planned. In the fiscal field, the fiscal deficit is being kept low; subsidies are being rationalized and fiscal prudence is being observed. In the monetary and credit field, flexibility in interest rate policy and frequent use of repo rate and CRR has curbed the growth of money supply beyond the required level. CRR was raised many times from 4.5% in 2003 to 7.75% in Jan. 2008 but it stood at 6% in April 2010. Greater autonomy is given to banks in their risk management, credit policy and interest rate policy. The RBI has been curbing the excess liquidity due to foreign inflow and foreign investment and credit creation by the banks through plastic money etc.

The call money rates are around the repo and reverse repo rates. Due to the recession in our economy, following the global recession 2009-10, The Reverse Repo was raised to 3.75% and Repo rate to 5.25%. The monetary policy was anti-inflationary. While the Rupee is getting strengthened against dollar in the forex market, the RBI, is thinking of allowing the currency futures in the markets. Derivative markets in stock index and equities are having a larger turnover than in the cash market, reflecting the larger operations of foreign FIs and MFs etc. The RBI is also allowing the rupee to find its own level but is keeping watch on the inflationary expectations.

It is in this context that the present book is revised to bring out the impact of these changes and to update the figures and data used in the text. In this task, I acknowledge with thanks the suggestions of the teaching colleagues and the co-operation of the Himalaya Publishing House.

— DR. V. A. AVADHANI
This book on Investment Management is intended as a textbook for the students of M.Com. and M.B.A. Courses in Finance. Admittedly, there are many books on Finance Management and Investment Management, but what made me write this book is that it covers the syllabus of many Universities for M.Com. and M.B.A. courses, specially designed to help the students with simple presentation, practical illustrations and in the Indian background. With my experience of 32 years in the Reserve Bank of India in economic and financial research, and nearly six years of research and training experience in the Bombay Stock Exchange and Hyderabad Stock Exchange, and teaching the subjects of Finance and Investment in many management institutes, including I.I.M. Calcutta, my background is down to earth practical and my approach is teaching for job orientation. I have trained many sub-brokers to become brokers and hundreds of investors to become wise investors, which all helped me to make theory useful for practical applications.

Many professors whom I know have encouraged me to venture into this useful service to the students by presenting the subjects in a practical manner and with an Indian background. In particular, I kept the syllabus for M.Com. and M.B.A. courses of the Osmania University, Andhra University, Kakatiya University and Madras University, among others, before me when I wrote the book. Shri D.P. Pandey of the Himalaya Publishing House has been constantly helping me and giving all encouragement during the course of my writing this book. Any suggestions for improvement may be sent to him and I shall incorporate such suggestions, in the next edition.

This book is structured in a manner to be very comprehensive and sweepingly wide so as to accommodate the syllabus of almost all universities, to the extent possible. This book has the mission of serving the student community, in the areas of Commerce, Finance and Management.

This book is meant to be highly practical with Indian bias but incorporates the theoretical inputs necessary to satisfy the components of the syllabus of M.Com. and M.B.A., and the practical needs for job orientation of students, in Indian Finance and Investment Companies, Mutual Funds, Merchant Banks, Stock Broker Firms etc.


I will be failing in my duty if I do not acknowledge the help of Shri D. P. Pandey in writing this book. I also owe a deep sense of gratitude to my parents who instilled in me the spirit of service to the community, in the faculty that God has given me.

— Dr. V. A. AVADHANI
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PART — I
Investment Setting

Chapter 1: Securities Markets
Chapter 2: Savings and Investment
Chapter 3: Macro Aspects of Savings and Investments
Chapter 4: Financial System - Intermediation
Chapter 5: Investment Avenues
Chapter 6: Features of Investment Avenues
Chapter 7: Tax Planning for Investment
Part I
Investment Management
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 other 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 I.O.U.s (I owe you) in financial form. These are issued by business organisations, corporate units and the Governments, Central or State. Public sector undertakings also issue 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 and public 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 and companies limited by guarantee cannot enter the market. 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 ownership instruments or debt instruments.

What are Securities?

Securities are claims on money and are like promissory notes or I.O.U. Securities are a source of funds for companies, Governments and Semi-Government bodies. There are two types of sources of funds namely internal and external and securities emerge when funds are raised from external sources.
The external sources of funds of the companies are as follows:

(A) Long-term Funds

(i) Ownership Capital — equity and preference capital, and Non-voting Shares.

(ii) Debt Capital — debentures and long-term borrowings in the form of deposits from public or credit limits or term loans or advances from banks and financial institutions, etc.

(B) Short-term Funds

(i) Borrowings from banks, and other corporates.

(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 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 and by activating idle funds.

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 I.O.U.s 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 I.O.U.s, 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. 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 some mutual funds can also be traded as they are quoted on the Stock Exchanges and they are close ended schemes.
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. These can be converted into securities by issue of bonus shares to existing share holders. 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 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 to the public 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 are now permitted and 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 have been permitted by change in law by the Government and they are now developing under strict control of SEBI, since 2000.

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 are under developed 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 book debts of banks and financial institutions 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 is yet to be developed in India.
Derivatives Markets in India

In India, options and futures were allowed as securities to be traded in stock exchanges by necessary changes in the S. C. (R) Act 1956, in the year 1996-97. But actual trading in them did not take place until 2000-2001, due to the need for preparing the members for this new system and for setting up the necessary architecture and infrastructure for trading in derivatives.

In June 2000, Index futures and in November 2001, stock futures were started, on NSE and BSE. But the index options were initiated in June 2001 and stock options in July 2001. More importantly interest rate futures were introduced only in June 2003 on the NSE. But the process in interest rate futures and currency futures are yet to take off.

The volume of turnover has grown faster on the NSE than on BSE. Secondly, turnover in derivative markets has grown faster than in the cash markets, although the former were started only a decade ago.

Schematic Presentation of Emergence of Market

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 financial assets invested by the household sector, namely, currency, deposits of banks, etc. Chart 1.5 presents the inter-relations 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. The further details of these charts are explained in later chapters.
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 ETC.
CALL MONEY, T.Bs, C.Ps, 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
GOVT. SECURITIES,
CORPORATE SHARES,
DEBENTURES,
UNITS, ETC.
**Chart 1.2**

Saving Profile of Macro Household

**SAVINGS FLOWS**

2008-09

TOTAL SAVINGS ESTIMATES (HOUSEHOLD SECTOR)

<table>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>1. Currency</td>
<td>9.2</td>
<td>10.5</td>
<td>8.6</td>
<td>11.4</td>
<td>12.4</td>
</tr>
<tr>
<td>2. Deposits of Banks</td>
<td>37.1</td>
<td>36.7</td>
<td>55.6</td>
<td>50.4</td>
<td>54.9</td>
</tr>
<tr>
<td>3. Deposits of Non-Bank Companies</td>
<td>0.4</td>
<td>4.9</td>
<td>0.1</td>
<td>1.8</td>
<td>3.6</td>
</tr>
<tr>
<td>4. LIC, Insurance, PF and Pension Funds</td>
<td>26.4</td>
<td>27.6</td>
<td>24.2</td>
<td>20.0</td>
<td>29.6</td>
</tr>
<tr>
<td>5. Claims on Govt. (Postal Savings, Govt. Securities etc.)</td>
<td>24.0</td>
<td>20.2</td>
<td>5.2</td>
<td>-4.0</td>
<td>-3.1</td>
</tr>
<tr>
<td>6. Shares and Debentures &amp; MFs</td>
<td>1.1</td>
<td>0.1</td>
<td>6.3</td>
<td>12.4</td>
<td>2.6</td>
</tr>
<tr>
<td>7. Others</td>
<td>1.8</td>
<td>Nil</td>
<td>—</td>
<td>8.0</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

**Source:** Latest RBI Annual Reports
INSTRUMENTS — PRIMARY MARKET

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
Chart 1.4
Secondary Market

Stock Exchanges

SEBI → Securities Appellate Authority

Govt. Companies → P.S.U.s.

Stock Exchanges

Broker Jobber → Depts. Functions

Own Business (Wholesale) — Jobber
Client Business (Retail) — Brokers

Customers

Individuals, Companies, FIs, Mutual Funds etc.

Trading

Bid — Offer/Purchase & Sale Prices

Specific Shares
Non-Specific Shares/Bonds, etc.

O.T.C. Options & Futures

Raising of Enabling Contracts & Notes

Clearing House Settlement Delivery Payment etc.

Govt. Sector Financing — Central — State
Local Bodies and Semi-Govt. Organisations

Gilt-Edged Market, RBI, Underwriters, Primary
Dealers, Banks, FIs — Brokers etc.

Corporate Sector Financing —
Equities, Preference Shares, Debentures, Bonds etc.

Registration, Consolidation, Sub-Division
Flow of Information on Company Affairs etc.
LEGAL FRAMEWORK FOR SECURITIES MARKETS

New Issues Market and Stock Exchange are a part of the Capital Market where the shares, debentures, bonds and other securities of companies and Government are traded. The Stock Exchange provides facilities for exchange of shares into money and vice versa. New Issues Market is the Primary market where the issuers can sell securities, but cannot buy. Stock Exchange is defined as an Association of Member Brokers who assist, facilitate and regulate trading in securities. One can buy and sell in the Stock Exchange or Secondary market.

These securities are issued by the Companies under the Companies Act and by the Government under the Indian Public Debt Act, since replaced by the Government Securities Act in 1999. Since the public are not interested in Government Securities due to lower level of interest rates on them, the public awareness of this market is little or negligible. This market is mainly confined to banks, financial institutions etc.

The capital market comprises of two components, namely, New Issues Market where companies issue directly securities to the public and the Stock Market or the Secondary Market where the existing securities are bought and sold.
Trading in old securities is governed by the Securities Contract (Regulation) Act of 1956 and the Securities Contract (Regulation) Rules of 1957. The Act has provided for recognition to the Stock Exchanges and gave wide ranging powers to the Government to control and regulate the Stock Exchanges. It has laid down the types of contracts in securities which can be traded or purchased and sold and for listing of securities of public limited companies, whose shares are being traded. The Act and the Rules made thereunder have provided for qualifications for members, contracts to be traded, trading period, permitted deals, settlement periods, clearance and delivery of shares etc. The actual Rules and Bye-laws of each Stock Exchange have enshrined these rules. The Act is applicable to Public Limited Companies, which are listed on Stock Exchanges and ensure transferability of shares and laid down the conditions under which transferability can be denied to investors.

Companies Act

The Companies Act which regulates the activities of the companies from birth to death has provided for the sources of finance for companies and the methods of marketing the public issues which are marketable. These are in the form of ownership category, namely, Equities and Preference shares and Debt capital in the form of convertible and non-convertible debentures, fixed deposits etc. Under the Companies Act, Sections 55 to 68 provided for issue of prospectus, its contents, Registration of Prospectus, civil and criminal liabilities of the Directors for any mis-statements in prospectus etc.

The Act has laid down the methods of raising new issues, namely, through prospectus, letter of offer or statement in lieu of prospectus, Rights and Bonus. Section 58 A and B deal with the conditions for acceptance of deposits, repayments of deposits, etc., while companies (acceptance of deposits) Rules of 1975 laid down the period of maturity, interest rates and other conditions. The company deposits are an avenue of investment, but are not tradeable. The details regarding them are dealt with briefly later.

Sections 69 to 73 deal with the allotment of new issues to applicants, delivery of certificates and their listing on Stock Exchanges. The allotment is also governed by the guidelines given by the Stock Exchanges as per the listing agreement in the case of listed companies.

The basic framework for trading is provided by the Companies Act in the form of:

1. Marketing the shares as movable property under Section 82.
2. Ensuring transferability of shares in respect of public limited companies under Sections 108 - 112.
3. The transfer deed through which share certificates are to be transferred is provided for under Section 108 which was amended to legalise the demat form of transfer since 1999.
4. The validity of the transfer deed under Section 111 is 12 months in the case of listed companies and 24 months in the case of non-listed companies.
5. Section 114 provides for issue of share warrants.

So far as investors are concerned, it is desirable that they know the main provisions of the Companies Act, because the issue of prospectus, the contents of it, allotment of new issues, despatch of certificates, transferability etc., are all laid down in it. The rights of shareholders and debentureholders, and different categories of creditors and debtors of companies are set out. The book closure for accounts, presentation of Balance Sheet and Income-Expenditure accounts, payments of dividends etc., are all provided for in this Act. In Particular, Section 82 provides for transferability of shares and Section 73 lays down the conditions for listing of Public Limited Companies. While these sections ensure the marketability of shares of listed public limited companies, trading in them is made possible by the Securities Contracts Regulation Act and the Rules made thereunder.

In view of the fact that purchase and sale of shares through recognised Stock Exchanges and through licensed Stock Brokers are only legal, and those are governed by the SC(R) Act, the investors have to be familiar with this Act and the Rules made thereunder. The relations between the Brokers and Investors and in particular, the disputes if any, between them are governed by the Rules and Bye-laws of the Stock Exchanges which are formulated under this Act.
Acceptance of Fixed Deposits

A company cannot accept deposits in excess of 35% of the paid up capital and free reserves. Of this, 25% deposits can be accepted from the public and the rest 10% from shareholders of the company. The minimum period of acceptance of deposits is one year and the maximum period is limited to 3 years. The company is under an obligation to maintain an amount not less than 15% of the company’s deposit liability maturing during the course of the year, in liquid investments such as Government securities, units, deposits with banks etc. The maximum rate of interest that can be offered on deposits is fixed at 11% to 14%. A ceiling on brokerage payable on deposits has been fixed at 1%. The interest earned on fixed deposits of companies does not enjoy any exemption from income tax. Neither does the amount of deposit qualify for any exemption under wealth tax. Under the existing provisions of the Income Tax Act, tax on interest paid/payable is deducted at source if the interest payment exceeds Rs. 2,500 in a financial year unless suitable declaration is furnished by the depositor in regard to the total income of the depositor not exceeding the minimum liable to tax in a financial year. (Form 15(H) under I.T. Act)

The acceptance of deposits by non-bank non-financial companies is governed by the Companies (Acceptance of deposits) Rules 1975 as amended from time to time. Along with the prescribed application form the terms and conditions of acceptance of deposits are required to be furnished by companies, to the RBI in the case of non-bank finance companies and a copy in case of non-bank non-finance companies.

A careful study of either the financial data in the advertisement or the prescribed particulars as available within the application form would generally reveal the working results and the financial position of the company.

Compulsory Repayment of Deposits which have Matured for Repayment

The Companies Act, 1956 has been amended by the Companies (Amendment) Act, 1988 with effect from 1.9.1989 so as to provide for compulsory repayment of deposits which have matured for repayment (Section 58(9)). Under the amended provisions, the Company Law Board has been empowered to take cognizance of non-repayment of any deposit on maturity and to direct repayment of such deposits on such conditions as may be specified by the Company Law Board in its Order. This will help and ensure repayment of public deposits and will create confidence amongst the public.

Procedure for Making Application to Company Law Board

The person holding a matured fixed deposit which he has not renewed and which the company has failed to repay, has to make an application in triplicate in Form No.11. The application has to be accompanied by a fee payable by way of bank draft in favour of the Pay & Accounts Officer, Dept. of Company Affairs, New Delhi/Mumbai/Kolkata/Chennai.

The Company Law Board has four Regional Benches. The aggrieved depositors may make an application to the Bench of the Company Law Board having jurisdiction according to the Registered Office of the company. The Company Law Board would, after giving a reasonable opportunity of hearing to the company and other persons interested in the matter, make suitable orders for repayment of such deposits. Non-compliance of the order of the Company Law Board is a punishable offence attracting penalty by way of imprisonment upto 3 years and fine of not less than Rs. 50 for every day till such non-compliance continues.

Where the deposit which has fallen due for payment remains unpaid the depositor can seek remedy in a civil court, or can file an application for winding up of the company to the court after serving on the company written demand requiring the company to repay the deposit (Section 433, 434 and 439 of the Companies Act may be referred to for the purpose). The SEBI is not permitting such companies to make public issues.

Cases in Respect of which Applications to the Company Law Board will not Lie

It is essential to know that under Section 58A of the Companies Act, the power to order repayment of matured deposits can be exercised by the CLB only in respect of deposits accepted Under the Companies (Acceptance of Deposit) Rules 1975 as amended from time to time. In other words, an application to the Company Law Board of repayment of matured deposits shall not lie in the following cases:

(i) Deposits made for booking purchases of scooter, car etc.
(ii) Deposits accepted by financial companies like, hire-purchase finance company, a housing finance company, an investment company, a loan/mutual benefit financial company, a chit fund company, which are governed by the rules made by the RBI.

(iii) Deposits accepted by companies which have been notified as ‘relief undertakings’ under special laws enacted by various State Governments. Court rulings point to the fact that the monetary liabilities of relief undertakings during the notified period stand suspended and any proceedings including the proceedings for compulsory repayment of deposits under Section 58A(9) shall accordingly remain stayed.

(iv) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985 in respect of which, the Board for Industrial and Financial Reconstruction has specifically, by order suspended the operations of any contract, agreement, settlement, etc. under Section 22(3) of the Act.

Facts about Company Deposits

The deposits accepted by a company are not repayable before the date of maturity. It is left to the discretion of a company to allow premature repayment of a deposit. If and when the deposits are prematurely repaid the depositors are entitled to a lower rate of interest than the contracted rate. Most importantly, the company deposits are unsecured and rank pari passu with other unsecured liabilities. Hence, the investor has no recourse to any asset of the company in case of default by a company to repay the deposit on maturity.

Care to be Exercised while Investing in Fixed Deposits

Invitation to deposits from public for various schemes of deposits is invariably published in newspapers in the form of a statutory advertisement giving the following details:

(i) Terms of acceptance of deposits, rate of interest on different maturities, minimum amount of deposits, cumulative or non-cumulative nature of the deposit, etc.

(ii) Brief details of the name of the company, date of its incorporation, business carried on by it, places where the company has offices and names and address of directors.

(iii) Details of profits and dividends for the last three years.

(iv) Summarised financial position to the company (i.e., assets and liabilities) as appearing in the two latest audited balance sheets, alongwith details of contingent liabilities not provided for.

(v) Details regarding maximum amount of deposits which a company can accept.

(vi) A specific declaration that deposits accepted are unsecured and would rank pari passu with other unsecured liabilities.

(vii) A statement of deposits remaining unpaid.

Problems in Securities Markets

Securities markets are highly sensitive to any socio-economic and political factors. As such, the stock market is said to be the window of the economy. A large element of speculation is rampant in these markets and a right dose of regulation is a necessary evil. The sensitivity of external factors has increased after 1992 economic and financial reforms, when liberalisation and globalisation trends began to be perceptible.

Lack of professionalisation and broker-banks nexus has led to a number of scams. Even big banks got involved in Scams, in 1991-92 and 2000-01. Corruption and malpractices including mismanagement led to many bank failures, involving the U.T.I. as well. The trust and confidence reposed in the markets by investors were rudely shaken by the failure of U.S. 64 Scheme of UTI, urban corporative banks’ failures and non-refund of deposits by many financial and non-financial companies. The laxity in regulation and in supervision by C.L.B., SEBI and RBI is one obvious reason for increased malpractices in the financial system, shaking the confidence of savers and investors. The failure of global Trust Bank, and scam of Satyam Computers are examples of laxity in supervision.