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SELF-INSTRUCTIONAL STUDY MATERIAL FOR JGND PSOU

JAGAT GURU NANAK DEV
PUNJAB STATE OPEN UNIVERSITY, PATIALA
(Established by Act No. 19 of 2019 of the Legislature of State of Punjab)

BACHELOR OF COMMERCE (Hons.)
(Accounting and Taxation)

SEMESTER – IV

EC2B32401 T
E-FINANCIAL MARKET AND SERVICES

Head Quarter: C/28, The Lower Mall, Patiala-147001
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PREFACE

Jagat Guru Nanak Dev Punjab State Open University, Patiala was established in December 2019 by Act 19 of the Legislature of State of Punjab. It is the first and only Open University of the State, entrusted with the responsibility of making higher education accessible to all, especially to those sections of society who do not have the means, time or opportunity to pursue regular education.

In keeping with the nature of an Open University, this University provides a flexible education system to suit every need. The time given to complete a programme is double the duration of a regular mode programme. Well-designed study material has been prepared in consultation with experts in their respective fields.

The University offers programme is which have been designed to provide relevant, skill-based and employ ability-enhancing education. The study material provided in this booklet is self- instructional, with self-assessment exercises, and recommendations for further readings. The syllabus has been divided in sections, and provided as units for simplification.

The University has a network of Learner Support Centre /Study Centers, to enable students to make use of reading facilities, and for curriculum-based counseling and practical's. We, at the University, welcome you to be a part of this institution of knowledge.

Prof. G.S. Batra
Dean Academic Affairs

B. Com (Hons.)

(Accounting and Taxation)
Core Course (CC)

Semester IV

(BCB32401T): E- Financial Market and Services

MAX. MARKS: 100

EXTERNAL: 70

INTERNAL: 30

PASS: 40%

Objective: **Credits: 4**

Provide knowledge and understanding to the students regarding financial market and tools, technique, application and use of E- Financial services.

Course Outcomes:

CO 1: To remember the role and significance of the Indian financial market.

CO 2: To understand various financial services and financial intermediaries.

CO 3: To analyze the concepts relevant to Indian financial markets and financial institutions.

CO 4: To apply the various mechanisms, depositories bodies, statements, regulation and indices.

Section A

Block 1: (Introduction to Financial Services)

Financial Services, Characteristics and Kinds of financial services. Financial intermediaries rendering financial services. Role of financial services in Indian financial system.
Introduction meaning of equity shares. Evolution, structure and functions of equity market in India. Market For Equity – Primary Markets IPO – Methods followed. Book building.

Block 2: (Financial Markets)

Secondary Markets: Definition and functions of Stock Exchanges.
Meaning of financial market, Types of traders, Types of trade, Brokerage calculation.
Depositary: An Introduction. Practical aspects and background of Depositaries: NSDL, CDSL.
Statements: Holding Statement, Transaction Statement. Dematerialization Procedure

Section B

Block 3 :(DEMAT and Settlement Procedure)

DEMAT: Account Opening Procedure, Nomination Practices; off line Demat Account & Online Demat Account. Clearing & Settlement Procedure, Delivery Instruction Slip Practices for Depositary Participants & Beneficial Owner.

Block 4: (Trading on Stock Exchange)

Trader Work station: User Interface, Practical terminology and operation of work stations.
Trading on stock exchange: Online trading, Internet trading. Composition of Sensex, Nifty and

Sectoral indices.

Suggested Reading:

1. Mishkin, F. S., & Eakins, S. G. (2023). Financial markets and institutions. Pearson Education India.
2. Pathak, B. V. (2014). Indian financial system. Pearson Education India.
3. Falconer, S. (2014). Financial services management: a qualitative approach. Routledge.
4. Gordon, E., & Natarajan, K. (2009). Financial markets and services. Mumbai: Himalaya Publishing House.
5. Khan, M. Y. (2004). Financial services. Tata McGraw-Hill.

INSTRUCTIONS FOR THE PAPER SETTER/EXAMINER:

1. The syllabus prescribed should be strictly adhered to.
2. The question paper will consist of three sections: A, B, and C. Sections A and B will questions from the respective sections of the syllabus and will carry 10 will attempt two questions from each section. Have four marks each. The candidates Section C will have fifteen short answer questions covering the entire syllabus. Each question will carry 3 marks. Candidates will attempt any ten questions from this section.
3. The examiner shall give a clear instruction to the candidates to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated.
4. The duration of each paper will be three hours.

INSTRUCTIONS FOR THE CANDIDATES:

Candidates are required to attempt any two questions each from the sections A and B of the question paper and any ten short questions from Section C. They have to attempt questions only at one place and only once. Second or subsequent attempts, unless the earlier ones have been crossed out, shall not be evaluated.

B. COM (HONS.)

(Accounting and Taxation)
E-FINANCIAL MARKET AND SERVICES

SEMESTER - IV

SECTION A

Unit No.	Name of the Unit
Unit 1	**Introduction to Financial Services**
Unit 2	**Financial Markets**

SECTION B

Unit No.	Name of the Unit
Unit 3	**DEMAT and Settlement Procedure**
Unit 4	**Trading on Stock Exchange**

B. COM (HONS.)

(Accounting and Taxation)

COURSE: FINANCIAL MARKET AND SERVICES

SEMESTER - IV

UNIT I: Introduction to Financial Services

Structure

1.0 Objectives

1.1 Introduction

1.2 Evolution of Financial Services in India

1.3 Characteristics of Financial Services

1.4 Significance of Financial Services

1.5 Kinds of Financial Services

1.5.1 Fund Based Financial Services

1.5.2 Non-Fund Based Financial Services

1.6 Summary

Glossary

Long answer type questions

Short answer type questions

Suggested readings

1.0 Objectives

After studying the Unit, you would be able to understand:

- Role of Financial Services in Economic Development
- Evolution of Financial Services in India
- Various functions of Financial Services
- Characteristics of Financial Services
- Various kinds of Financial Services

1.1 Introduction

Since 1990, the financial services sector in India has changed significantly. Prior to its formation, the Indian industry's financial needs were handled by commercial banks and other financial institutions. Only with economic liberalization did the financial services industry start to become somewhat well-known. This industry has now grown out of this sector. In actuality, the financial services sector is currently among the biggest in the world. One crucial component of the financial system is financial services. A contemporary economy is built on the foundation of financial services. A country's financial services industry is essential to its economy.

All operations that are financial in nature can generally be classified as financial services. Financial services, as a whole, refer to the mobilization and allocation of savings. As a result, it covers every action required to convert savings into investments. Services offered by the finance sector are referred to as financial services. A wide variety of businesses that handle money management make up the financial sector. Banks, credit card firms, insurance providers, consumer financing providers, stockbrokers, investment funds, and certain government-sponsored businesses are some examples of these organizations.

The goods and services provided by financial institutions to enable different financial transactions and other associated activities can be categorized as financial services. Financial intermediation is another word for financial services. The practice of mobilizing money from several savers and making it accessible to everyone in need—especially business clients—is known as financial intermediation. A multitude of establishments provide financial services. Among the establishments are banks, mutual funds, leasing companies, factoring companies, merchant banks, accountancy firms, investment companies, and financial institutions. These organizations offer corporate businesses a range of services. We refer to these offerings as financial services.

Financial services are thus defined as services provided by financial service organizations

to final consumer markets and industrial companies. These infrastructure and services are necessary for the financial markets to run smoothly. Financial services are, to put it briefly, services supplied by financial intermediaries.

Financial services are provided by specialized organizations that coordinate the client's efforts to generate money, manage money, and turn savings into investments. Market participants, financial instruments, specialized institutions, and regulatory authorities make up the financial services. Merchant banking, underwriting, leasing, hire-purchase, housing and consumer finance, venture capital finance, factoring services, securitization, and credit rating are examples of specialized financial services.

Financial services providers include discount houses, depositories, venture capital firms, acceptance houses, credit rating agencies, and many other specialized institutions in the market. These institutions provide a variety of financial instruments, including debt, equity, hybrid, and financial engineering instruments. The Reserve Bank of India, the Securities Exchange Board of India, the Insurance Regulatory Development Authority, the Department of Banking, and the Central Government's Insurance are the primary regulatory bodies.

1.2 Evolution of Financial Services in India

The evolution of financial services in India has been a dynamic and transformative journey, marked by significant changes in policies, technology, and market dynamics. Here is a brief overview of the key milestones and trends in the evolution of financial services in India:

a) Pre-Independence Era:

- Traditional banking services were prevalent with a focus on rural credit and agricultural finance.
- The Reserve Bank of India (RBI) was established in 1935 as the central banking institution.

b) Post-Independence Era:

- Nationalization of Banks: In 1969, major banks were nationalized to promote financial inclusion and social objectives.
- Expansion of Branch Network: The government initiated efforts to expand the banking network to rural areas.

c) Liberalization (1990s):

- Economic Reforms: In 1991, India initiated economic reforms, liberalizing the financial sector and opening it up to private and foreign players.

- Introduction of New Financial Instruments: The introduction of new financial instruments, such as mutual funds, and the establishment of the National Stock Exchange (NSE) in 1992, contributed to the growth of capital markets.

d) Emergence of Private and Foreign Banks:

- Private Banks like HDFC Bank, ICICI Bank, and Axis Bank entered the market, bringing innovation and competition.
- Foreign banks were allowed to set up subsidiaries in India.

e) Technology and Digitalization:

- Introduction of Core Banking Solutions (CBS) to enhance efficiency and customer service.
- Growth of ATMs and online banking services.
- Digital Payment Revolution: The emergence of digital wallets, UPI (Unified Payments Interface), and mobile banking.

f) Government Initiatives:

- Demonetization in 2016 aimed at curbing black money and promoting digital transactions.
- Implementation of Goods and Services Tax (GST) for a unified tax system.

g) Recent Trends:

- Expansion of neo-banks and digital-only banks.
- Sustainable and responsible banking gaining importance.
- Continued focus on financial literacy and education.

1.3 Characteristics of Financial Services

We may comprehend the nature of financial services by looking at the following traits:

a) The majority of financial services are directed towards customers. Before choosing their financial plan, the companies that offer these services thoroughly analyses the demands of their clients, taking costs, liquidity, and maturity into account. Financial services companies are in constant communication with their clients in order to provide goods.

b) Intangibility: Financial services are characterized by their intangibility. As a result, they are neither standardized or repeatable in the same way. Customers should have more faith in the organizations providing the financial services and a better perception of them. If not, they might not be successful. They have to concentrate on the creativity and caliber of their offerings. Only then will they be able to establish their credibility and win the clients' trust.

c) Interdependence: Financial services must be produced and supplied concurrently.

Therefore, there needs to be complete communication and interdependence between financial service providers and their clients.

d) Concurrent: The provision of financial services and their production need to happen simultaneously. These two responsibilities, generating fresh and inventive financial services and offering them, must be carried out concurrently.

e) Perishability: Just like other services, the supply and demand for financial services must match. It is not possible to store services. When clients require them, you have to supply them.

f) Market dynamics: These include shifts in disposable income, living standards, and educational attainment among different customer segments. These factors all have a significant impact on market dynamics. The dynamics of the market must be taken into consideration as financial services are continuously redefined and improved.

g) Variability: Financial service companies must provide a broad range of goods and services in order to meet the diverse financial and related needs of various clients in various locations. This implies that financial services have to be customized to meet the needs of clients. In order to establish their unique character, the service institutions differentiate their offerings.

h) Human element dominance: The human element is the main factor in financial services. Financial services require a lot of manpower as a result. Marketing high-quality financial goods takes knowledgeable and experienced staff.

i) Information-based: Financial services sector is an Information based Industry. It includes the production, sharing, and application of information. A crucial element in the creation of financial services is information.

j) Intermediation: Financial institutions frequently serve as a bridge, bringing together individuals in need of money and those with surplus funds. The movement of money between savers and borrowers, investors and issuers, and buyers and sellers is facilitated by banks, investment firms, and other financial intermediaries.

k) Globalization: As communication and technology have advanced, financial services have become more globally integrated. Cross-border financial transactions, investments, and other activity can result in a global financial system that is increasingly integrated and interdependent.

1.4 Significance of Financial Services

Financial services play a crucial role in the functioning of modern economies and societies. Their significance extends to various levels, including individuals, businesses, and

governments. Here are some key aspects that highlight the importance of financial services:

a) Financial services facilitate the efficient allocation of capital by directing funds from savers to borrowers.

b) Financial services provide tools and instruments for managing and mitigating various types of risks.

c) Financial services encourage saving and investment by offering a range of products such as savings accounts, certificates of deposit, and investment funds.

d) Financial services assist individuals and families in managing their wealth.

e) Payment systems, electronic banking, and other financial services make it easier for individuals and businesses to conduct transactions.

f) Financial services support entrepreneurship by providing access to capital for startups and small businesses.

g) Financial services offer tools and products that can help individuals and businesses hedge against inflation.

h) The global nature of financial services facilitates international trade and investment.

i) Financial services are vital for governments to raise funds through bond issuance and manage fiscal policies.

j) Financial services contribute to overall economic stability by providing mechanisms for risk-sharing and diversification.

1.5 Kinds of Financial Services

1.5.1 Fund Based Financial Services

Fund-based financial services involve transactions and services that directly involve the lending or borrowing of money. These services typically involve the flow of funds from one party to another, and interest or other charges may be associated with the use of these funds. Here are some common examples of fund-based financial services:

a) Underwriting

Any person who assesses and takes on another party's risk in mortgages, insurance, loans, or investments in exchange for a fee—typically in the form of a commission, premium, spread, or interest—is an underwriter. Typically, an underwriter is a member of a financial organization. Underwriters attempt to ascertain whether sufficient collateral is available in the event of a default and whether the borrower would likely make payments on schedule. When it comes to insurance, underwriters work to distribute the prospective risk among as many people as they can by evaluating a policyholder's health and other variables. In the financial world, underwriters are essential to various sectors of the economy, including as

the mortgage, insurance, and equities markets, as well as certain popular forms of debt securities trading.

b) Dealing in Secondary Market Activities

Securities are purchased and sold by investors on the secondary market. Instead of coming from the corporations that issue the securities, trades occur on the secondary market between traders and other investors. The secondary market is commonly linked to the stock market. Secondary markets are national exchanges like the BSE, NSE, NASDAQ and the New York Stock Exchange (NYSE). Securities that are listed for sale on the primary market are then exchanged on the secondary market.

c) Participating in Money Market Instruments like CPs, CDs:

Securities issued for short-term (usually no more than a year) borrowing include Treasury bills (T-bills), commercial paper (CP), and certificates of deposit (CDs). Though these instruments are occasionally issued in denominations small enough for consumers to invest in them, professional investors are typically found in most markets. These investors include firms, fund managers, banks, etc. Typically, all three of these instruments are "negotiable," which means that they can be purchased and sold in the "secondary market" following their original issuance.

d) Equipment Leasing/Lease Financing

A lease is a contract that gives a business the use rights to capital assets, such as machinery, in exchange for a certain amount of money known as lease rentals. Lessees are those who purchase rights, either individually or as a business. He is not given possession of the item. All he gets is the ability to use the asset. The term "lessor" refers to the individual (or business) that grants the right.

e) Hire Purchase and Consumer Credit

Leasing has a substitute, hire purchase. In a hire purchase transaction, products are bought and sold with the requirement that payment be made in installments. The buyer is only given the things in possession. He is not granted ownership. Ownership is only transferred to him once the final installment being paid. The seller may take back the products if the buyer doesn't make any installment payments. Interest is also included in each installment.

f) Bill Discounting

One of the finance businesses' most alluring fund-based financial services is bill discounting. When a time bill is payable after a predetermined amount of time, the holder does not have to wait until the due date or maturity. He can negotiate a bill discount with

his banker if he needs money. The banker credits the customer's account with the remaining money after taking off a specified amount, or a discount. Therefore, after purchasing the bill, the bank credits the customer's account with the bill's total less the discount. The payee settles with the banking on the due date. The banker will retrieve the money from the client who reduced the cost if he doesn't pay. To put it briefly, discounting the bill refers to granting loans based on the security

a) **Venture Capital:** With the establishment of the Risk Capital Foundation (RCF), supported by the Industrial Finance Corporation of India (IFCI) to augment promoters' equity and encourage technologists and professionals to promote new industries, all India Financial Institutions introduced the concept of venture capital to the country. Generally speaking, venture capital refers to long-term investments in industrial enterprises with a strong potential for reward. This investment can be made at any point during the project's execution, from the beginning to the end of commercial production. Consequently, the organised financing of relatively nascent businesses with the goal of generating significant cash profits is known as venture capital. The phrase "venture capital" and this kind of investment both imply a high degree of risk.

b) **Housing Finance:** One of society's fundamental demands is housing. It is intimately related to the process of a nation's general socioeconomic growth. For a considerable amount of time, this industry was neglected. It was only taken into consideration in the Seventh and Eighth Five-Year Plans. The absence of better investment options may have contributed to the industry's current growth, as the banking sector has shown a strong interest in it. The current cost of a dwelling shelter is so expensive that a person's savings are insufficient to cover the costs of building a house. Consequently, there is a high demand for outside financing for homes. Consequently, there is a high demand for external housing finance. In order to capitalize on this circumstance, lending institutions are vying with one another for market share by providing their clients with extremely alluring terms, such as longer payment durations, more flexible collateral requirements, and cheaper interest rates. In addition to fixed rate products, several institutions have created variable rate products, which give the borrower the option of conversion for a small fee.

c) **Insurance Services:** Since insurance is, as we all know, the best way to manage risks, it is also known as "risk cover." Risk is nothing more than the possibility that a loss will occur, such as fatalities, accidents that result in lifelong disabilities, the loss of homes due to flooding, etc. Insurance is a contract between two parties. The insured is one party, and the insurer is the other. The individual whose life or property is covered by insurance is known as an insured person. In other words, the insured is the one whose risk is covered.

The insurance business to which the insured transfers risk is known as the insurer. In other words, the insurer is the one who assumes the risk on behalf of the insured.

d) **Factoring:** The needs of the Indian industries in the evolving business environment are met by factoring services. Its inception dates from the sixteenth century. Factoring is a business arrangement in which a financial institution or banks (the "factor") buys out the book debts of clients (the "suppliers") that deliver goods or services to their customers on credit.

Foreign languages, rules and customs, fear of distance, ocean barriers, and other issues are obstacles that prevent entrepreneurs from pursuing export business, hence impeding the nation's exports. With the use of a process called factoring, exporters can provide open account terms to their foreign clients without worrying about credit losses. The factory takes over the management of the customer's sales ledger, debtor follow-up, and credit risk assessment. The factory often charges a percentage of the factored receivables' worth as payment for these services.

e) **Forfaiting**: One method of financing receivables connected to international trade is forfeiting. It is the non-recourse acquisition of receivables resulting from the export of products and services by a banker or other financial institution. The exporter gives up his claim to future payment from the buyer to whom the items were delivered to the forfeiter. Through the use of forfaiting, an exporter can sell his goods on credit and still get paid well in advance of the due date. Forfaiting, to put it briefly, is a method wherein a finance agency, or forfeiter, discounts an export bill and gives the exporter immediate cash. Export bills do not require to be collected by the exporter. He merely needs to focus on exporting goods.

f) **Mutual Fund**: Mutual funds are financial intermediaries in the financial system that pool people's savings and use them to buy a variety of government and corporate securities. These securities are actively managed by the mutual fund operators, who get paid in dividends, interest, and capital gains. Eventually, the income is passed on to shareholders in mutual funds shareholders.

g) Overdraft Facilities

Account holders with overdraft privileges have the ability to take out more money from their bank accounts than what is actually there. It offers the possibility of short-term borrowing and levies interest on the overdraft amount.

h) Credit Cards

Credit cards offer their users a credit line that they can utilize to make purchases.

Cardholders are obligated to repay the borrowed amount by the due date, typically with interest, and are only able to borrow up to a specified amount.

i) Term Loans

Loans having a set payback period are known as term loans. They are frequently used for specific goals like capital expenditures, corporate expansion, or equipment purchases. They can be short-term or long-term.

j) Working Capital Financing

Working capital finance is giving companies the money they need to pay for salaries, inventories, and other operating costs in order to support their daily operations. Credit lines or loans may be used for this.

k) Mortgages

Long-term loans intended exclusively for the acquisition of real estate are called mortgages. The borrower repays the loan balance plus interest over a longer period of time, with the property acting as collateral for the loan.

l) Personal Loans

Unsecured loans for personal use, such as debt consolidation, medical costs, or travel, are known as personal loans. They might have higher interest rates, but they don't need collateral.

m) Vehicle Loans

Auto loans, commonly referred to as vehicle loans, are used to finance the purchase of automobiles. The car is used as collateral, and over a certain time period, debtors return the loan balance plus interest.

n) Trade Finance

Documentary credits, import financing, export financing, and other fund-based services are examples of trade finance. These services are meant to promote international trade. These services aid companies in handling the monetary facets of international trade.

o) Bridge Financing

Bridge finance, also known as bridge loans, are used frequently in real estate transactions or in the interim between buying and selling a property. They offer short-term funding to close a financial gap.

1.5.2 Non-Fund Based Services

a) Customers aren't content with just getting financing these days. People have higher

standards for financial service providers. As a result, financial service providers and intermediaries also offer services related to non-fund activities. These services are sometimes referred to as fee-based services. Among them are the following:

b) Merchant banking: Supplying non-fund-based services, such as organising money instead of supplying them, is the essence of merchant banking. The commercial banker serves only as a middleman. Transferring capital from those who own it to those who require it is its primary function. These days, a merchant banker serves as an organisation that comprehends the needs of banks, financial institutions, stock exchanges, and money marketplaces in addition to promoters. SEBI (Merchant Bankers) Rule, 1992 defines merchant banker as, "Any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing to securities, or acting as manager, consultant, advisor, or rendering corporate advisory services in relation to such issue management."

c) Credit rating: A credit rating is an expert assessment provided by a rating agency on the issuer of a debt instrument's relative willingness and capacity to fulfil its financial commitments on schedule and in full. Throughout the term of the rated instrument, it calculates the relative risk of an issuer's capacity and willingness to repay principal as well as interest. It is an assessment of the financial and commercial prospects of a company. Credit rating is, in essence, the evaluation of a company's creditworthiness by an impartial agency.

d) Stock broking: These days, stock broking is recognized as a form of expert advice. A member of an accredited stock exchange is a stockbroker. He trades shares and securities, buying and selling them. In order to conduct business as a broker, each stockbroker must register with SEBI. Being a stock exchange member, he will be subject to the rules, policies, bylaws and guidelines of the organization.

e) Custodial services: To put it simply, custodial services are services rendered by a custodian (custodian services). An organization or individual that receives securities from the owners of the securities for safekeeping is known as a custodian. A custodian is someone who looks after stocks or other public property. Custodians act as a middleman between businesses and their patrons, or security holders, and organizations, including mutual funds and financial institutions. The real owners of securities or properties and the custodian have an arrangement whereby the custodian will function as the custodian for the people who turn them over. Keeping the securities or papers in safe custody is the responsibility of a custodian. Being a custodian comes with a lot of risk and expense. He receives payment for providing his services in the form of custodial charges.

f) Loan syndication: A system known as loan syndication allows several banks to work together to supply money for a single loan. A collection of banks, ranging from 10 to 30, join in a loan syndication to supply funding, with one bank serving as the lead manager. Corporate firms choose this lead bank based on their level of trust in the lead manager. A large loan cannot be granted by one bank. Thus, multiple banks come together to establish a syndicate. We call this loan syndication. Thus, consortium financing and loan syndication are extremely similar.

g) Portfolio Management: The technique of managing an individual's investments to optimize profits within a certain time frame is known as portfolio management. These procedures also guarantee that individual investors' capital is not overexposed to market risk. The ability to make wise decisions is the foundation of the entire process. These decisions usually have to do with reaching a profitable investment mix, distributing assets based on risk and financial objectives, and diversifying resources to stop capital loss. Portfolio management primarily functions as a SWOT analysis of various investment routes, taking into account investors' risk tolerance and aims. Thus, it contributes to the generation of significant profits and the safeguarding of those profits from dangers.

h) Merger and Acquisition: Merger calls for the consolidation of two businesses into a single new company, presumably incorporating members of each business's previous ownership and management structure. The more popular way to distinguish a deal is to say if it's an acquisition (acquisition) or a favorable merger. Cash is not needed for mergers to happen, but each company's autonomy is diminished. When one business assumes full responsibility for all operational management decisions made by another, this is known as an acquisition. While acquisitions demand substantial sums of money, the buyer has complete control.

i) Restructuring: A corporation that undertakes a restructuring does so in order to make significant changes to both its financial and operational aspects. This typically occurs when industry demands or financial strains put the company under pressure, therefore the goal is to improve the company while minimizing financial harm. These include getting ready for an acquisition, buyout, merger, expansion, general direction change, or ownership transfer. At their core, companies require money in order to operate. This money might come from sales as well as capital infusions from loans and the sale of company equity.

j) Secularization (of debt): Customer loans are assets held by the bank. We refer to them as loan assets. Loan assets cannot be traded or transferred, in contrast to investment assets. Loan assets are therefore not liquid. How to make a bank loan liquid is the issue.

Converting the loans into tradable securities will fix this issue. Loans are now tradable. They acquire the attribute of being able to be sold. The secularization technique is used to accomplish this. One financial innovation is secularization. It involves converting projected or actual cash flows into securities that are marketable and available for purchase by investors. It is the procedure that turns financial assets into securities, including trade debtors, credit card balances, hire purchase debtors, lease receivables, and loan receivables.

k) **Debenture Trusteeship:** To keep the security documents in a secure location and hold the Security/Charge on behalf of the holders of debentures. To provide Issuer Company with advice regarding the process of creating a security and registering a debenture trust deed. To guarantee adherence to SEBI regulations, the Companies Act, 2013, and the Listing Agreement.

l) **Letter of Credit:** A letter of credit is a financial instrument that a bank issues on behalf of an importer or buyer to ensure that the seller or exporter will be paid if specific requirements are met. In order to reduce payment risks, it is frequently utilised in international trade.

m) **Bank Guarantees:** A bank's financial pledge to take on payment or performance obligations from a debtor is known as a bank guarantee. In business negotiations, they are frequently employed to reassure one party that the other would carry out its end of the bargain.

n) **Trade Finance Services:** Export credit insurance, bank guarantees, letters of credit, and other non-fund-based instruments are examples of trade finance services. These services lessen the risks involved in payment and delivery, which promotes international trade.

o) **Foreign Exchange Services**: Currency exchange, forward contracts, options, and other non-fund-based foreign exchange services are provided by banks and other financial institutions. These services assist companies in controlling currency risk when conducting international business.

p) **Advisory and Consultancy Services** In relation to financial management, risk assessment, mergers and acquisitions, and other strategic financial choices, financial institutions offer advising and consultation services. These services, which are frequently fee-based, are meant to assist consumers in making wise financial decisions.

q) **Escrow Services:** With escrow services, assets or money are held by a third party (the escrow agent) on behalf of two parties to a transaction. After a few requirements are satisfied, the money is sent to the appropriate party.

1.8 Treasury and Cash Management Services: To assist companies in managing liquidity, streamlining financial operations, and optimizing cash flows, financial institutions provide treasury and cash management services. Electronic funds transfers, disbursement services, and cash concentration are typical examples of these services.

1.6 Summary

Financial services are the foundation of economic activity because they offer the infrastructure and instruments that people, companies, and governments need to manage their money, distribute resources, and promote stability and growth in the economy. For society to be prosperous and generally well-off, financial services must be readily available and efficient. India's financial services industry has undergone a rapid and revolutionary transition, with notable shifts in market dynamics, technology, and policies. Financial services are primarily defined by their intangibility, globalization, information-based nature, perishability, variability, and inseparability. Financial services transmit savings from savers to borrowers, facilitating the effective allocation of capital. They also offer instruments and methods for risk management and mitigation.

Financial services facilitate the efficient allocation of capital by directing funds from savers to borrowers and it provide tools and instruments for managing and mitigating various types of risks. Fund-based financial services involve transactions and services that directly involve the lending or borrowing of money. These services typically involve the flow of funds from one party to another, and interest or other charges may be associated with the use of these funds. Some common examples of fund-based financial services are underwriting, dealing in secondary market activities, equipment leasing, hire purchase and customer credit, bill discounting, venture capital, housing finance, insurance services, factoring, forfaiting and mutual fund, overdraft facilities, term loans, working capital finance, mortgages, personal loans, vehicle loans, trade finance, bridge finance. Today, customers are not satisfied with the mere provision of finance. They expect more from financial service companies. Hence, the financial service companies or financial intermediaries provide services based on non-fund activities also. Such services are also known as fee-based services. These include merchant banking, credit rating, stock broking, custodial services, loan syndication, portfolio management, merger and acquisition, restructuring, securitization, debenture trusteeship, letter of credit, bank guarantees, trade finance services, foreign exchange services, advisory and consultation services, Escrow services, treasury and cash management services, derivatives trading.

Glossary

a) **Financial Services:** Activities offered by financial institutions such as banks, investment firms, insurance companies, and credit card companies, which encompass a wide range of services including banking, investing, insurance, and financial planning.

b) **Banking Services:** Services provided by banks including savings accounts, checking accounts, loans, mortgages, and credit cards.

c) **Investment Services:** Services related to investing money in various financial instruments such as stocks, bonds, mutual funds, and retirement accounts.

d) **Insurance Services:** Services provided by insurance companies including life insurance, health insurance, property insurance, and casualty insurance.

e) **Wealth Management:** Services aimed at managing and growing the wealth of individuals and families through investment advice, financial planning, retirement planning, and estate planning.

f) **Financial Planning:** Services focused on creating a comprehensive financial plan tailored to an individual's or a family's financial goals and circumstances, covering areas such as budgeting, saving, investing, retirement planning, and risk management.

g) **Credit Services:** Services related to extending credit to consumers and businesses, including credit cards, loans, mortgages, and lines of credit.

h) **Payment Services:** Services facilitating the transfer of funds between individuals, businesses, and institutions, including electronic payments, wire transfers, checks, and mobile payment solutions.

i) **Foreign Exchange Services:** Services related to currency exchange and foreign exchange transactions, including currency conversion, hedging, and international payment services.

j) **Risk Management Services:** Services aimed at identifying, assessing, and managing various types of financial risks faced by individuals and businesses, including market risk, credit risk, operational risk, and liquidity risk.

k) **Financial Advisory Services:** Services provided by financial advisors and wealth managers, offering personalized advice on investment strategies, asset allocation, portfolio management, and financial decision-making.

l) **Retirement Planning Services:** Services focused on helping individuals and families plan for retirement by setting financial goals, estimating retirement income needs, selecting retirement accounts, and developing retirement investment strategies.

m) **Estate Planning Services:** Services aimed at organizing and managing an individual's assets and affairs to ensure their smooth transfer to heirs or beneficiaries upon death, including wills, trusts, and estate administration.

n) **Tax Planning and Preparation Services**: Services focused on minimizing tax liabilities and maximizing tax efficiency through strategic tax planning, tax optimization strategies, and tax return preparation.

o) **Compliance and Regulatory Services:** Services aimed at ensuring compliance with financial regulations and regulatory requirements imposed by government authorities and regulatory bodies.

Long Answer Type Questions

a) State the features of financial services.

b) What are the characteristics of financial services?

c) Differentiate between fund based and fee based financial services?

d) State the significance of Financial Services.

e) What are the functions of Financial Services?

f) What are the challenges facing the Financial Services industry**?**

g) Investigate in detail the evolution of financial services in India.

h) Elaborate in detail the “Hire purchase and consumer credit” type of Financial Service.

i) Write a short note on Housing finance financial services.

j) Elaborate in detail the “Venture Capital” type of Financial Service.

Short Answer Type Questions

a) Define the term Financial Services.

b) Discuss in brief the concept of “Intangibility” in the context of financial services.

c) What do you understand by “Underwriting”?

d) Write a short note on Merchant Banking

e) Enlist the various functions of Stock Brooking

f) Discuss in brief the concept of “Variability” in the context of financial services.

g) What do you understand by “Credit Rating”?

h) Define Equipment leasing

i) Define Hire purchase

j) Define Bill discounting

Suggested Readings:

- **a)** Punithavathy Pandian (2009) ‘Financial Services and Markets’; Vikas Publishing House
- **b)** Gordon, Natarajan (2011) ‘Financial Markets and Services’; Himalaya Publishing House
- **c)** Sandeep Goel (2012) ‘Financial Services’; PHI Learning Private Ltd
- **d)** Siddaian T. (2011) ‘Financial Services’. Person Education, New Delhi
- **e)** Vij M. and Dhawan, S. (2012) ‘Merchant Banking and Financial Services’. Tata McGraw-Hill Education Private Ltd., New Delhi
- **f)** Gurusamy G. (2009) ‘Merchant Banking and Financial Services’. Tata McGraw-Hill Education Private Ltd., New Delhi
- **g)** Jain T. R. (2011) ‘Indian Financial System’. V K Global Publication Pvt. Ltd., New Delhi
- **h)** Gurusamy G. (2009) ‘Financial Services’. Tata McGraw-Hill Education Private Ltd., New Delhi
- **i)** Khan M.Y. (2010) ‘Financial Services’. Gurusamy G. (2009) ‘Merchant Banking and Financial Services’. Tata McGraw-Hill Education Private Ltd., New Delhi
- **j)** Rajesh Kothari (2010), Financial Services in India, Sage Publications, New Delhi.

B. COM (Hons.)

(Accounting and Taxation)

COURSE: E-FINANCIAL MARKET AND SERVICES

SEMESTER - IV

UNIT II: Financial Intermediaries Rendering Financial Services, Role of Financial Services in Indian Financial System

Structure

2.0 Objectives

2.1 Introduction

2.2 Basic Services Offered by the Financial Intermediaries

2.3 Benefits of Financial Intermediaries

2.4 Potential Problems of Financial Intermediaries

2.5 Functions of Financial Intermediaries

2.6 Classification of Financial Intermediaries

2.6.1 Capital Market Financial Intermediaries

2.6.2 Non-Banking Financial Intermediaries Involved in Primai Capital Market

2.6.3 Non-Banking Financial Intermediaries Involved in Secondary Capital Market

2.7 Summary

Glossary

Long answer type questions

Short answer type questions

Suggested Reading

2.0 Objectives

After studying the Unit, you would be able to understand:

- Basic Services Offered by the Financial Intermediaries
- Potential benefits of Financial Intermediaries
- Challenges associated with Financial Intermediaries
- Basic functions of Financial Intermediaries
- Detailed classification of Financial Intermediaries

2.1 Introduction

Financial intermediaries help the economy raise capital by obtaining excess funds from investors and lending them to borrowers. Financial intermediaries include non-financial organizations like stock exchanges, mutual fund firms, life insurance companies, and financial brokers, as well as banking organizations including commercial, development, and private banks.

A financial intermediary is a company or organization that serves as a mediator between a borrower and a saver. Both the borrower and the saver may be organizations or individuals. Financial intermediaries facilitates the mobilization of public funds for useful purposes and give the general people a return on their investment.

The public surplus fund is made available as a loan to individuals or institutions in need of money for regular business or daily expenses. Financial service providers make up the financial intermediaries. A bank, a non-banking finance company, or a mutual fund company can provide financial services. The consumer is a borrower who need money to do specific financial tasks. Many people have money left over after covering all of their expenses. They want to invest those money and get higher yields. Some borrowers, however, require finances in order to carry out their business activity. The middlemen that stand between those who want to invest their excess money and others in need of it are known as financial intermediaries. They transfer excess funds from savers, whether they are individuals or organizations, to either individual or institutional borrower.

Financial institutions serve as a conduit for the collection and distribution of the financial surpluses of certain social groups—such as households—to other social groups—such as firms—that are experiencing a deficit. This process is known as financial inter mediation. It is common knowledge that banks handle the task of receiving deposits from clients and extending credit to other clients. Comparably, insurance companies—especially those engaged in the long-term life assurance business—collect premiums from policyholders and use the stock market to invest the excess in business and industrial ventures Disruptions in the financial markets in any country can cause contagion that can spread quickly and have negative economic effects, as seen by the expanding magnitude of financial activity in relation to overall economic activity in a globally integrated world. Thus, the financial services industry's function as a financial intermediary is vital to mobilizing savings for investments.

2.2 Basic Services Offered by the Financial Intermediaries

The provision of financial advisory services to investors concerning the potential for investment or portfolio management; oversight of the real and financial markets; traditional transactions pertaining to the acquisition and disposal of financial assets on the market, as well as other transactions involving national and international payments and settlements; funding of economic activity, national and international investments, and foreign trade; managerial experience, such as providing business management consulting; underwriting financial operations; providing banking collateral's for foreign payments; providing insurance against financial risks; and collateralizing the issuance of financial securities.

2.3 Benefits of Financial Intermediaries

The primary benefits that arise from inter mediation on the domestic and global financial markets are ascertained by educating, counselling, and directly involving the users. Among these benefits are:

a) Financial advice provided to capital users and investors

b) The potential for more effective collection and evaluation of the market's current information.

c) Additional resources offered to capital owners and consumers, some of which are absorbed by intermediary organizations.

d) Cheaper search costs: It is up to a professional to discover the suitable lenders; specialist would this on your behalf.

e) Dispersing the risk. You can deposit money with a financial intermediary who lends to a range of borrowers rather than just one, so you won't lose all of your money if one of them defaults.

f) Economies of scale. A bank can become more productive in terms of lending and deposit collection. Lower average costs due to economies of scale are made possible. You could have to expend a lot of time and energy researching the most advantageous strategies to borrow and save if you had to look for your own savings.

2.4 Potential Problems of Financial Intermediaries

a) They may or may not distribute the risk. They might jeopardize depositors' money on poorly thought-out investment strategies as a result of inadequate management.

b) Bad information: Financial intermediaries have the potential to lose their depositors' money by investing in risky schemes and becoming careless about spreading the risk.

c) High transaction costs as a result of commissions, fees, and tax collection.

d) Loss of direct access to the global financial market, which makes certain investors less aware of the warning signals from the markets.

e) The interaction with the financial intermediary is routine, and many markets are guided by the solutions that significant intermediary firms have consistently provided over time.

2.5 Functions of Financial Intermediaries

The following list includes the several roles that financial intermediaries play:

a) Financial intermediaries' primary responsibility is to gather money from surplus fund units and direct it towards fund deficit units, or, in other words, to turn savings into investments.

b) To offer both long- and short-term loans.

c) Assisting customers in making the best investments possible to increase their profits.

d) To lower risk by spreading client savings over a range of financial products.

2.6 Classification of Financial Intermediaries

An essential part of a financial system are financial intermediaries. The most significant source of funding for a nation's manufacturing sector is its financial institutions. They are critical to the expansion and advancement of an economy. They assist in directing funds from fund surplus units to fund deficit units, thereby supplying capital to enterprises and industries. Their significance extends beyond the money market to the capital market. The following is a basic taxonomy of several financial firms that function as middlemen in the financial market:

2.6.1 Capital Market Financial Intermediaries

The capital market financial intermediaries are broadly divided into two categories:

a) Banking Institutions

The foundation of any nation's financial system is its banking sector. Both the money market and the capital market greatly depend on them. In the capital market, they provide medium term and long-term funds to the fund deficit units. By gathering money from the surplus funds units and distributing it to the fund deficit units, they act as a middleman between savers and borrowers. They are the creator as well as supplier of funds. They are separated into two groups: nationalized banks, commonly known as public sector banks, and private sector banks. Both international and Indian private banks are able to provide financial services in India. In addition to serving metropolitan India, there are numerous co-ops and Regional Rural Banks (RRBs) that provide financial services in rural areas. All of these banks are major players in the capital market.

b) Non-Banking Institutions

2.6.1 Development Financial Institutions (DFIs) at the national and state levels, Non-banking Finance Companies (NBFCs), mutual fund providers, investment firms, stock exchanges, depository participants, insurance companies etc. are examples of non-banking financial intermediaries. In the section that follows, each is discussed separately along with its function in the capital market. A wide range of financial services are available in both the primary and secondary capital markets through the numerous financial intermediaries that take part in the capital markets.

2.6.2 Non-Banking Financial Intermediaries Involved in Primary Capital Market

New securities are issued or new capital is raised in the primary market. Capital or funds are raised in the primary market through bonus issues, prospectuses, private placements, and rights offerings. Companies occasionally offer bonus shares to raise capital, lower the price of their stock, or improve stock liquidity. Bonus shares assist in turning retained earnings into capital rather than providing new capital. Through prospectus, public subscriptions, private placements, and rights offerings, banks and financial institutions, government and non-government organizations, and private firms in India can generate additional capital.

Public subscriptions and prospectus are how issues are made available to the general public. The firms appoint merchant bankers to coordinate these Public Issues initiatives. The SEBI-led process for Public Issues of new securities must be followed, and raising capital in this way is time- and money-consuming. Companies can raise capital more quickly through private placements of securities than through Public Issues. In a private

placement, the company offers securities to some selected individual investors or institutional investors without the need to submit a prospectus.

a) The primary market consists of three key players: the issuers of securities, the intermediaries, and the investors interested in purchasing these securities. The intermediaries are the organizations that offer services to other organizations in the selling and purchase of newly issued securities. Examples of intermediaries involved in the issuance of new securities include Book Running Lead Managers (BRLM), registrars, syndicate members, bankers, escrow companies, underwriters, depository participants, solicitors, auditors, and so on.

b) **Book Running Lead Managers (BRLM):** In accordance with the SEBI Merchant Bank Regulations, 1992, merchant bankers who are registered with SEBI are known as Book Running Lead Managers (BRLM). The lead merchant banker is responsible for carrying out all pre-issue tasks, including due diligence on management, operations, legal, business plans, and strategies; creating and designing offer documents; finagling the prospectus; selecting marketing strategies; and making sure that all formalities and requirements with the Registrars of Companies (ROC) and Stock Exchanges are fulfilled. The chief merchant banker takes on post-issue duty following the public offer. Post-issuance activities include overseeing the escrow accounts where public applicants for the new issue deposit their funds, liaising with other intermediaries involved in the process, notifying applicants of their securities allocation, non-institutional allocation, listing and trading securities, dematerializing securities, and arranging with registrars to send refunds to applicants who were not successful in receiving their securities allotted.

(c) Registrar to the Issue:

- In the context of securities offerings, a registrar to the issue is a financial institution responsible for ensuring the proper distribution and allotment of securities during an initial public offering (IPO) or a rights issue.
- The registrar works closely with the company issuing securities, managing the application and allotment process, handling the refund process for unsuccessful applicants, and maintaining records of shareholders.
- The role of the registrar is crucial for maintaining transparency and efficiency in the issuance of securities.

(d)Banker to the Issue:

- The banker to the issue is another key entity involved in the process of issuing securities. This could be a financial institution appointed by the issuer company.

- The banker to the issue handles the collection of application money from investors during the IPO or rights issue. They may provide various channels for investors to make payments, such as through banks or online platforms.
- The banker to the issue works in coordination with the registrar to ensure a smooth and organized collection of funds from investors.

2.6.3 Non-**Banking Financial Intermediaries Involved in Secondary Market**

The secondary market is commonly called the stock market. It is the market where the existing securities are bought and sold again.

a) Commercial Banks

The main element of the structured financial system is made up of commercial banks. Commercial banks' primary job is to receive deposits from savers, both individually and institutionally, and then transfer these funds to borrowers, also individually and institutionally. They both create things and give people and organizations credit for them. Financial services are offered to the money and capital markets by commercial banks.

Commercial banks have begun to diversify their sources of funding during the past few decades. They are now more than just deposit or lending banks, and their reach extends beyond the money market. By directly subscribing to the shares and debentures of corporate firms and making loans against them, they have successfully entered the capital market. They handle the payment process in stock trading and play a significant role as financial intermediaries. When someone sells shares, his bank account is credited with the proceeds after all brokerage and other costs are subtracted. In a similar vein, an individual's bank account will be debited the amount of shares they purchase. Banks also serve as securities custodians on behalf of their merchant banking businesses.

In the capital markets, banks can have a variety of responsibilities. Here is a summary of them:

- A financial securities investor, holding stocks, debentures, and equity oriented mutual funds.
- Providing loans to people so they can make capital market investments.
- Lender for making advances to individuals secured against financial securities.
- Provide advances to market makers and sub-brokers as a lender.
- A lender to stockbrokers for margin trading.
- Lenders issue loans for any purpose where financial securities like shares,

debentures, etc. are taken as primary security,

- Offering funds for venture capital.
- Offering bank loans to cover the promoter's contribution.
- Lending money to corporations in exchange for securities such as shares and debentures.
- Presenting organizations with bridge loans secured by expected equity flow or issues.

b) Non-Banking Financial Companies (NBFC)

Non-Banking **Financial Companies** resemble commercial banks in many ways, with the exception that their deposits are not included in the money supply. They take deposits from the general public and lend the money of one year more. They offer a range of services, some of which are mentioned below:

- Offering advisory services to businesses on a range of financial concerns, underwriting new issues, corporate mergers, and loan syndication.
- Financing households to buy durable goods for their homes.
- Letting equipment on lease.
- Financing businesses who want to buy industrial equipment on a hire-purchase basis.
- Factoring services
- Evaluating and disseminating information about the creditworthiness of different corporate houses.

NBFC are the major player in the capital market. Certain NBFCs are specialized and solely deal in securities trading. Their sole activity consists of stock market investing. They also lend money to investors so they can make capital market purchases. As a result, they play a crucial role as financial intermediaries in the capital market by supplying liquidity. The following sums up their function in the capital market:

- Investment Company: These are banks whose primary activity on the capital market is the purchase and sale of securities.
- Provide services for portfolio management.

c) Development Financial Institutions (DFIs)

These financial institutions were set up by governments or nonprofit organizations to support economic development initiatives. They go under the name Development Finance Companies as well. On a non-commercial basis, they offer capital to particular industries. Instead of taking deposits from the general public, they either borrow money from the government or make public bonds available for purchase. They offer services like underwriting, consulting, corporate guarantor to the bank, subscribers of securities like shares, debentures, etc., and financial and technical support to a variety of sectors.

- The Industrial Development Bank of India (IDBI)
- Industrial Reconstruction Corporation of India (IRCI)
- Export-Import Bank (EXIM),
- Export-Finance Corporation of India (IFCI)
- State Financial Corporations (SFCs)
- National Industrial Development Corporation (NIDC),
- National Bank for Agriculture and Rural Development (NABARD)
- Industrial Finance Corporation of India (IFCI) are among the several development finance institutions in India

d) Mutual Funds

Mutual funds function as financial intermediaries, gathering consumer money and allocating them to a variety of government and corporate securities. These securities are actively managed by the mutual fund operators, who get paid in dividends, interest, and capital gains. Eventually, the income is distributed to shareholders in mutual funds. Naturally, the open-ended nature of mutual funds guarantees that you will always have access to funds at short notice. In other words, the scheme purchases securities on behalf of unit holders, keeps track of interest and dividend payments from these securities, and sells the securities when you need cash.

Investors may purchase units of the scheme on stock exchanges where they are listed, or they may choose to purchase or sell them at the time of an initial public offering (IPO). Alternatively, they may choose to participate in closed-ended funds. Certain schemes provide the option of selling the units back to the mutual fund through repurchases on a periodic basis at prices linked to NAV. Investors must be given access to at least one of the two exit options, per SEBI regulations. The tax refund is an additional benefit of pension plans and tax-saving Equity Linked Savings Schemes (ELSS).

e) Insurance Companies

In the capital market, insurance companies have grown to be crucial middlemen. In addition to life insurance, these companies provide a range of investment program mes. The capital market is where the funds gathered from participants in these schemes are invested. In India, there are numerous public and private insurance companies offering their services. Their substantial financial resources are allocated to investments in capital markets and currency. The Life Insurance Corporation of India (LIC), Oriental Insurance Company, General Insurance Corporation of India (GIC), United India Insurance Company Ltd., National Insurance Company, SBI Insurance, HDFC Life, and other well-known insurance companies are among those operating in India.

f) Stockbrokers

Stockbrokers are people or businesses that are registered with a stock exchange and who can purchase or sell shares for institutional and retail clients. They serve as the entrance to the reputable stock exchange of which they are members. For the services they render, they charge fees. Trading platforms, call and trade facilities, buying and selling securities on behalf of clients, issuing contract notes for transactions, and other services are among the many that they provide.

g) Underwriters

Underwriters are the people or organizations that take on the risk involved in securities distribution from the issuing entity and public issues of securities. In the event that the public does not fully subscribe to the Initial Public Offering (IPO), the underwriter undertakes to buy a specific proportion of the company's shares. The price and risk of a specific stock are set by the underwriter in the capital market. Investment banks purchase or underwrite the issuing company's securities prior to selling them on the open market in initial public offerings (IPOs). The issuers receive a fully subscribed IPO, and the underwriters receive a premium for this service. Investors can make better-informed and wiser investment decisions with the assistance of the underwriters' information.

h) Depository and Depository Participants (DP)

The shares were originally issued as actual paper documents before 1996. An investor used to receive actual paper shares from a corporation whenever he bought shares. Maintaining these shares and keeping them safe from loss or destruction proved challenging. These tangible shares were turned into digital form, or "dematerialized form,". These demat shares require an account to be held in, just like bank accounts. Digital securities are kept in these accounts, which go by the name of "demat

accounts."

Financial securities are kept in digital or dematerialized form in depositories. It keeps track of ownership information and makes dematerialized securities trading easier. There are now two depositories in India. They are Central Depository Services (India) Limited (CDSL) and National Securities Depository Limited (NSDL). It has been required to retain securities in digital form in a demat account since 1996. Agents of a depository acting as go-betweens for depositories and investors are known as depository participants. Investors must open a demat account with a depository participant in order to use depository services. Investors can simply purchase or sell assets online using a demat account.

i) Clearing Corporations

The organizations set up to oversee transaction execution, money settlement, and securities delivery are known as clearing firms, or clearing corporations. The Clearing Corporation of India Limited (CCIL) was founded in 2001 to manage trading, clearing, and settlement of transactions in the stock market. The Clearing Corporation of India Limited (CCIL) is a subsidiary of the Bombay Stock Exchange. The National Security Clearing Corporation Ltd. (NSCCL), a wholly owned subsidiary of the National Stock Exchange (NSE), was founded to clear transaction settlements.

Ensuring successful trade closure and facilitating a seamless transaction process for both buyers and sellers are the roles played by clearing corporations. It also guarantees that the settlement happens quickly. It offers a counter-party risk assurance in addition to monitoring transaction risk. The primary role of CCIL is to efficiently handle transaction settlements, prevent operational problems, and shield the financial system from associated risk.

Clearing corporations perform following functions:

- Assured security transaction clearing and settlements in the capital market.
- Making sure security transactions are transparent.
- Management of liquidity risk by guaranteeing that, when the securities transaction is completed, neither the seller nor the buyer will default.
- Risk management to guarantee that, in the event that an investor defaults, the investors suffer insignificant procedural losses in the transaction.
- Increasing market efficiency.

j) Registrars

An organization or trust that keeps thorough records of every securities transaction an issuer makes available to the public is known as a registrar. Registrars keep track of every record of securities issued and update them periodically. Records includes the name, address, quantity of securities purchased, signature, and so on. They take on a number of duties, including paying debentures and issuing new share certificates in the event that the originals are lost or damaged. The following lists the several duties and roles that registrars perform:

- Keep a record of shareholders and update it periodically.
- If a shareholder has misplaced or mislaid their certificate, share certificates should be issued to both new and current shareholders.
- Organizing AGM, or annual general meeting.
- Distribute annual reports to every shareholder.
- Keep an eye on the distribution of dividends to shareholders.
- Assisting with the transfer of shares with the event that a mutual transfer occurs or an existing shareholder passes away.
- Print the holding statements for the client and the broker.

k) Stock Exchanges

Stock exchanges were created to make the process of purchasing and selling shares easier. It's a marketplace where investors can purchase or sell company stock. A stock exchange is defined as "a body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling, or dealing in securities," according to Section 2(3) of the Securities Contracts (Regulation) Act, 1956. Facilitating stock transactions and the complete stock trading process is the stock exchange's primary purpose. To generate income, stock exchanges charge transaction fees. In India, equities are traded on regional stock markets, the National Stock Exchange (NSE), and the Bombay Stock Exchange (BSE).

2.7 Summary

A financial system consists of four key elements: financial markets, financial institutions, financial instruments, and financial services. Financial institutions also known as financial intermediaries help the economy raise capital by obtaining excess funds from investors and lending them to borrowers. They support the financial exchange that takes place between borrowers and investors. Financial consulting, which is provided to investors regarding the potential for investment or the management of an

owned portfolio, as well as the oversight of the real and financial markets, constitutes the fundamental services provided by financial intermediaries. The primary benefits of Financial Intermediaries include lower search costs, easier access to quantities, and financial advice provided to capital users and investors.

Financial intermediaries may run the danger of losing depositors' money on poorly thought-out investment plans and incurring significant transaction expenses as a result of collecting taxes, fees, and commissions. Financial intermediaries' primary responsibility is to gather money from surplus fund units and transfer it to fund deficit units, or, in other words, to turn savings into investments. Book Running Lead Managers (BRLM), registrars to the issues, syndicate members, bankers to the issue, escrow companies, underwriters, depository participants, solicitors, auditors, and so on are some of the intermediaries involved in the new securities issuance. A negotiation, investment agreement, business contract, etc. can be facilitated by individuals, financial institutions, or non-financial organizations acting as intermediates in the capital market. The Indian capital market is home to a wide range of financial intermediaries. Commercial banks, non-bank financial Companies (NBFCs), stockbrokers, underwriters, registrars, stock exchanges, mutual fund companies, insurance companies, clearing organizations, and so on are among them.

Glossary

a) **Financial System:** The financial system refers to the system that facilitates the transfer of funds between savers (investors) and borrowers (companies or governments). It includes financial institutions, markets, instruments, and regulatory bodies.

b) **Financial Intermediaries:** Financial intermediaries are institutions that act as a middleman between savers and borrowers. They accept funds from savers and provide them to borrowers. Examples include banks, credit unions, and insurance companies.

c) **Financial Market:** A financial market is a marketplace where buyers and sellers trade financial instruments such as stocks, bonds, commodities, and derivatives. Financial markets can be classified into money markets and capital markets.

d) **Capital Market:** The capital market is a segment of the financial market where long-term securities (stocks and bonds) are bought and sold. It consists of the primary market (new securities are issued) and the secondary market (existing securities are traded).

e) **Money Market:** The money market deals with short-term debt instruments with

maturities typically less than one year. It includes instruments like Treasury bills, commercial paper, and certificates of deposit.

f) **Financial Instruments:** Financial instruments are tradable assets that represent a financial agreement between two parties. Examples include stocks, bonds, derivatives, and certificates of deposit.

g) **SEBI (Securities and Exchange Board of India):** SEBI is the regulatory body in India that oversees the securities and commodity market. Its role includes protecting the interests of investors, promoting the development of the securities market, and regulating stock exchanges and intermediaries.

h) **NBFC (Non-Banking Financial Company):** NBFCs are financial institutions that provide banking services without meeting the legal definition of a bank. They may offer services such as loans, credit facilities, and investment products.

i) **Stock Broker:** A stock broker is an individual or firm that facilitates the buying and selling of stocks on a stock exchange. They execute trades on behalf of investors.

j) **Underwriters:** Underwriters are entities that assume the risk of selling newly issued securities to the public. They guarantee a certain price to the issuing company and then sell the securities to investors.

k) **Stock Exchange:** A stock exchange is a marketplace where buyers and sellers trade stocks and other securities. Examples include the New York Stock Exchange (NYSE) and the Bombay Stock Exchange (BSE).

Long Answer Type Questions

a) State the need of Financial Intermediary

b) Discuss the Basic Services Offered by the Financial Intermediaries

c) What are the potential benefits of Financial Intermediaries?

d) Investigate in detail the problems encountered with Financial Intermediaries

e) Enlist the various advantages of Financial Intermediaries

f) Investigate in detail the various aspects of "Mutual Funds".

g) Enlist the various functions of Financial Intermediaries

h) Elaborate the various functions of "Development Financial Institutions".

i) Discuss the role of "Insurance Companies" as Financial Intermediary.

j) State the differences between Stockbrokers and Underwriters.

Short Answer Type Questions

a) Define the term Financial Intermediary.

b) What are NBFCs?

c) What do you understand by “Capital Market Financial Intermediaries”.

d) Explain “Book Running Lead Managers”.

e) Enlist the various functions of Stock Broking.

f) Discuss in brief the significance of National Securities Depository Limited (NSDL).

g) What do you understand by “Clearing Corporations”?

h) Expand SEBI.

i) Who is Banker to an Issue?

j) Define Commercial Banks.

Suggested Readings

a) Gurusamy G. (2009) ‘Merchant Banking and Financial Services’. Tata McGraw-Hill Education Private Ltd., New Delhi

b) Jain T. R. (2011) ‘Indian Financial System’. V K Global Publication Pvt. Ltd., New Delhi

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B. COM (Hons.)

(Accounting and Taxation)

Semester IV

E- Financial Markets and Services BCDB33606T

UNIT III- Introduction Meaning of equity shares. Evolution, structure and functions of equity market in India. Market For Equity – Primary Markets IPO – Methods followed. Book building

Structure:

3.1 **Equity shares: Introduction**

3.2 Equity Shares: Salient Features

3.3 Equity market: Meaning

3.4 Stock valuation and ownership stake

3.4.1 Stock

3.4.2 Stock valuation on the basis of P/E ratio

3.5 Structure of Indian stock market

3.6 Functions of Indian stock market

3.7 Market for Equity

3.7.1 Initial Public Offering (IPO)

3.7.2 Subsequent offers

3.8 Process of Book Building

3.9 Summary

Glossary

Long Answer Type Questions

Short Answer Type Questions

Suggested Reading

3.0 Objectives

- After studying the Unit, students would be able to understand:
- Concept of Equity Market
- Various Features of Equity Market
- Stock valuation and ownership stake
- Structure of Indian stock market
- Functions of Indian stock market
- Initial Public Offering
- Process of Book Building

3.1 Equity Shares: Introduction

Whenever any business concern starts their venture, they have two choices available with them to arrange funds. First choice is to arrange funds from investors as owner i.e. equity investment. Second choice can be to borrow funds in the form of debentures. Equity shares become their preferred choice being long term financing option. Each equity share represents a unit of part ownership in the business. Being real owner of the company, equity shareholders get voting right where they are entitled to take part in the decision making of company.

A share is a partial ownership in the company. When a company is formed, the initial capital amount is invested by investors and partners of the company. As the company grows, the requirement of capital increases. There are various ways to raise capital like loans from banks and other financial institutions, approaching investors, adding partners for expertise and capital. The most common way to raise capital is by issuing equity shares. An equity share, also known as ordinary share represents a part ownership where each member is a fractional owner. Equity shares are a long term financial sources for any company. Although degree of risk in equity shares is comparatively high but they generally provide high rate of return also. In addition to this being an equity shareholder gives the investor right to vote, share profits and claim assets of the company. Investing in equity shares has its own benefits.

- Investment in equity shares boosts wealth creation through dividend and appreciation of existing investment which improves standard of living.
- Money invested in equity shares provides return, higher than the rate of inflation. Thus the real value of investments tends to rise over time.

- An investor can benefit from portfolio diversification where investor can invest in shares of multiple companies on the basis of his knowledge and can benefit from the price fluctuations.

3.2 Equity Shares: Salient Features

Below mentioned are some of the important features of equity shares:

- **Ownership**: Equity shares are entitled with voting right which means they can participate in the decision making of business. Each equity share typically carries one voting right which allows them to approve or reject major corporate decision.
- **Return**: Part of profits is distributed among equity shareholders in the form of dividend. However, return on equity through dividend is not fixed. It varies depending on decision of management and as approved by shareholders. Dividend return on equity is not guaranteed return. Company may decide to distribute more profits in the form of dividend if they don't aim for any future investment proposal. Else, they may prefer to retain profits for reinvestment and declare lesser dividend
- **Residual claim**: Equity shareholders are paid in last in the event of winding up of company. Hence, as a preference order, whenever company is liquidated and dues are paid from financial assets of the company then the first preference will be to the debenture holders, second to the preference shareholders. Any residual assets will be claimed by equity shareholders
- **Risk and volatility**: As compared to other forms of investment, Equity shares carry highest degree of risk. Shares prices are volatile and may fluctuate depending upon many unknown factors.
- **Limited liability:** It means liability of equity shares is limited to the extent of their investment only. Hence, in case of financial losses, Shareholders are not personally liable beyond their committed investment
- **Preemptive Right**: It is also known as right of first refusal. This means whenever new shares are issued by company, Existing equity shareholders have right to purchase new shares before they are offered to others

3.3 Equity Market: Meaning

An equity market is a market in which shares of companies are issued and traded, either through exchanges or over-the-counter markets. Commonly known as the stock market, it is one of the most crucial elements of a market economy. It gives companies access to capital to grow their business, and investors a piece of ownership in a company with the potential to realize gains in their investment based on the company's future performance.

The idea underlying how the stock market operates is straightforward. Think of an auction house where buyers and sellers negotiate prices and make trades. Replace the auction house and the objects with the stock market and the shares. An exchange is where businesses list their shares. Shares are available for purchase on both the primary market, or IPOs, and the secondary market. Financial watchdogs oversee the regulation of the stock market. Stock exchanges, as well as numerous stakeholders like brokers, dealers, clearing corporations, etc., maintain the equity market. It is an extended family of institutions and this is the true equity market meaning.

3.4 Stock Valuation and Ownership Stake

3.4.1 Stock

The ownership stake in a corporation that is represented by a single share is relatively tiny. By dividing the number of shares you possess by the total number of shares outstanding and multiplying the result by 100, stockholders can calculate their ownership stake in a corporation. The typical benefit of owning stock in a firm is the ability to vote on corporate matters and receive dividend payments.

3.4.2 Stock Valuation on the Basis of P/E ratio

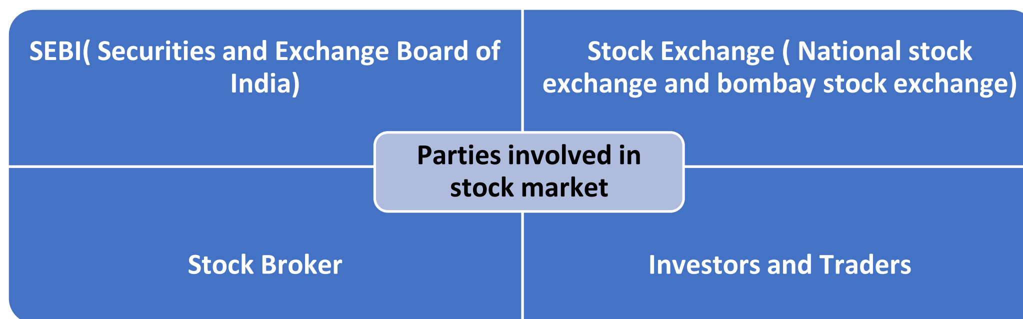
The price-to-earnings (P/E) ratio of the company is the most used method of stock valuation. The P/E ratio is calculated by dividing the stock price by the most recent reported earnings per share for the company (EPS). A low P/E ratio suggests that a company is offering an appealing amount of value to the person purchasing it. It helps the investor to analyse how much to pay for a stock on the basis of its current earnings. It also helps in determining the valuation of a company.

Earnings Per Share= Earnings of the company / No. of shares outstanding

P/E ratio= Current price / EPS

3.5 Structure of Indian Stock Market

The stock market is an avenue where investors trade in shares, bonds, and derivatives. Stock exchanges, which can be thought of as markets that connect buyers and sellers, facilitate this trading. Parties involved in the stock market are:-



a) **Securities and Exchange Board of India (SEBI):** SEBI oversees the smooth operation of India's securities markets as the country's stock market regulator. The Securities and Exchange Board of India (SEBI) is a government organization that controls the capital markets to safeguard investors from fraud. The term "regulation" refers to the measures taken by organizations established by the government to regulate certain aspects of the capital markets. It is the only organization that controls the Indian Capital Market.

- **Stock Exchange:** Companies are listed on two main stock exchanges. The National Stock Exchange and the Bombay Stock Exchange (BSE) (NSE)
- **Stock Broker:** A broker is a middleman who, in exchange for a fee or a commission, carries out buy and sell orders for investors.
- **Investors and Traders**: Investors are individuals who purchase stocks to become part owners in the company.

Types of Market

1) **Primary Market** - The main market generally focuses on new securities that are first introduced to the stock market. As a result, it is also known as the "new issue market." The main objective of the primary market is to facilitate the transfer of newly issued shares to the public by firms. The major investors in this type of market include banks, financial institutions, and others.
2) **Secondary Market**- The secondary market is where shares of a company are traded after being initially offered to the public in the market where buyers and sellers meet directly.

3.6 Functions of Indian Stock Market

Equity market or share market plays a very dominant role in the Indian Financial System. It is a common platform to buy or sell equity shares of publicly listed companies. Main functions of Indian equity market are:

- **Capital Formation**: In the capital markets, there are two groups of people: investors who don't immediately need money and debtors who do. The capital markets make it possible to invest extra money rather than letting kept idle. As a result, it allows businesses the option to borrow money instead of keeping it in a bank account to invest in new

machinery or other capital equipment. In return, the company gains access to more efficient equipment and the investor get benefit of receiving dividend on surplus funds invested. Basically, through equity market companies can raise funds by issuing equity shares to the public through Initial Public Offering (IPO). Companies may use these funds to expand their business, conducting R&D for new product innovation, acquisitions etc.

- **Lack of Entry and Exit Barriers**: Investors now frequently trade on mobile devices, making financial markets more accessible than ever. Almost anybody may now access financial markets because to the development of technology. As soon as they open an account with a broker, investors are essentially ready to make investments. In addition, there are now international markets. People can exit the market just as rapidly as they joined due to the rise in asset demand.
- **Trading Platform:** Equity Market in India provides a regulated platform to investors and borrowers where they can buy or sell equity shares based on their investment objectives. This market ensures liquidity by matching time preferences of borrowers and investors and also establish fair price by managing demand and supply forces.
- **Liquidity:** Due to the existence of the financial markets, people who have money can invest it. In return, they get to be the owner of a bond or stock. It can be necessary to liquidate the bond certificates since they cannot be used to buy a car, food, or other assets. Selling assets to a third party for liquid monies on the capital markets is a reasonably simple process for investors (cash). If one wants to sell something at the going rate, there is almost always a market for it, allowing you to turn the asset into real money.
- **Wider Opportunities to Investors:** Investors can enhance their savings by investing in stock market which provides returns higher than traditional banking system. All the information is provided to the investors about the companies in which they wish to invest in the stock market. Hence, equity market offers investment opportunities to both individual as well as institutional investors to participate in the growth potential of listed companies. Investor can choose from wide variety of available shares depending upon their sect oral preference, Size of business, risk profile etc.
- **Economic Growth:** As stock market provides investment opportunities, it boosts savings and further it helps in raising fund for the new and existing projects which also provides employment opportunities. Thereby, an economy grows with it. When an economy is in favorable condition, the price of stock rises and vice versa. The proceeds from the investment can further be utilized by any country for technology advancement, enrich human capital and better production. Hence, Performance of equity market is an

important indicator. It simply provides light on overall economy, investors' sentiments, market confidence etc. In India, BSE Sensex and NSE Nifty are closely observed by financial analysts and experts to understand economic trends

- **Price Discovery:** As the stock market is highly sensitive to various factors such as media, economic factors, company's financial and social position etc. These factors affect the price of any stock. Stock market is a place where buyers and sellers meet at a single place and facilitate the regulation of price. Equity market in India facilitates fair price discovery through adjustment in market forces. Price discovery enables the investors to get information about market sentiments and perceived value of companies.

3.7 Market for Equity

As a business starts growing, the need for finance also grows. The business houses arrange the finance through their individual capitals, bank loans, credit limits, etc. But these sources work up to a limit, at a point to raise their business they have changed the nature of the organization to a company/listed company where they can finance their business need through the general public. Then, these companies issue equity shares to the general public in exchange for funds for their future business plans and expansions. As discussed previously, Equity shares are ordinary shares that provide the investors/subscribers of it with ownership rights, voting rights, dividend rights, etc. Subscribers to the equity may trade these shares at the stock exchange anytime and can liquidate the money they have invested in it. Dividends and appreciation of capital are a few other important benefits of investing in equity.

The market for equity, also known as the stock market or the equity market, is a financial market where shares of publicly traded companies are bought and sold. It is a vital component of the broader financial system and serves as a platform for companies to raise capital and for investors to buy and sell ownership stakes in those companies.

In the equity market, companies can issue shares of stock through an initial public offering (IPO) or subsequent offerings. These shares represent ownership in the company and provide certain rights and privileges to the subscriber, such as voting rights and a claim on the company's assets and earnings. Both individual and institutional investors participate in the equity market by buying and selling shares. They may aim to generate returns through capital appreciation (buying low and selling high) or through dividends that companies distribute to their shareholders. The equity market operates through stock exchanges, where the trading of shares takes place. Examples of well-known stock exchanges include the National Stock Exchange (NSE), Bombay Stock Exchange (BSE), New York Stock Exchange (NYSE), NASDAQ, London Stock Exchange (LSE), and

Tokyo Stock Exchange (TSE).

In the case of private companies, equities are subscribed through private placements, ESOPs, convertible securities, and right offerings, etc. They don't have any right to go for public issues. But in case, these companies want to raise funds publicly, they must have to convert into a public company. Listing is one additional mandatory requirement to trade at any stock exchange. However, companies can issue securities through two modes

a) Initial Public offering (IPO)

b) Subsequent Offers such as Follow on Public offering (FPOs), offer for sale (OFS), Institutional placement Program (IPP), bonus issues, right issues, etc.

3.7.1 Initial Public Offer (IPO)

Requirement of funds by companies for the purpose of expansion, acquisition or repaying debt may lead the business firms towards going public through IPO. Initial Public Offering (IPO) is the process through which a private company offers its shares to the public for the first time, thereby becoming a publicly traded company. This is very important event in the life cycle of any company as it transforms from privately owned to publicly traded entity. The company desirous of going public through IPO appoints one or more (depending upon the size of issue) investment banks as underwriter. This underwriter helps them in assessing the required documentation, determining the offer price, marketing of shares etc.

The IPO process involves several key steps and methods. Here are the two common methods of IPO which prevail in the Indian market:

a) **Book Building**: Book building is a price discovery method commonly used in IPOs. In case of book building offer price of shares is determined through process whereby potential investors indicate number of shares they are willing to buy and at what price? The company and its underwriters solicit indications of interest from potential investors, determining the demand for the shares and the price range at which investors are willing to buy. Based on this feedback, the final offer price is determined. The allocation of shares among individual and institutional investors is also determined

b) **Fixed Price IPO**: In a fixed price IPO, the company and its underwriters set a fixed price at which the shares will be offered to the public. Investors who wish to participate in the IPO can subscribe to the shares at the predetermined price.

An IPO ensures the company availability of investible funds i.e access to capital, and liquidity for shareholders. It also provides increased regulatory scrutiny and accountability. On the other side, investors get opportunity to participate in growing companies and get benefits through share trading. It's important to understand that the

specific method used for an IPO depends on various factors, including the company's size, industry, market conditions, and regulatory requirements in the relevant jurisdiction. The company and its advisors determine the most appropriate method to achieve the company's goals while considering market dynamics and investor demand. The IPO process typically involves extensive legal, financial, and regulatory requirements. Companies seeking to go public often work closely with investment banks, legal advisors, and other professionals to navigate the complexities and ensure compliance with applicable regulations.

3.7.2 Subsequent Offers

Companies can offer the equities to their investors subsequently once they listed and get their IPO subscribed. If in future the companies need more money for running or expanding their business, then they can go for subsequent offering as follow:

a) **Follow-on Public Offering (FPO)**: An FPO is an offering made by a listed company to raise additional capital from the public or existing shareholders when the need for finance arises in subsequent future. In an FPO, the company offers new shares to the general public or their existing shareholders, or in combination of both.

b) **Offer for Sale (OFS)**: An OFS is a method where existing shareholders, such as promoters or private equity investors, sell their shares to the general public basically the retail investors. The company is not going receive any amount from an OFS as it involves the sale of existing shares. The party receives the money is promoters or private equity investors who sold their shares. The shares are offered at a fixed price, and the allocation is made based on the bids received.

c) **Institutional Placement Program (IPP)**: IPP is a method of issuing shares to institutional investors without a public offering. It allows eligible institutional investors to subscribe to shares directly from the company. This method is typically used by qualified institutional buyers (QIBs) and has specific eligibility criteria and regulations.

d) **Rights Issue**: A rights issue is an offering made by a company to its existing shareholders, allowing them to purchase some additional shares at a predetermined price which will be lower than current market price. Existing shareholders receive rights entitlements based on their shareholding, and they can exercise these rights to subscribe to new shares in proportion to their existing holdings. They might sell the right entitlements.

3.8 Process of Book Building

As discussed above the way of offering IPO, the Book Building method is one of the important ways to issue securities after analyzing demand for their issue. In this, the final

price is not decided at the very beginning but at the end of receiving the bids for the subscribers. Book building suits large companies, companies that are not confirmed about the pricing of their securities, and companies with complex valuations. In the process of book building potential investors indicate their choice for number of shares they wish to buy and at what price. So, this process will involve collecting and scrutinizing the investors' responses to determine final offering price. Steps involved in this process are:

Appointment of Book Running Lead Manager (BRLM):

a) The Issuer who is planning to issue securities must have to appoint one or more lead merchant bankers as 'book runners'. BRLM are investment bankers who are responsible to manage IPO process. Book runners basically help in the structuring of the offer, marketing of securities, and to coordinated the process of Book building. The Issuer will decide the number of securities to be issued and he will also decide the price band of securities in consultation with the Book Runner.

b) **Preparation of Prospectus**: The company will issue a prospectus which is basically an offer document and contains detailed information about the company, its offering, securities, etc. This document will include detail information about working of company, future prospects, financial risks and proposed IPO. Company will also provide it to the regulatory authority and will make it available for potential subscribers to the issue

c) **Price Band**: After consulting with BRLM, company will declare price band for IPO. Price band basically indicated a range within which potential investors can bid for proposed shares.

d) **Book Building Period**: It refers to a limited fixed period within which investors can revise their bids based on market conditions and demand of shares

e) **Marketing of Issue**: The merchant banker will do marketing efforts to market the issue as much as possible to make it in the knowledge of the potential investors.

f) **Collection of Bids**: Normally, it is the responsibility of BRLMs to collect bids from investors throughout the book building process. Company may appoint the syndicate member who will receive the bid. They receive the bid through electronic mode. The bids include quantity of shares and their corresponding price at which investors are willing to buy shares.

g) **Book Building Analysis**: Afterward the investors will submit their bid along with the number of securities and the prices they are willing to pay for the issue. Now, BRLMs will analyze bids to access demand and determine price. They may consider different factors for this like number of bids received, bid quantity, bid price etc. They will receive and put the orders into an 'electronic book'. The book remains open for a period of 3 days. Usually number of bids cannot be beyond the range as specified by the issuer. Once the

time is over, books get closed and the Book runner in consultation with the issuer decides the price of securities to be offered so that their whole issue gets subscribed.

h) **Price Determination**: After analysis of the bids, Company and BRLMs will decide about the price within the price band. Finally shares are allocated to the successful bidders as per the final pricing of securities and allocation criteria.

i) **Final prospectus**: After the price determination process is complete, final prospectus is issued along with final issue price and size of issue. The qualified bidder will get the allotment of the securities in their accounts while others will be issues the refund of their amount.

After completion of the process, shares will list on the stock exchange and investors can trade for them as per their choice.

3.9 Summary

Equity shares are preferred choice for investors who have ability to assume high degree of risk in anticipation of high return. Over the past few decades, investors have become more knowledgeable. They understand the market volatility and how to derive gains from equity shares taming the market movements. In India, SEBI regulations for issue of equity shares has fetched the trust of investors. Investors now don't readily in duldge in speculation to get gains from equity share investment rather they believe in long term holding in order to get real term benefits. On the other side, business firms also manage and regulate the equity issue process as per SEBI regulations. New methods are derived to raise capital from investors. Book building process is used to match demand and supply of shares and preferences of investors for particular equity shares.

Glossary

a) **Equity Shares**: Equity shares represent ownership in a company and entitle the shareholder to a portion of the company's profits and assets. They are also known as ordinary shares and typically carry voting rights in corporate decisions.

b) **Capital Formation**: Companies raise capital by issuing equity shares in the primary market, which facilitates investment in new projects and expansion.

c) **Liquidity**: Equity shares traded on the secondary market provide investors with liquidity, allowing them to buy and sell securities easily.

d) **Price Discovery**: Equity markets determine the prices of securities based on supply and demand dynamics, providing crucial information to investors.

e) **Book Building**: Book building is a price discovery method where the price of the IPO is determined through a bidding process.

f) **Stock Broker:** A broker is a middleman who, in exchange for a fee or a commission, carries out buy and sell orders for investors.

g) **Investors and Traders**: Investors are individuals who purchase stocks to become part owners in the company.

h) **Institutional Placement Program (IPP)**: IPP is a method of issuing shares to institutional investors without a public offering. It allows eligible institutional investors to subscribe to shares directly from the company.

i) **Rights Issue**: A rights issue is an offering made by a company to its existing shareholders, allowing them to purchase some additional shares at a predetermined price which will be lower than current market price.

Long Answer Type Questions

a) Define equity shares and explain their significance in a company's capital structure.

b) How do equity shares differ from other types of securities, such as preference shares or debt instruments?

c) Highlight key milestones, regulatory changes, and technological advancements that have shaped the Indian equity market over time.

d) Discuss the primary and secondary markets within the Indian equity market and explain their functions.

e) Enumerate and elaborate on the various functions performed by the equity market in India.

f) Define the primary market and its significance in the context of equity issuance.

g) Discuss the process of issuing equity shares in the primary market, including Initial Public Offerings (IPOs) and other methods of raising capital.

h) Compare and contrast the methods followed in IPOs, such as fixed price issues and book building, highlighting their respective advantages and limitations.

i) Discuss the steps involved in the book building process and its significance in determining the final offer price of securities.

j) Define book building and explain how it is used in the pricing of IPOs.

Short Answer Type Questions

a) What do equity shares represent in a company?

b) How do equity shares differ from preference shares?

c) Name the two major stock exchanges in India.

d) What are the primary and secondary markets in the equity market?

e) What role does the equity market play in capital formation?

f) How does the equity market contribute to price discovery?

g) What does IPO stand for?

h) Name two methods followed in IPOs.

i) Explain the concept of book building.

j) How does book building determine the IPO price?

Suggested Readings:

a) Khan, M. Y., “Indian Financial System” , Mc Graw Hill , 11 th Edition

b) Mishkin Frediric, Eakins Stanley, Jayakumar Tulsi and R. K. Pattnaik., “ Financial Markets and Institutions” Pearson India Education

c) Bhole, L.M., and Mahakud Jitendra., “ Financial Institutions and Markets: Structure, Growth and Innovation” Mc Graw Hill Education

d) MachiRaju, H.R., “ Indian Financial System” Vikas Publishing house

B. COM (Hons.)

(Accounting and Taxation)
SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT 4: Secondary Market: Definition and Functions of Stock Exchanges

Structure

4.0 **Objectives**

4.1 **Introduction**

4.2 **Functions of Secondary Market**

4.3 **Constituents of Secondary Market**

4.4 **Development of the Stock Market in India**

4.5 **Functions of Stock Exchanges**

4.6 **Role of Stock Exchanges**

4.7 **Working of Stock Market in India**

4.8 **Recent Developments in Stock Exchanges**

4.9 **Various Stages of a Business Transaction in a Stock Exchange**

4.10 **Summary**

Glossary

Long answer questions

Short answer questions

Suggested Reading

4.0 Objectives

After studying the Unit, you would be able to understand:

- Role of secondary market in Economic Development
- Difference between primary market and secondary market
- Various functions of stock exchange
- Basic functioning of stock exchange in India
- Different Stages of a Business Transaction in Stock Exchange

4.1 Introduction

A market for the sale of securities is called the secondary market. Put differently, this market is used for trading securities that have previously made their way through the New issue market or primary market. These securities are typically quoted on the stock exchange, which offers a constant and regular market for securities purchases and sales.

All stock exchanges approved by SEBI and the Indian government make up this market. The Securities Contracts (regulation) act of 1956 governs the stock exchanges in India. The two main stock exchanges in India that set the standard for other stock markets are the National Stock Exchange and the Bombay Stock Exchange. Through the exchanges' members, secondary market operations occur on stock exchanges and over-the-counter exchanges.

The markets in which previously issued financial claims are traded are referred to as secondary markets. Purchasing shares from another investor rather than the firm that issued them is an example of a secondary market transaction. The stock market is a common term for a secondary market. For a number of reasons, an active secondary market in securities is essential. First off, by guaranteeing investors that they will be able to sell shares if they so choose, it helps the main market by making it easier for issuers to place securities. Furthermore, a secondary market serves as the foundation for figuring out the rates that will be charged for fresh issuance.

Thirdly, it swiftly captures the dynamic market situations, demonstrating the market's receptiveness to new issues. Fourthly, investors can swiftly adjust the size, risk, return, liquidity, and maturity of their portfolios thanks to a dynamic secondary market. Lastly, it enables the central bank to engage in open-market operations, or the buying and selling of assets with the aim of controlling the liquidity in the financial markets.

The new issuers market (primary market) and the stock market (secondary market) are the two interrelated and inseparable components of the capital market. Issuers get new capital in the primary market through right issues, initial public offerings, or private placements; in contrast, the secondary market gives these instruments liquidity through trading and settlement on stock exchanges. The issuer and investors interact directly in the primary market, while transactions in the secondary market take place between two investors and do not involve the issuers.

The exchange-traded market and the over-the-counter (OTC) market are the two channels via which the secondary market operates. OTC markets are an informal market category where securities are traded and settled bilaterally over the counter, along with trade negotiations. OTC exchanges are known as OTCEI in the Indian market, although they don't offer large volumes.

Trades executed on the stock market are settled by the clearing organization, which serves as a counter party and ensures settlement, in accordance with the fixed tome schedule. A stock exchange is described as "any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating, or controlling the

business of buying, selling, or dealing in securities" in Section 2(3) of the stocks Contract (Regulation) Act, 1956.

4.2 Functions of Secondary Market

a) To make securities, such as debt and equity instruments, liquid and marketable

b) To promote economic growth by channelizing funds through the process of investment in the most effective channel

c) To safeguard the interests of investors by ensuring a certain level of safety and fair dealing in the trading of securities.

d) To offer a quick assessment of securities considering internal environment (industry and company) developments. The micro-level cost of capital and rate of return of the enterprises are measured as a result of this valuation process.

e) To encourage businesses to perform better since investors may easily access the market price of the security, which represents the business's performance.

4.3 Constituents of Secondary Market

a) Stock Market: The stock market is the name given to the exchanges where securities, shares, and stock are traded. Stated differently, a stock market is an exchange where publicly traded business stocks and shares, along with related financial products like stock options, convertibles, and stock index futures, are traded. These marketplaces were often open outcry, with trading taking place on an exchange's floor. These days, a growing number of marketplaces are cyber-financial markets where transactions take place through online real-time order matching between buyers and sellers. Another name for this is electronic trading. For a company's offerings to be listed and traded on the exchange, they must comply with its rules.

b) Spot Market: The spot market, sometimes referred to as the cash market, is where financial instruments are exchanged and paid right away. However, it is a forward transaction if the item is exchanged today with settlement scheduled for around two weeks from now. Spot markets can be classified as either OTC or exchange, or organized markets.

c) Derivatives Market: It is a market where derivatives, such as securities whose value is based on fluctuations in price and derived from assets, are exchanged. Future contracts, forward contracts, options, and credit swaps are examples of derivatives.

4.4 Development of the Stock Market in India

The evolution of stock exchanges in India is marked by significant historical milestones and regulatory changes. Here's a brief overview of the key stages in the evolution of stock

market in India:

a) Indian stock market came into existence when long-term negotiable securities were first issued at the end of the eighteenth century.

b) Investor interest in corporate securities was piqued by the Companies Act of 1850, which created the concept of limited liability.

c) The Bombay Stock exchange was the first organized stock market to be formed in India. It was established in 1875 and was said to be the oldest in Asia.

d) The establishment of the Ahmadabad Stock Exchange in 1894 to enable trading in the shares of the textile factories located there.

e) Established in 1908, the Calcutta stock exchange served as a marketplace for plantation and jute mill shares.

f) In 1937, Madras Stock Exchange was founded.

g) The Securities Contract (Regulation) Act, 1956, was a comprehensive piece of legislation introduced by the Indian government to encourage the orderly growth of the stock market.

h) The main stock exchange in India up to 1960 was the Calcutta Stock Exchange (CSE). There were 1203 listed businesses on India's various stock markets in 1961. 297 of these were listed on the BSE, 576 on the CSE, and the other shares were placed on other public markets.

i) The Securities and Exchange Board of India (SEBI) was established in 1988 as an autonomous regulatory body to oversee and regulate the securities market in India. SEBI played a crucial role in bringing transparency and efficiency to the functioning of stock exchanges.

j) The BSE was at the top of the list of regional stock exchanges that made up the Indian stock market till the early 1990s.

k) Reforms were initiated in 1991.The 1990s saw economic liberalization and financial sector reforms in India. The government implemented policies to encourage foreign investment, simplify regulations, and improve market infrastructure.

l) The National Stock Exchange (NSE) was incorporated in 1992 and started operations in 1994. NSE introduced electronic trading and screen-based systems, revolutionizing the way stocks were traded in India. The introduction of NSE led to increased competition and technological advancements in the stock market.

m) The stock exchange of stock exchanges is called ISE. The trading activities of the ISE were initiated on February 26, 1999.

n) In 1996, the process of dematerialization of securities began, allowing investors to hold and trade securities in electronic form. The National Securities Depository

Limited (NSDL) and Central Depository Services Limited (CDSL) were established to facilitate the dematerialization process.

o) Derivatives trading, including futures and options, was introduced in the early 2000s. This provided investors with new tools for risk management and speculation, further deepening the financial markets.

p) Following-Reforms Market Situation, The Indian secondary market today consists of four tiers: regional stock exchanges, national stock exchanges (BSE and NSE), the Over-the-Counter Exchange of India (OTCEI), and the Inter-Connected Stock Exchange of India (ISE).

q) Over the years, the market capitalization of Indian stock exchanges has witnessed significant growth, reflecting the increasing depth and breadth of the capital markets.

r) Indian stocks have been included in global indices, such as the MSCI indices, leading to increased foreign portfolio investment and global visibility.

s) The evolution of stock exchanges in India has been characterized by a transition from open outcry systems to electronic trading, increased regulatory oversight, and the development of a more dynamic and integrated financial market. Ongoing efforts continue to enhance market efficiency, transparency, and investor protection.

4.5 Functions of Stock Exchanges

a) Act as Economic Barometer: The stock exchange is a nation's window into its economic situation. Share prices show significant shifts in a nation's economy, whether for social, political, economic, or environmental causes. The economy's cycles of boom, recession, or depression are indicated by changes in stock values. A nation's commercial and economic conditions are reflected in the stock exchange, which serves as an economic barometer.

b) Capital formation and savings mobilization: An intermediary between investors and debtors is the stock exchange. The fund surplus entities make stock market investments with their money. Securities are used by the fund deficit units or borrowers to raise funds. Thus, the stock exchange helps the mobilization of savings and capital formation by serving as a conduit between investors and funding deficiency businesses.

c) Educating the Investors: Spreading the stock cult entails educating the public about investing and persuading them to purchase securities through improved trading procedures and regulations on new issues. People are encouraged to invest in larger ownership securities by the stock exchange, which also teaches them about investing.

d) **Creating Room for speculation:** Speculation is the buying of financial securities with the exclusive intent of profiting from price movement towards a target price. The stock exchange offers a limited and regulated environment for speculation.

e) **Improved Capital Allocation:** Financial resources move from less profitable businesses to more profitable ones as a result of stock market transactions. Profit-making corporations typically have high share prices and regularly trade their shares on the exchange, which makes it easier for them to raise further funding and expand. It also aids investors in obtaining higher returns by directing their money through lucrative avenues.

f) **Impetus for Economic Development:** Financial securities are traded on stock exchanges. Securities are purchased and traded. Capital formation is aided by this process of disinvestment and reinvestment. The money that the businesses make can be put to good use by engaging in profitable ventures that boost industrial output and support economic expansion.

g) **Securities Pricing:** Based on supply and demand, the stock market aids in the pricing of securities. The securities of successful, expanding businesses are in more demand and are worth more money. The government and creditors might also benefit from this securities valuation in addition to investors. The government has the authority to impose taxes on the value of securities, creditors have the ability to assess creditworthiness, and investors are aware of the value of their investment.

h) **Transaction Security:** Only when all of their credentials have been verified can a company get listed on the stock exchange, and once listed, they are subject to all rules and regulations. When trading on the stock exchange, this process guarantees the security of the transactions.

i) **Encouraging the Investment and Savings Habit:** Proper market research and financial literacy can help investors get a healthy return on their securities investment. This may encourage people to save and invest, which will increase the amount of money flowing into the stock market.

j) **Giving Current Securities Marketability and Liquidity:** A ready and ongoing market for trading, or the buying and selling of assets, is the stock exchange. It offers a platform on which investors can purchase and sell securities. Both short-term and long-term securities are available for investment by the investors. Selling those assets would be an easy way for them to turn their investments into cash in an emergency.

4.6 Role of Stock Exchanges

a) The secondary market's function is to efficiently supply liquidity. In a sense, it strengthens the primary market, decreases the cost of financing for businesses and governments, and directly increases the value of the securities.

b) It carries out this task by bringing buyers and sellers together and determining the price at which equilibrium is reached.

c) It provides a venue where traders and investors may communicate and trade securities in accordance with their needs and opinions regarding the real worth of the asset.

d) Over time, national exchanges have performed far more than just provide a venue for trade and disseminate information regarding pricing and sales.

e) The stock exchange offers individual securities issuance a continuous market. This is arguably its most significant role. A continuous market with a high volume of sales and a little difference in price between the asking price and the bid, as well as between the current sale and the prior sale, is anticipated. It also relies on how quickly commands are carried out. The exchange's trading regulations promote these circumstances.

f)National exchanges guarantee investors fundamental financial protection and information as well. For instance, they mandate that a company furnish its shareholders with a balance sheet that enumerates its assets and liabilities as well as a statement of earnings.

g) To ensure a wide and active market, there are also adequate buyers and sellers of the shares in the stock of each firm traded, as well as a sufficient number of brokers and other exchange members processing orders. Such a market has the benefit of increasing the traded securities' marketability and liquidity.

h) h) Securities have a strong collateral value for loans since there is a constant market for them and supply and demand determine price. Given that current events have the potential to significantly impact stock prices, it is evident that an exchange's capacity to give a fair market price is constrained. When taking into account long-term investment values, a particular price could not be fair. A market should only produce a price that is freely determined by forces of competition. Widespread auction markets typically increase a security's marketability, making them stronger loan collateral.

i)A steady market for fairly valued shares creates an environment that is conducive to raising money. The assets traded on the exchange create a price pattern that acts as a standard of worth even if the securities are sold by investment bankers outside the market. Corporate financing should benefit from such a comparison. The new offering is easier to sell to investors since there will be a continuous market available after the shares have been sold.

j)There are often few members of each exchange, significant membership costs, minimal trading volume, and low share prices on the local exchange. New issuance by both new

and established businesses and governments are examples of primary market operations. The issues could be debenture bonds, shares, rights issues, or public offerings. There isn't any trading component, and investors can apply straight to the issuer.

k) When borrowing money from the capital market is quite inexpensive and taking on debt is expensive, this method of financing is pursued. Subscribers do so in order to receive capital gains and dividends. Through their members, secondary market operations occur on stock exchanges and over-the-counter (OTC) exchanges. Members operate as the activities' middlemen. Members operate as the activities' intermediaries are middlemen, transfer agents, investment advisers and portfolio managers.

4.7 The Indian Stock Market's Operation

Through an initial public offering (IPO), new businesses offer shares to both institutional and general public investors. The companies submit to SEBI a draft offer document that includes details on the company, the number of shares up for grabs, the price range, and financial statements. They can make their shares available to investors in the primary market or New Issue Market once they have received approval from SEBI. Following the IPO, the corporation distributes shares to investors based on their bids. Following their listing on the stock exchange, the shares are now available for secondary market trading.
The shares were earlier exist in physical/paper forms. They are currently in electronic form, sometimes referred to as dematerialized form. Purchasing and selling stocks requires a demat account for the investor. Investors can open demat accounts with Depository Participant (DP), an agent of the depository. A depository is a company that digitally stores investor securities. A stockbroker or broker enters the market and matches an investor's buy order with a seller's sell order when the investor submits a buy order online for a specific security. The order is successfully completed upon matching.

The buyer and seller also receive confirmation following receipt from the stock exchange. In India, trades that are executed are settled on a T+2 basis, meaning that they are settled two working days after the transaction date. Funds are moved to the seller's account and the shares are moved to the buyer's demat account. Because everything is done electronically over computer networks, there has been a significant reduction in transaction and processing times.

4.8 Recent Developments in Stock Exchanges

Derivative securities are traded in capital markets in addition to the securities covered in the previous parts of this article. Financial contracts known as

derivative securities have values that are generated from underlying assets. There are two primary features shared by most derivative securities. Initially, they give an investor the opportunity to forecast changes in the underlying assets without actually having to buy them. This offers a high level of financial leverage by enabling the investor to take on sizable investment positions without sizable initial outlays. As a result, investing in derivatives instruments yields returns that are even higher than those of purchasing the underlying assets.

Derivative contract speculation can yield greater rewards for investors, but it also increases risk compared to speculation in the underlying assets. Secondly, in the event that the value of the underlying assets decreases, gains may be realized through the use of derivative securities. As such, derivative securities can be used by financial institutions and other businesses to hedge their current securities holdings. Global capital markets have been more globally integrated due to the removal of obstacles between nations, increased information availability, decreased transaction costs, and regulatory standardization. They also become increasingly vulnerable to changes in interest rates overseas as the market becomes more integrated.

The majority of stock exchanges have stopped using the outcry method of stock trading or are in the midst of switching to a screen-based trading system in its stead. The floor less exchange is the way of the future. In recent times, there has been a surge in international debt and equity issues due to the relaxation of regulations brought about by rivalry for foreign direct investment with other emerging nations. This has coincided with the growth of the domestic debt and equity market. Online order takers can get bids in real time and company details from internet brokers. Automated systems carry out trades. All new issues must be in the form of dematerialization, or demat. The demat form allows the transfer of shares and guarantees that there are no bogus or forged shares or poor delivery. Of securities.

4.9 Various Stages of a Business Transaction in a Stock Exchange

a) **Making an order through a broker**: A customer makes an order through a stockbroker, who is the only person authorized to conduct business on a stock exchange by purchasing or selling firm shares at best market values or at fixed prices.

b) **Order execution:** The order will be carried out by the broker or his designated clerk, and it will be recorded in the Stock Exchange Daily Official List along with the quantity and price of shares that were traded.

c) **Reporting the deal to the client:** The brokers provide clients with a contract note detailing the securities purchased or sold, the price, the broker's compensation, and other pertinent information as soon as the deal is completed.

d) **Transaction settlement:** There are two approaches to transaction settlement. When it comes to transactions involving ready delivery (also known as cash), payment needs to be provided right away upon the transfer of the securities or between one and seven days later. Regarding forward delivery arrangements, payments are settled on a predetermined day. There is a carry-over system in place for forward delivery, which involves delaying delivery or making a payment to another party. There is a lot of room for speculation in the forward market with this carry-over structure.

4.10 Summary

The markets in which previously issued financial claims are traded are referred to as secondary markets. Purchasing shares from another investor rather than the firm that issued them is an example of a secondary market transaction. Investors can get liquidity thanks to the secondary market. Through their members, secondary market operations occur on stock exchanges and over-the-counter (OTC) exchanges. Exchanges for stocks make it easier for traders to trade current stocks on secondary marketplaces. The ability of secondary markets to provide assets with liquidity and marketability, as well as to route funds into the most effective channels through the process of disinvestment and reinvestment, are among their most significant roles in promoting economic growth. Securities or shares can be purchased or sold on the stock market. Also, financial instruments are traded and resolved instantly on the spot market, also referred to as the cash market. It has been discovered that the derivatives market is one kind of market where derivatives are exchanged. When long-term negotiable securities were first issued at the end of the eighteenth century, the Indian stock market was born. The Bombay (now Mumbai) Stock market was the first organized stock market to be formed in India. It was established in 1875 and was said to be the oldest in Asia. A nation's commercial and economic conditions are reflected in the stock exchange, which serves as an economic barometer. The primary purposes of a stock exchange are to facilitate the mobilization of savings and capital formation, as well as to price securities, provide transaction security,

propagate the equity cult, provide opportunities for speculation, improve capital allocation, and encourage the saving and investing habits of people.

The goal of a stock exchange is to facilitate the trading of company stocks and other financial instruments. It is an association of brokers and investment bankers. Shares issued by corporations, unit trusts, derivatives, pooled investment products, and bonds are among the securities traded on a stock market. A security needs to be listed on a particular stock market in order to be traded there. Members alone are able to trade on an exchange. The most recent alteration to the way a stock exchange operates is that orders are now accepted online by Internet brokers, who also offer real-time prices and company information. Trades are now completed by automated systems, and all new issues must be issued in dematerialized (demat) form. The demat form guarantees that there aren't any faked or fraudulent shares.

Glossary

a) **Investors:** Individual Investors: Retail investors who buy and sell securities for personal investment purposes.

b) **Institutional Investors:** Large entities such as mutual funds, pension funds, hedge funds, and insurance companies that trade securities on behalf of their clients or for their own portfolios.

c) **Stock Exchanges:** Organized and regulated platforms where securities are listed and traded. Examples include the Bombay Stock Exchange (BSE), National Stock Exchange (NSE), New York Stock Exchange (NYSE), NASDAQ, London Stock Exchange (LSE), and Tokyo Stock Exchange (TSE).

d) **Brokers and Brokerage Firms:** Intermediaries that facilitate the buying and selling of securities between buyers and sellers. They execute trades on behalf of investors and provide various financial services.

e) **Market Makers:** Entities that facilitate trading by providing liquidity. Market makers quote both buy and sell prices for a financial instrument, helping to ensure a continuous market.

f) **Clearing Houses:** Organizations that handle the settlement of trades. They ensure that securities and funds are transferred between buyers and sellers, reducing counter party risk.

g) **Depositories:** Institutions that hold and safeguard securities in electronic form. They facilitate the transfer of ownership without the need for physical certificates. Examples include National Securities Depositories Limited (NSDL) and Central Depositories Services

Limited (CDSL) in India and the Depository Trust & Clearing Corporation (DTCC) in the United States.

h) **Regulatory Bodies:** Government agencies that regulate and oversee the functioning of the secondary market to ensure fairness, transparency, and investor protection. Examples include Securities and Exchange Board of India (SEBI), Securities and Exchange Commission (SEC) in the United States and the Financial Conduct Authority (FCA) in the United Kingdom.

i) **Securities:** Financial instruments such as stocks, bonds, derivatives, and mutual funds that are traded in the secondary market.

j) **Information Providers:** Entities that disseminate financial information, market data, and research to help investors make informed decisions. This includes financial news outlets, rating agencies, and research firms.

k) **Technology Infrastructure:** The technological systems and networks that enable the electronic trading of securities. This includes trading platforms, order matching systems, and electronic communication networks (ECNs).

Long Answer Questions

a) List the differences between primary market and secondary market.

b) Explain in detail the various functions of a secondary market.

c) Investigate the different constituents of a secondary market.

d) Differentiate between stock market and spot market.

e) Elaborate in detail the various Functions of Stock Exchanges

f) How do stock exchanges Promote the Habit of Savings and Investment?

g) Discuss the Working of Stock Market in India

h) Investigate in detail the various roles performed by stock exchanges.

i) Explain the recent developments in stock exchanges.

j) Discuss the need of Secondary Market for economic growth?

4.10.1 Short Answer Questions

a) Define the term “Secondary Market”.

b) Discuss in brief the concept of OTC markets.

c) Name the Act under which a stock exchange is defined.

d) Write a short note on “Derivatives Market”.

e) How do stock exchanges help in pricing securities?

f) Discuss in brief the four stages of a business transaction in stock exchange.

g) What do you understand by an “IPO”?

h) How do stock exchanges facilitate liquidity in the market?

i) Where are stocks traded in a stock exchange?

j) Define Spot Market

Suggested Readings

a) Bharti Pathak (2017) Indian Financial System: Pearson India Education Services Pvt. Ltd.

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B. COM (Hons.)
(Accounting and Taxation)

SEMESTER - IV
E-FINANCIAL MARKET AND SERVICES

UNIT V:
MEANING OF FINANCIAL MARKET, TYPES OF TRADERS, TYPES OF TRADE, BROKERAGE CALCULATION

5.1 Financial Markets
- **Meaning & Introduction**
- **Key Components**
- **Functions**
- **SEBI Guidelines for Financial Markets**
- **Types of Financial Markets**

5.2 Trade
- **Meaning**
- **Role of Trade in Financial Markets**
- **Types of Trades**
- **Types of Traders**

5.3 Brokerage
- **Broker**
- **Meaning**
- **Key Responsibilities of a Broker**
- **Types of Brokers**
- **Brokerage Meaning**
- **Key Aspects of Brokerage**
- **Methods of Brokerage Calculation**

5.4. Let Us Sum Up
- **Long Answer Type Questions**
- **Short Answer Type Questions**
- **Glossary**
- **Suggested readings**

5.0 Objectives

- After studying the unit, the students will be able to understand:
- Detailed Concept of Financial Markets
- Functions of Financial Markets
- SEBI Guidelines for Financial Markets
- Types of Financial Markets
- Role of Trade in Financial Markets
- Key Responsibilities of a Broker
- Types of Brokers
- Brokerage Meaning
- Key Aspects of Brokerage
- Methods of Brokerage Calculation

5.1 Introduction:

Financial markets are platforms where individuals, companies, and governments engage in various transactions involving financial assets. These markets facilitate the buying and selling of financial instruments such as stocks, bonds, currencies, derivatives, and commodities.

The primary function of financial markets is to enable the flow of capital between investors and borrowers, allowing them to allocate resources efficiently. They provide a mechanism for raising capital for businesses, governments, and individuals while offering investment opportunities to those seeking to grow their wealth.

Here are some key components and participants commonly found in financial markets:

a) **Securities:** Financial instruments representing ownership or debt obligations, such as stocks (equities) and bonds. Stocks represent ownership in a company, while bonds are debt securities issued by entities seeking to borrow funds.

b) **Stock Market:** A market where shares of publicly traded companies are bought and sold. Investors can participate in stock markets through exchanges like the New York Stock Exchange (NYSE) or Nasdaq.

c) **Bond Market:** The market for buying and selling bonds, which are typically issued by governments and corporations. Bonds are often traded on bond exchanges or over-the-counter (OTC) markets.

d) **Foreign Exchange (Forex) Market:** This market involves the trading of different currencies. It enables individuals, businesses, and institutions to exchange one currency for another and facilitates international trade and investment.

e) **Derivatives Market:** Derivatives are financial contracts whose value derives from an underlying asset. This market includes futures contracts, options, swaps, and other complex financial instruments used for speculation, hedging, and risk management.

f) **Commodities Market**: In this market, commodities like gold, oil, natural gas, agricultural products, and metals are bought and sold. Commodities are often traded on specialized exchanges.

g) **Participants:** Financial markets involve various participants, including individual investors, institutional investors (such as pension funds and mutual funds), banks, brokerage firms, and financial intermediaries. These participants trade, invest, and provide liquidity to the market.

Financial markets play a crucial role in determining asset prices, capital allocation, and overall economic stability. They provide opportunities for individuals and organizations to raise capital, manage risks, and generate returns on investments. However, they also involve risks, such as market volatility and the potential for losses, requiring participants to be knowledgeable and cautious in their decision-making.

Meaning: A financial market refers to a marketplace or a system where buyers and sellers come together to trade financial assets, such as stocks, bonds, currencies, commodities, and derivatives. It is a platform that facilitates the exchange of financial instruments between participants, allowing them to buy, sell, and transfer ownership of these assets.

Financial markets serve several important functions in the economy:

a) **Capital Allocation**: They enable the efficient allocation of capital by channeling funds from savers and investors to individuals, companies, and governments that need capital for investment or financing activities.

b) **Price Determination**: Financial markets provide a platform for discovering the prices of financial assets based on the interaction of supply and demand. The forces of supply and demand determine the fair value of securities and other financial instruments.

c) **Liquidity Provision**: Financial markets provide liquidity, allowing investors to easily buy or sell their financial assets. This liquidity is crucial for maintaining market efficiency and ensuring that investors can quickly convert their investments into cash.

d) **Risk Management**: Financial markets offer various tools, such as derivatives, that help market participants manage and mitigate risks. These instruments allow investors to hedge against potential losses or speculate on future price movements

e) **Investment Opportunities**: Financial markets provide individuals and institutions with opportunities to invest their savings and generate returns. By investing in financial assets,

investors can participate in the growth and profitability of businesses or benefit from changes in market conditions.

f) **Economic Indicator**: Financial markets often serve as indicators of economic health. The performance of stock markets, bond yields, and currency exchange rates can reflect the overall state of the economy, investor sentiment, and market expectations.

Financial markets can be classified into different categories based on the types of assets traded, such as stock markets, bond markets, foreign exchange markets, derivatives markets, and commodities markets. These markets can operate through exchanges, over-the-counter (OTC) platforms, or electronic trading systems, with varying degrees of regulation and transparency.

Overall, financial markets play a vital role in facilitating economic growth, capital formation, risk management, and investment opportunities, acting as a crucial backbone of the global financial system.

Financial markets possess several distinctive features that contribute to their functioning and characteristics. Here are some key features of financial markets:

a) **Market Participants**: Financial markets involve various participants, including individual investors, institutional investors (such as banks, insurance companies, and pension funds), corporations, governments, and financial intermediaries. These participants engage in buying, selling, and trading financial assets, contributing to market liquidity and price discovery.

b) **Financial Instruments**: Financial markets facilitate the trading of a wide range of financial instruments. These instruments include stocks (equities), bonds, currencies, commodities, derivatives (such as options and futures contracts), and more. Each instrument has its own characteristics, risks, and potential returns.

c) **Market Transparency**: Financial markets strive to provide transparency by disseminating relevant information to market participants. This information includes company financial reports, economic indicators, news releases, and regulatory disclosures. Transparent markets enhance investor confidence, facilitate informed decision-making, and contribute to efficient price discovery.

d) **Price Discovery**: Financial markets serve as platforms for price discovery, where the interaction of buyers and sellers determines the fair value of financial instruments. The forces of supply and demand influence prices, reflecting market sentiment, expectations, and fundamental factors affecting the underlying assets.

e) **Liquidity**: Liquidity refers to the ease with which financial assets can be bought or sold without significantly impacting their prices. Financial markets aim to provide liquidity by

bringing together a large number of buyers and sellers, ensuring that participants can enter or exit positions as needed. Higher liquidity reduces transaction costs and enhances market efficiency.

f) **Market Efficiency**: Financial markets strive to be efficient, meaning that prices quickly and accurately reflect all available information. Efficient markets promote fair valuation of assets, reduce arbitrage opportunities, and contribute to overall market stability.

g) **Regulatory Framework**: Financial markets operate within a regulatory framework designed to ensure fairness, transparency, and investor protection. Regulatory bodies, such as securities commissions and central banks, enforce rules and regulations to maintain market integrity and stability.

h) **Risk and Return**: Financial markets inherently involve risks and potential returns. Investors assess the risk-reward tradeoff when making investment decisions. Higher-risk investments tend to offer potentially higher returns, while lower-risk investments provide more stability but lower potential returns.

i) **Market Segmentation**: Financial markets can be segmented based on factors such as geography, asset class, and trading mechanism. For example, there are regional stock exchanges, bond markets, and currency markets that cater to specific regions or countries.

j) **Market Volatility**: Financial markets are subject to volatility, which refers to the degree of price fluctuations over a given period. Volatility can be influenced by various factors, including economic conditions, geopolitical events, investor sentiment, and market participants' actions.

SEBI Guidelines

SEBI (Securities and Exchange Board of India) is the regulatory authority in India that oversees and regulates the securities and financial markets. SEBI has issued various guidelines and regulations to ensure the fair, transparent, and efficient functioning of the financial markets in India. Some of the key SEBI guidelines for financial markets include:

a) **Insider Trading Regulations:** SEBI has established regulations to prevent insider trading, which is the trading of securities based on non-public information. The regulations require companies to maintain insider trading codes of conduct, disclose price-sensitive information, and prohibit insiders from trading during certain periods.

b) **Listing and Disclosure Requirements:** SEBI has laid down guidelines for companies seeking to list their securities on stock exchanges. These guidelines outline the eligibility criteria, disclosure requirements, and obligations that companies must adhere to when listing their securities for public trading.

c) **Investor Protection Measures**: SEBI has introduced various initiatives and regulations to protect the interests of investors. This includes regulations on disclosure and transparency, mandatory investor education programs, grievance redressal mechanisms, and regulations to curb fraudulent and unfair trade practices.

d) **Market Infrastructure Institutions**: SEBI regulates various market infrastructure institutions, such as stock exchanges, depositories, clearing corporations, and credit rating agencies. It sets guidelines for their functioning, governance, risk management, and compliance requirements.

e) **Mutual Funds Regulations**: SEBI has issued comprehensive regulations for the mutual fund industry. These regulations cover areas such as fund formation, investment restrictions, disclosure requirements, investor protection measures, and governance of mutual fund companies.

f) **Takeover and Mergers and Acquisitions (M&A) Regulations**: SEBI has formulated regulations governing takeovers, mergers, and acquisitions to ensure fair practices and protect the interests of shareholders. These regulations specify the disclosure requirements, open offer obligations, and procedures to be followed during such transactions.

g) **Foreign Portfolio Investment (FPI) Regulations**: SEBI has issued guidelines governing foreign portfolio investments in Indian securities markets. These regulations outline the registration process, investment limits, compliance requirements, and reporting obligations for foreign investors.

h) **Corporate Governance Guidelines**: SEBI has introduced corporate governance guidelines to improve transparency, accountability, and board effectiveness of listed companies. These guidelines cover areas such as board composition, independent directors, audit committees, disclosure requirements, and related-party transactions.

i) **Market Surveillance and Enforcement:** SEBI conducts market surveillance to detect market manipulations, insider trading, and other irregularities. It has the power to investigate and take enforcement actions against entities violating securities laws and regulations.

j) **Continuous Disclosure and Reporting Requirements**: SEBI mandates timely disclosure of information by listed companies. Companies are required to make regular disclosures on financial results, corporate actions, shareholding patterns, and other material information to ensure transparency and provide investors with timely and accurate information.

These guidelines and regulations issued by SEBI aim to protect investors, ensure market

integrity, promote transparency, and foster the development of a robust and well-regulated financial market in India.

Types of Financial Markets

In India, several types of financial markets exist, facilitating the trading and investment of various financial instruments. Here are some of the main types of financial markets in India:

a) **Stock Market (Equity Market):** The primary stock market in India is the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). These exchanges enable the trading of equity shares of publicly listed companies. Investors can buy and sell shares, participate in initial public offerings (IPOs), and engage in secondary market trading.

b) **Bond Market (Debt Market):** The bond market in India consists of government securities, corporate bonds, and other debt instruments. The Reserve Bank of India (RBI) conducts government bond auctions, and bond trading also takes place on the NSE and BSE. The Debt Market Segment of the NSE provides a platform for trading debt instruments.

c) **Foreign Exchange Market (Forex Market**): The forex market in India is primarily regulated by the RBI. It involves the trading of various currencies, including the Indian Rupee (INR), against major global currencies. The forex market enables individuals, businesses, and institutions to exchange currencies for purposes such as international trade, investment, and hedging.

d) **Commodity Market**: India has multiple commodity exchanges where agricultural commodities, metals, energy resources, and other commodities are traded. Notable commodity exchanges in India include the Multi Commodity Exchange (MCX), National Commodity and Derivatives Exchange (NCDEX), and Indian Energy Exchange (IEX).

e) **Derivatives Market:** The derivatives market in India comprises equity derivatives and commodity derivatives. The derivatives segment of the NSE and BSE facilitates the trading of equity derivatives, including futures and options contracts based on underlying stocks. Commodity exchanges also offer commodity derivatives, such as futures contracts on various commodities.

f) **Money Market**: The money market in India deals with short-term borrowing and lending of funds. It includes instruments such as Treasury bills, certificates of deposit (CDs), commercial paper, and money market mutual funds (MMMFs). The RBI regulates and manages the money market in India.

g) **Mutual Fund Market:** India has a vibrant mutual fund industry, which provides investment options to retail and institutional investors. Mutual funds pool money from investors and invest in a diversified portfolio of securities, such as stocks, bonds, and money market instruments. Mutual funds are regulated by SEBI.

h) **Insurance Market**: The insurance market in India encompasses life insurance, general insurance, and health insurance. Insurance companies offer various insurance policies to individuals and businesses to mitigate risks and provide financial protection. The Insurance Regulatory and Development Authority of India (IRDAI) regulates the insurance market.

i) **Real Estate Market**: The real estate market in India involves the buying, selling, and leasing of properties, including residential, commercial, and industrial properties. Real estate developers, brokers, and investors participate in this market, which is influenced by factors such as property demand, supply, and government regulations.

These are some of the main types of financial markets in India. Each market plays a crucial role in the country's economy, providing avenues for investment, capital formation, risk management, and economic growth. The markets are regulated by authorities such as SEBI, RBI, IRDAI, and specific exchanges' regulatory bodies to ensure transparency, investor protection, and market integrity.

5.2 Meaning of Trade: Trade refers to the exchange of goods, services, or financial instruments between parties. It involves the buying and selling of products or services in various markets to meet the needs and preferences of individuals, businesses, or nations.

In the context of economics, trade is a fundamental aspect of economic activity and is driven by the principle of specialization and comparative advantage. Different regions or countries often have different resources, skills, or technologies, which creates opportunities for trade. By engaging in trade, parties can benefit by focusing on producing and exporting goods or services in which they have a comparative advantage, while importing goods or services that they can obtain more efficiently or at a lower cost from other regions or countries.

Trade can occur within a local market, between regions or states within a country, or on an international scale between different countries. It can involve physical goods such as commodities, manufactured products, or agricultural produce, as well as intangible goods such as services, intellectual property, or financial instruments.

Trade can take place through various channels, including direct sales between buyers and sellers, through intermediaries such as wholesalers or retailers, or via electronic platforms and online marketplaces. The terms of trade, including the price, quantity, quality, and conditions of the exchanged goods or services, is typically determined through negotiations or market mechanisms.

Trade plays a crucial role in promoting economic growth, fostering specialization, and facilitating the efficient allocation of resources. It enables access to a wider range of goods and services, promotes competition, and can lead to the transfer of knowledge and technology across

borders. Governments often establish trade policies, regulations, and agreements to facilitate and regulate trade activities, ensuring fair competition, protecting domestic industries, and promoting international cooperation.

In the context of financial markets, a trade refers to the buying or selling of financial instruments such as stocks, bonds, currencies, derivatives, commodities, or other investment products. Financial market trades are executed by investors, traders, institutions, or brokers with the aim of generating profits, hedging risks, or managing their investment portfolios.

Financial market trades can take place in various marketplaces, including stock exchanges, commodity exchanges, bond markets, foreign exchange markets, and derivatives markets. These markets provide platforms and infrastructure for participants to buy and sell financial instruments based on market prices, supply and demand dynamics, and prevailing market conditions.

When executing a financial market trade, the buyer and seller agree on the terms of the trade, including the type and quantity of the financial instrument, the price at which the trade will be executed, and the settlement date. Trades can be executed using different types of orders, such as market orders, limit orders, stop orders, or specialized order types, depending on the specific requirements and trading strategies of the participants.

Financial market trades can be conducted by individual investors, institutional investors, hedge funds, mutual funds, banks, or other financial intermediaries. These trades can be based on various strategies, including fundamental analysis, technical analysis, quantitative models, or a combination of these approaches.

The execution of financial market trades involves the interaction of buyers and sellers, facilitated by market intermediaries such as brokers, market makers, or electronic trading platforms. These intermediaries help match buyers and sellers, ensure liquidity in the market, and provide efficient execution and settlement of trades.

Trades in financial markets are subject to regulations and oversight by regulatory authorities to maintain fair and orderly markets, protect investors, prevent market manipulation, and ensure compliance with applicable laws and regulations.

Overall, financial market trades play a vital role in the functioning of the financial system, allowing investors and participants to allocate capital, manage risks, and participate in the growth and development of the economy.

Traders play a crucial role in financial markets, contributing to market liquidity, price discovery, and efficient allocation of capital. **Here are some key roles and contributions of traders in financial markets:**

a) **Market Liquidity**: Traders provide liquidity to the financial markets by continuously buying and selling financial instruments. They facilitate the smooth functioning of markets by being willing to enter into transactions and provide counterparties for other

market participants. Their presence ensures that there is a ready supply of buyers and sellers, allowing for efficient execution of trades and narrow bid-ask spreads.

b) **Price Discovery**: Traders actively participate in the process of price discovery in financial markets. Through their buying and selling activities, they help determine the supply and demand dynamics, which influence the prices of financial instruments. Traders analyze market information, news, and other factors to assess the fair value of assets and contribute to the ongoing price formation process.

c) **Efficient Allocation of Capital**: Traders contribute to the efficient allocation of capital by assessing the relative value and risk of different financial instruments. They deploy capital based on their assessment of potential returns and risks, directing investments to areas with perceived opportunities. This helps channel capital to its most productive use, supporting economic growth and development.

d) **Risk Management**: Traders play a vital role in managing and mitigating risks in financial markets. They engage in various risk management strategies, such as diversification, hedging, and position sizing, to protect their portfolios from adverse market movements. Through their risk management practices, traders help stabilize market conditions and reduce the overall systemic risk.

e) **Market Efficiency**: Traders actively participate in the market by exploiting pricing inefficiencies, mispricing, or temporary market imbalances. By identifying and capitalizing on such opportunities, they contribute to the efficiency of financial markets. Their activities help align prices with the underlying fundamentals and reduce potential market distortions.

f) **Market Research and Analysis**: Traders conduct extensive research and analysis to assess market trends, economic indicators, company fundamentals, and other relevant factors. They analyze data, monitor news, and utilize various tools and techniques to gain insights into market movements and make informed trading decisions. Their research and analysis help provide valuable market intelligence to market participants.

g) **Market Innovation:** Traders often drive market innovation by developing new trading strategies, techniques, and technologies. They leverage advances in technology, quantitative models, and algorithmic trading to enhance trading efficiency, execution speed, and accuracy. Their innovations contribute to the evolution of financial markets and shape the way trading is conducted.

Types of Trades

In financial markets, various types of trades are executed to buy or sell financial instruments. Here are some common types of trades:

a) **Market Order:** A market order is an instruction to buy or sell a financial instrument at the current market price. It aims to execute the trade immediately at the best available price. Market orders prioritize execution speed over price certainty, and the trade is executed as soon as there is a willing counterparty at the prevailing market price.

b) **Limit Order**: A limit order is an instruction to buy or sell a financial instrument at a specific price or better. For a buy limit order, the specified price is the maximum price the buyer is willing to pay. For a sell limit order, the specified price is the minimum price the seller is willing to accept. Limit orders provide price certainty but do not guarantee immediate execution.

c) **Stop Order**: A stop order, also known as a stop-loss order or stop-buy order, becomes a market order when a specific price, known as the stop price, is reached. A stop-loss order is used to limit potential losses by selling a security if its price falls to or below the stop price. A stop-buy order is used to initiate a purchase if the price rises to or above the stop price.

d) **Stop-Limit Order**: A stop-limit order combines features of a stop order and a limit order. It has a stop price that triggers the order to become a limit order. Once the stop price is reached, the limit order is activated, specifying the price at which the trade should be executed. This type of order allows traders to set both a stop price for risk management and a specific price for execution.

e) **Market-on-Close (MOC) Order**: A market-on-close order is an instruction to buy or sell a security at the closing price of the trading session. These orders are executed as close to the market close as possible, ensuring that the trade is priced based on the day's closing value.

f) **Day Order**: A day order is an instruction to buy or sell a security that is valid only for the current trading day. If the trade is not executed by the end of the trading session, it expires and is canceled.

g) **Good 'til Cancelled (GTC) Order**: A good 'til cancelled order remains active until it is either executed or manually canceled by the trader. GTC orders remain in effect across multiple trading sessions until the specified conditions for execution are met or the trader decides to cancel the order.

h) **All-or-None (AON) Order**: An all-or-none order requires the complete execution of the entire order quantity or none at all. If the requested quantity cannot be filled in its entirety, the trade is not executed. AON orders are used when traders want to ensure that their entire order is filled or prefer not to execute a partial order.

i) **Fill-or-Kill (FOK) Order**: A fill-or-kill order requires the immediate execution of the entire order quantity, or it is canceled ("killed"). If the full order cannot be executed at once, the trade is not partially filled, and the order is canceled.

In India, various types of trading strategies and approaches are employed by participants in the financial markets. Here are some common types of trading in the Indian financial market:

a) **Day Trading:** Day trading involves executing trades within a single trading day. Day traders aim to take advantage of short-term price fluctuations and typically close out all their positions by the end of the day. They rely on technical analysis, charts, and market indicators to make quick trading decisions.

b) **Swing Trading**: Swing trading involves holding positions for a few days to a few weeks, capitalizing on medium-term price movements. Swing traders analyze charts, trends, and technical indicators to identify potential entry and exit points. They aim to capture short-to-medium-term price swings and often use stop-loss orders to manage risk.

c) **Position Trading:** Position trading is a longer-term trading strategy where positions are held for weeks, months, or even years. Position traders focus on fundamental analysis, economic indicators, and long-term trends to make trading decisions. They aim to capture significant price movements over a more extended period and may have a lower trading frequency compared to other strategies.

d) **Scalping:** Scalping is a high-frequency trading strategy characterized by making multiple quick trades to profit from small price fluctuations. Scalpers aim to capitalize on short-term liquidity imbalances and bid-ask spreads. They often use advanced trading technology, algorithms, and real-time data to execute trades rapidly.

e) **Arbitrage Trading**: Arbitrage trading involves exploiting price discrepancies between different markets or instruments to make risk-free profits. In India, common forms of arbitrage trading include cash-futures arbitrage, where traders simultaneously buy and sell a stock/index in the cash market and futures market to profit from price differentials.

f) **Algorithmic Trading:** Algorithmic trading, also known as algo trading or automated trading, involves using computer programs and algorithms to execute trades automatically based on predefined rules and parameters. Algorithms analyze market data, signals, and patterns to generate trading decisions. Algorithmic trading is prevalent among institutional investors and professional traders in India

g) **Options Trading**: Options trading involves trading options contracts, which give the holder the right to buy (call option) or sell (put option) an underlying asset at a predetermined price (strike price) within a specified period. Traders can use options for

speculative purposes, hedging, or income generation through strategies like covered calls, straddles, or spreads.

h) **Futures Trading:** Futures trading involves trading standardized contracts that obligate the buyer to purchase or the seller to sell an underlying asset at a future date and a predetermined price. Futures contracts in India include equity index futures, commodity futures, and currency futures. Traders speculate on the future price movements of the underlying assets.

i) **High-Frequency Trading (HFT)**: High-frequency trading involves using sophisticated algorithms and high-speed trading systems to execute a large number of trades within very short timeframes. HFT relies on ultra-low-latency technology and market data feeds to identify and capitalize on small price inefficiencies.

Types of Traders: In the financial markets, traders can be classified into various types based on their trading objectives, time horizons, and trading styles. Here are some common types of traders:

a) **Day Traders**: Day traders are individuals who execute multiple trades within a single trading day. They aim to profit from short-term price fluctuations and typically close out all their positions before the market closes. Day traders rely on technical analysis, charts, and market indicators to make quick trading decisions.

b) **Swing Traders**: Swing traders hold positions for a few days to a few weeks, aiming to capture medium-term price movements. They analyze charts, trends, and technical indicators to identify potential entry and exit points. Swing traders seek to take advantage of short-to-medium-term price swings and often use stop-loss orders to manage risk.

c) **Position Traders**: Position traders take longer-term positions that can be held for weeks, months, or even years. They focus on fundamental analysis, economic indicators, and long-term trends to make trading decisions. Position traders aim to capture significant price movements over an extended period and may have a lower trading frequency compared to other traders.

d) **Scalpers:** Scalpers are high-frequency traders who execute numerous quick trades to profit from small price fluctuations. They aim to capitalize on short-term liquidity imbalances and bid-ask spreads. Scalpers often use advanced trading technology, algorithms, and real-time data to execute trades rapidly.

e) **Algorithmic Traders**: Algorithmic traders, also known as algo traders, use computer programs and algorithms to execute trades automatically based on predefined rules and parameters. They develop or use pre-existing algorithms that analyze market data,

signals, and patterns to generate trading decisions. Algorithmic trading is prevalent among institutional investors and professional traders.

f) **Options Traders**: Options traders specialize in trading options contracts, which give them the right to buy (call option) or sell (put option) an underlying asset at a predetermined price within a specified period. Options traders employ various strategies to profit from options, such as directional bets, hedging, or income generation through options spreads.

g) **Futures Traders**: Futures traders focus on trading futures contracts, which obligate the buyer to purchase or the seller to sell an underlying asset at a future date and a predetermined price. They speculate on the future price movements of the underlying assets, including equity index futures, commodity futures, or currency futures.

h) **Long-Term Investors:** Long-term investors are individuals or institutions who take long-term positions in the financial markets, with the intention of holding their investments for extended periods, often years or decades. They base their investment decisions on fundamental analysis, company performance, and long-term growth prospects.

i) **Institutional Traders**: Institutional traders represent large financial institutions, such as banks, hedge funds, mutual funds, or pension funds. They execute trades on behalf of their clients or the institution itself. Institutional traders often have access to extensive resources, research, and market intelligence.

j) **Retail Traders**: Retail traders are individual traders who participate in the financial markets with their personal funds. They trade using their own accounts and may employ various trading strategies and time horizons.

5.3 Brokerage

Broker: A broker in the financial market is an individual or a firm that acts as an intermediary between buyers and sellers of financial instruments, such as stocks, bonds, commodities, or currencies. Brokers facilitate the execution of trades on behalf of their clients and provide various services related to trading and investing.

Here are a few key roles and responsibilities of a broker in the financial market:

a) **Trade Execution:** Brokers receive buy and sell orders from their clients and execute those orders in the market. They have access to trading platforms and exchanges where they can place orders on behalf of their clients to buy or sell financial assets.

b) **Market Research and Analysis**: Brokers often provide research and analysis on financial markets, sectors, and specific securities. They offer insights, recommendations, and market commentary to help their clients make informed investment decisions.

c) **Order Routing**: Brokers route orders to the appropriate exchanges or trading venues to ensure efficient and timely execution. They may use electronic trading systems or direct market access (DMA) to achieve the best possible execution for their clients.
d) **Custodial Services:** Some brokers also offer custodial services, which involve holding and safeguarding their clients' financial assets. This is particularly relevant for brokers dealing with securities, as they may hold the securities in custody on behalf of their clients.l
e) **Margin Trading and Leverage:** Brokers often provide margin trading facilities, allowing clients to trade with borrowed funds or leverage. This allows traders to amplify potential returns but also carries increased risk.
f) **Investment Advice**: Brokers may offer investment advice to their clients, providing personalized recommendations based on their financial goals, risk tolerance, and market conditions. However, it's important to note that not all brokers are authorized to provide investment advice, and clients should understand the specific services offered by their broker.
g) **Compliance and Regulatory Obligations**: Brokers must adhere to regulatory requirements and maintain compliance with applicable laws and regulations. They are responsible for ensuring that their activities and operations meet the necessary legal and ethical standards.

Brokers can operate in different markets, including stock markets, foreign exchange markets, commodities markets, and derivatives markets. They may specialize in specific asset classes or cater to different types of investors, such as retail clients, institutional investors, or high-net-worth individuals.

It's worth noting that the specific services and functions of brokers may vary depending on the jurisdiction and the type of brokerage firm. It's essential to conduct thorough research and choose a reputable broker that aligns with your investment needs and objectives.

Types of Brokers: There are several types of brokers in the financial market, each specializing in different areas and catering to specific client needs. Here are some common types of brokers:

a) **Stockbroker:** Stockbrokers facilitate the buying and selling of stocks and other securities on stock exchanges. They can be categorized as full-service brokers who provide a range of services, including research, investment advice, and portfolio management, or discount brokers who focus on executing trades at a lower cost.
b) **Forex Broker:** Forex brokers specialize in facilitating the trading of foreign currencies in the foreign exchange (forex) market. They provide platforms for retail traders and

institutional investors to trade currency pairs and often offer leverage, allowing traders to control larger positions with smaller amounts of capital.

c) **Commodities Broker**: Commodities brokers deal with the trading of physical commodities such as gold, oil, natural gas, agricultural products, and more. They facilitate transactions between buyers and sellers in commodity markets and provide market analysis, research, and risk management services.

d) **Futures Broker**: Futures brokers specialize in trading futures contracts. Futures are derivative financial instruments that obligate the buyer to purchase an asset or the seller to sell an asset at a predetermined price and future date. Futures brokers execute trades on futures exchanges and may offer additional services like margin trading and risk management.

e) **Options Broker**: Options brokers assist clients in trading options contracts. Options are derivative contracts that provide the right, but not the obligation, to buy or sell an underlying asset at a predetermined price within a specific timeframe. Options brokers provide platforms and tools for options trading and may offer educational resources on options strategies.

f) **Mortgage Broker**: Mortgage brokers act as intermediaries between borrowers and lenders in the real estate market. They help individuals and businesses find suitable mortgage loans by assessing their financial situation, shopping for loan options, and assisting with the application process. Mortgage brokers work with multiple lenders and offer loan products from various sources.

g) **Insurance Broker**: Insurance brokers assist individuals and businesses in finding suitable insurance coverage. They work with multiple insurance companies to provide options and recommendations based on clients' needs. Insurance brokers help clients navigate different types of insurance policies, compare rates, and manage their insurance portfolios.

h) **Investment Broker**: Investment brokers provide a range of investment services, including executing trades, managing portfolios, and offering investment advice. They may operate as full-service brokers, financial advisors, or wealth management firms. Investment brokers cater to different types of investors, such as retail clients, high-net-worth individuals, or institutional investors.

Brokerage: Brokerage refers to the services and activities provided by a brokerage firm or broker in the financial market. A brokerage serves as an intermediary between buyers and sellers, facilitating the buying and selling of financial instruments on behalf of their clients. The term "brokerage" can refer to both the firm itself and the specific services offered by the firm.

Here are some key aspects of brokerage:

a) **Trade Execution**: A brokerage firm executes trades on behalf of clients by placing buy and sells orders in the market. They have access to trading platforms and exchanges where they can execute trades efficiently and securely.

b) **Investment Advice and Research**: Many brokerages provide investment advice and research services to assist clients in making informed investment decisions. This can include market analysis, stock recommendations, economic research, and other insights to help clients navigate the financial markets.

c) **Account Management**: Brokerages typically offer account management services to help clients manage their investment portfolios. They may provide tools and platforms for clients to monitor their holdings, track performance, and make adjustments as needed.

d) **Custodial Services**: Some brokerages offer custodial services where they hold and safeguard their clients' financial assets, such as stocks, bonds, or other securities. This ensures the safekeeping and proper administration of the assets owned by clients.

e) **Margin Trading and Leverage**: Many brokerages provide margin trading facilities, allowing clients to trade with borrowed funds or leverage. This enables traders to amplify potential returns but also increases risk. Margin trading is subject to specific rules and requirements set by regulatory authorities.

f) **Account Types**: Brokerages often offer different types of accounts to cater to various investor needs. These can include individual brokerage accounts, retirement accounts (such as IRAs or 401(k)s), education savings accounts (such as 529 plans), and more.

g) **Fees and Commissions**: Brokerages charge fees and commissions for their services, which can vary depending on the type of trade or service provided. Common fee structures include commission-based fees, where the broker charges a percentage of the trade value, or flat fees for specific services.

h) **Regulatory Compliance**: Brokerages are subject to regulations and oversight by financial authorities in the jurisdictions where they operate. They must adhere to applicable laws and regulations to ensure client protection, fair practices, and transparency.

How to Calculate Brokerage?

The methods of calculating brokerage fees can vary depending on the brokerage firm and the specific services provided. Here are some common methods used to calculate brokerage fees:

a) **Flat Fee**: Some brokerages charge a fixed or flat fee for each trade regardless of the trade size or value. For example, they may charge $10 per trade, whether you are buying or

selling 10 shares or 1,000 shares. This method is straightforward and can be cost-effective for larger trades.

b) **Percentage of Trade Value**: Many brokerages calculate the brokerage fee as a percentage of the trade value. For instance, they may charge 1% of the trade value as the commission. So, if you trade $10,000 worth of stocks, the brokerage fee would be $100. This method is proportional to the trade size and is commonly used for various types of trades.

c) **Sliding Scale Commission:** Some brokerages use a sliding scale commission structure where the commission rate decreases as the trade size increases. For example, the brokerage may charge 1% for trades up to $10,000, but if the trade value exceeds $10,000, the commission rate reduces to 0.75% or lower. This method incentivizes larger trades and can result in lower fees for larger investors.

d) **Per-Share Commission**: In certain cases, especially with smaller trades or specific asset classes like penny stocks, brokerages charge a per-share commission. They levy a fixed fee for each share bought or sold. For example, they might charge $0.01 per share, which means a trade of 500 shares would incur a $5 brokerage fee. This method is commonly used for trading stocks or exchange-traded funds (ETFs).

e) **Fee Based on Account Size**: Some brokerages charge fees based on the size of the client's investment account or portfolio. Instead of transaction-based fees, they may charge a percentage of the total assets under management (AUM) annually. This method is often used by full-service brokerages or wealth management firms and is more common for managing larger portfolios.

f) **Additional Fees**: Apart from the brokerage fee for executing trades, there may be additional fees charged by brokerages for specific services. These can include account maintenance fees, inactivity fees for dormant accounts, fees for accessing research reports or data feeds, and fees for specific types of trades or investment products.

To calculate brokerage fees for a specific trade, you need to consider the brokerage fee structure provided by your broker. Here are two common methods for calculating brokerage fees:

a) **Flat Fee Calculation**:

If your broker charges a flat fee for each trade, the calculation is straightforward. You simply need to multiply the flat fee by the number of trades executed. For example, if the brokerage fee is $10 per trade and you execute 3 trades, the total brokerage fee would be 3 trades * $10 = $30.

b) **Percentage of Trade Value Calculation**:

If your broker charges a percentage-based fee, you need to calculate the fee based on the trade

value. To do this, follow these steps:

Step 1: Determine the trade value.

Calculate the total value of the securities bought or sold in the trade. For example, if you purchase 100 shares of a stock at $50 per share, the trade value would be 100 shares * $50 = $5,000.

Step 2: Calculate the brokerage fee.

Multiply the trade value by the brokerage fee percentage. For instance, if the brokerage fee is 1%, the brokerage fee would be 1% * $5,000 = $50.

Note: Some brokerages may have a minimum fee requirement. If the calculated brokerage fee is below the minimum fee, the minimum fee will be charged instead.

It's important to review your broker's fee structure and any additional fees that may apply, as these can vary from broker to broker. Always refer to the specific fee schedule provided by your broker to ensure accurate calculation of brokerage fees for your trades.

Certainly! Let's consider an example where we calculate brokerage fees using different methods: flat fee and percentage of trade value.

Example:

You execute a trade to buy 500 shares of Stock ABC at a price of $30 per share. Your brokerage offers a flat fee of $10 per trade and also charges a commission of 0.2% on the trade value.

a) **Flat Fee Calculation**:

Brokerage Fee = Flat fee per trade

Brokerage Fee = $10

Regardless of the trade value or the number of shares, the flat fee remains the same. So, in this case, the brokerage fee would be $10.

b) **Percentage of Trade Value Calculation:**

Step 1: Determine the trade value.

Trade Value = Number of shares * Share price

Trade Value = 500 shares * $30 = $15,000

Step 2: Calculate the brokerage fee.

Brokerage Fee = Trade Value * Commission percentage

Brokerage Fee = $15,000 * 0.2% = $30

Using the percentage-based method, the brokerage fee for this trade would be $30.

In this example, the flat fee and percentage of trade value methods result in different brokerage fees. The flat fee remains constant regardless of the trade value, while the percentage-based fee increases with the trade value.

5.4. Summary

Financial markets serve as platforms where individuals, institutions, and governments trade various financial assets such as stocks, bonds, currencies, and derivatives. They facilitate the efficient allocation of capital, enabling investors to invest in businesses, governments to raise funds for projects, and individuals to manage their wealth. Financial markets also play a crucial role in price discovery, risk management, and liquidity provision within the economy.

Traders in financial markets can be categorized into different groups based on their characteristics and objectives. Retail traders are individual investors who trade securities for personal investment purposes, while institutional traders, including mutual funds and hedge funds, handle large volumes of capital on behalf of clients. Market makers, such as brokerage firms, provide liquidity by quoting bid and ask prices for securities, facilitating smooth trading operations. Trades in financial markets can take various forms, depending on the execution method and order type. Market orders are executed at the prevailing market price, while limit orders are executed only if the market reaches a specified price limit set by the trader. Brokerage fees are charges imposed by brokerage firms for executing trades on behalf of clients. These fees vary depending on factors such as the type of asset traded, trade size, and brokerage firm policies. Brokerage fees can be fixed per trade, a percentage of the trade value, or a combination of both. Traders need to consider brokerage fees when evaluating the cost-effectiveness of their trading strategies and selecting brokerage services that align with their financial goals and preferences. Understanding brokerage calculations is essential for traders to manage their trading costs effectively and optimize their investment returns.

Glossary

a) Financial markets are platforms where individuals, companies, and governments engage in various transactions involving financial assets. These markets facilitate the buying and selling of financial instruments such as stocks, bonds, currencies, derivatives, and commodities.

b) Trade refers to the exchange of goods, services, or financial instruments between parties. It involves the buying and selling of products or services in various markets to meet the needs and preferences of individuals, businesses, or nations.

c) Broker in the financial market is an individual or a firm that acts as an intermediary between buyers and sellers of financial instruments, such as stocks, bonds, commodities, or currencies. Brokers facilitate the execution of trades on behalf of their clients and provide various services related to trading and investing.

d) Brokerage refers to the services and activities provided by a brokerage firm or broker in the financial market. A brokerage serves as an intermediary between buyers and sellers,

facilitating the buying and selling of financial instruments on behalf of their clients. The term “brokerage” can refer to both the firm itself and the specific services offered by the firm.

Long Answer Type Questions

a) Explain the concept of brokerage calculation by giving suitable examples.

b) Highlight the role of SEBI in financial markets.

c) “Brokers play a critical role in the financial market” Comment and discuss the types of brokers.

d) Explain the types of trade in financial market.

e) Define Stock Exchange. Discuss its role.

f) “Stock exchanges in India are emerging faster for the development of economy” Discuss and highlight the growth and future aspects of Stock exchange in India with a view to enhance financial markets.

g) Discuss brokerage in detail.

h) Discuss key components of financial markets

i) What are the key aspects and functions of financial markets in India?

j) Explain various types of brokers

Short Answer Type Questions

a) Define financial markets

b) Define trade

c) Define role of SEBI in financial markets

d) Explain role of broker

e) Brokerage

f) Types of broker

g) Brokerage calculation

h) Key Components of financial markets

i) Types of brokerage

j) Steps to calculate brokerage

Suggested readings

a) Bhalla, V.K. “Management of Financial Services”, Anmol Publications Pvt. Ltd., NewDelhi.

b) Pathak, Bharati, “Indian Financial System”, Pearson Education, New Delhi

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT VI: Depositary: An Introduction, Practical aspects and background of Depositaries: NSDL, CDSL.

Structure

6.1 Introduction

6.2 Depository System

6.3 NSDL

6.3.1 Functions of NSDL

6.3.2 Significance of NSDL

6.4 CDSL

6.4.1 Benefits

6.4.2 Functions of CDSL

6.5 Difference between NSDL and CDSL

6.6 Summary

6.7 Glossary

Long Answer Type Questions

Short Answer Type Questions

Suggested Readings

6.0 Objectives

After going through this unit, student will be able to:

- Explain the concept of depositories;
- Discuss the importance of depository;
- Elucidate the functioning of depositories; and
- Describe the mechanism of dematerialization appreciate involvement of technology in depository.

6.1 Introduction

A Depository is like a bank account which enables the holding of securities in the electronic form and enables securities transactions to be processed by book entry in your Demat account. It will eliminate the risk of the physical handling of financial securities. The Depository Participant (DP), who acts as an agent of the depository who offers depository services to investors? A DP will also assist you in buying or selling securities. They are also called stockbrokers. He/she is act as a registered agent or stockbroker. The DP will provide you with a trading platform. Depository Participants/DP will play a vital role to help an investor to open an account with the depository. Depositories, whether they are central securities depositories (CSDs) or other types of financial institutions offering custody and related services, possess several features that make them essential components of the financial infrastructure. Following are features of depositories

a) **Safekeeping of Securities:**

Custodial Services: Depositories hold securities, such as stocks, bonds, and other financial instruments, in electronic form on behalf of investors. They ensure the safekeeping and protection of these securities against loss, theft, or damage.

Dematerialization: Depositories facilitate the conversion of physical securities into electronic form, a process known as dematerialization. This eliminates the need for physical certificates, reducing the risk of loss or forgery.

b) **Securities Settlement:**

Efficient Settlement: Depositories play a crucial role in the settlement of securities transactions. They facilitate the transfer of securities and funds between buyers and sellers, ensuring timely and accurate settlement of trades.

Delivery versus Payment (DVP): Depositories often operate on a delivery versus payment basis, where the transfer of securities is synchronized with the transfer of funds to minimize settlement risk.

c) **Asset Servicing:**

Actions Processing: Depositories handle corporate actions such as dividends, interest payments, stock splits, mergers, and acquisitions on behalf of investors. They ensure that investors receive timely notifications and instructions regarding corporate actions and facilitate the processing of related entitlements.

Proxy Voting: Depositories may provide proxy voting services, allowing investors to participate in corporate governance matters and exercise voting rights associated with their securities holdings.

d) **Record-Keeping and Reporting**:

Transaction Records: Depositories maintain detailed records of securities holdings, transactions, and account balances for investors. They provide investors with regular statements and reports, enabling them to track their investment portfolios and monitor transaction activity.

Regulatory Reporting: Depositories fulfill regulatory reporting requirements by providing regulators with accurate and timely information on securities holdings, transactions, and investor accounts.

e) Risk Management:

Risk Mitigation: Depositories implement robust risk management practices to mitigate operational, financial, and systemic risks associated with securities custody and settlement activities.

Collateral Management: Depositories may offer collateral management services, allowing market participants to use securities held in custody as collateral for transactions such as securities lending, repurchase agreements, and derivatives trading.

f) **Regulatory Oversight**:

Regulatory Compliance: Depositories are subject to regulatory oversight by financial regulators and securities market authorities. They must comply with applicable laws, regulations, and industry standards governing securities custody, settlement, and related activities.

Risk-Based Supervision: Regulators monitor depositories' compliance with regulatory requirements and conduct periodic assessments of their risk management practices and operational resilience.

g) Integration with Financial Infrastructure:

Interoperability: Depositories often interact with other components of the financial infrastructure, including stock exchanges, clearinghouses, payment systems, and securities regulators, to facilitate seamless and efficient securities trading, settlement, and investor services.

Technology Integration: Depositories leverage advanced technology and infrastructure

to support their operations, enhance service delivery, and ensure the security and integrity of electronic securities transactions.

h) **Types of Depositaries**:

Bank Depositaries: Commercial banks and other financial institutions often provide depositary services as part of their broader range of banking and financial services.

Central Securities Depositories (CSDs): CSDs are specialized depositaries that provide central custody and settlement services for securities traded in financial markets. They play a critical role in ensuring the efficiency and integrity of securities trading and settlement systems.

Global Custodians: Large financial institutions known as global custodians offer depositary services on a global scale, catering to institutional investors, asset managers, and other financial market participants.

i) Regulatory Framework:

Depositaries are typically subject to regulatory oversight by financial regulators and securities market authorities in the jurisdictions where they operate. Regulatory requirements may vary depending on the nature of depositary services and the types of clients served. Regulatory frameworks governing depositaries often focus on safeguarding client assets, ensuring operational reliability and resilience, maintaining adequate capital and liquidity buffers, and complying with legal and regulatory obligations related to securities custody and settlement.

j) Importance in Financial Markets:

Depositaries play a vital role in supporting the functioning and efficiency of financial markets by providing essential infrastructure and services for securities trading, settlement, and asset management. They contribute to investor confidence and market stability by ensuring the safekeeping and integrity of securities holdings and transactions, reducing counterparty and operational risks, and facilitating investor access to global capital markets. Depositories play a critical role in the functioning of financial markets by providing custody, settlement, asset servicing, and risk management services that promote market efficiency, investor confidence, and systemic stability. Their features contribute to the smooth operation of securities markets and the effective management of investors' assets.

6.2 Depository System

Depository system essentially aims at eliminating the voluminous and cumbersome paper work involved in the scrip-based system and offers scope for ‘paperless’ trading through state-of-the-art technology. It is an institution which maintains an electronic record of ownership or securities. The storage and handling of certificates is hence immediately

eliminated which generates a reduction in costs like back office cost for handling, transporting and storing certificates. Following are the key features of Depository System

a) **Objective of the Depository System**: The depository system aims to replace the traditional paper-based system of trading securities with an electronic system. This transition eliminates the need for physical share certificates and reduces the associated paperwork, thus streamlining the trading process.

b) **Role of Depository Participants (DPs)**: Depository participants act as intermediaries between investors and the depository. When investors transfer their securities to a DP, their accounts are credited in the depository system, and their holdings are recorded electronically.

c) **Dematerialization of Securities**: The process of dematerialization involves converting physical share certificates into electronic form. This is done by surrendering the share certificates to the DP, who sends them to the respective companies for cancellation. The securities are then credited to the investor's depository account.

d) **Benefits of Dematerialization**: Dematerialized securities appear as balances in the investor's depository account, making them easily transferable without the need for physical movement of share certificates. Investors can buy and sell securities electronically, with their depository accounts being updated for transactions.

e) **Rematerialization**: If investors wish to convert their dematerialized securities back into physical certificates, they can do so through a process called rematerialization. The depository handles this conversion, and the investor's name is entered into the company's ownership register as the beneficial owner.

f) **Legal Ownership and Beneficial Ownership**: While the legal ownership of securities remains with the depository, the beneficial ownership lies with the investors. This means that investors are entitled to benefits such as dividends, interest, bonus shares, and voting rights associated with their securities.

g) **Role in Company Ownership Register**: The depository's name is registered in the ownership register maintained by the company instead of individual investors' names. This simplifies the process of updating ownership records for the company, as transfers of securities only occur within the depository system.

h) **Advantages of the Depository System**: The depository system alleviates hardships faced by investors by providing a more efficient and secure method of trading securities. It also

offers flexibility by allowing investors to convert their securities between electronic and physical forms as needed.

i) **Global Adoption of Depository Systems**: Depository systems have been prevalent in advanced countries for a long time and have played a significant role in global stock markets. This indicates the effectiveness and reliability of the depository system in facilitating securities trading worldwide.

Constituents of Depository System

The depository system comprises of:

a) Depository

Depository functions like a securities bank, where the dematerialized physical securities are traded and held in custody. This facilitates faster risk free and low cost settlement. Depository is much like a bank and performs many activities that are similar to a bank depository:

- Enables surrender and withdrawal of securities to and from the depository through the process of 'demat' and 'remat',
- Maintains investors' holdings in electronic form
- Effects settlement of securities traded in depository mode on the stock exchanges,
- Carries out settlement of trades not done on the stock exchanges (off market trades).

Depository, operating in India, shall have a net worth of rupees one hundred crore and instruments for which depository mode is open need not be a security as defined in the Securities Contract (Regulations) Act 1956. The depository, holding securities, shall maintain ownership records in the name of each participant. Despite the fact that legal ownership is with depository, it does not have any voting right against the securities held by it. Rights are intact with investors. There are two depositories in India at present i.e., NSDL and CDSL.

b) Depository Participants (DP)

A DP is investors' representative in the depository system and as per the SEBI guidelines, financial institutions/banks/custodians/stock brokers etc. can become DPs provided they meet the necessary requirements prescribed by SEBI. DP is also an agent of depository which functions as a link between the depository and the beneficial owner of the securities. DP has to get itself registered as such under the SEBI Act. The relationship between the depository and the DP will be of a principal and agent and their relation will be governed by the bye-laws of the depository and the agreement between them. Application for registration as DP is to be submitted to a depository with which it wants to be associated. The registration granted is valid for five years and can be renewed. As depository holding the securities shall maintain ownership records in the name of each DP, DP in return as an agent of depository, shall maintain ownership records of

every beneficial owner (investor) in book entry form. A DP is the first point of contact with the investor and serves as a link between the investor and the company through depository in dematerialisation of shares and other electronic transactions. A company is not allowed to entertain a demat request from investors directly and investors have to necessarily initiate the process through a DP.

6.3 NSDL

The full form of NSDL is "National Securities Depository Limited." This name accurately reflects its primary function, which is to act as a depository for securities on a national scale, serving investors and financial institutions across India. NSDL, or the National Securities Depository Limited, is a pivotal institution in India's financial infrastructure. It is a central securities depository, and its primary role is to facilitate the holding, trading, and settlement of securities in electronic form. In simpler terms, NSDL is responsible for maintaining electronic records of securities, such as stocks and bonds, in dematerialized (demat) form, thus eliminating the need for physical certificates.

NSDL operates by holding securities in electronic form on behalf of investors. When an individual or entity opens a demat account with a depository participant (DP), which could be a bank or a financial institution registered with NSDL, they can electronically store their securities with NSDL. These securities are held in a dematerialized form, which means they exist only as electronic records, and physical certificates are no longer required. When an investor buys or sells securities, the transaction is recorded electronically in their demat account. NSDL ensures the safekeeping and maintenance of these electronic records, making it convenient for investors to buy, sell, and transfer securities seamlessly.

6.3.1 Functions of NSDL

NSDL performs several critical functions within the Indian financial system:

a) **Dematerialization**: NSDL facilitates the conversion of physical share certificates into electronic form. This process is known as dematerialization, and it has significantly reduced the paperwork associated with securities transactions.

b) **Depository participant services**: NSDL authorizes and regulates depository participants (DPs), which are financial institutions that offer demat account services to investors. These DPs act as intermediaries between investors and NSDL, helping investors manage their securities

c) **Safekeeping of securities:** One of NSDL's primary roles is to ensure the safekeeping of electronic securities in demat accounts. This mitigates the potential for physical certificate loss or damage.

d) **Settlement of trades:** NSDL plays a crucial role in the settlement of securities transactions. When a trade is executed, NSDL ensures the transfer of securities from the seller's demat account to the buyer's demat account, facilitating a smooth settlement process.

e) **Corporate actions:** NSDL assists in the processing of corporate actions such as dividends, bonus issues, and rights issues. Shareholders receive these benefits directly in their demat accounts.

f) **Electronic voting**: In cases where shareholders need to vote on corporate matters, NSDL facilitates electronic voting, making it easier for investors to participate in important decisions.

g) **Reducing frauds**: By eliminating physical certificates and ensuring electronic record-keeping, NSDL has contributed significantly to reducing fraud and forgery related to securities.

6.3.2 Significance of NSDL

The establishment of NSDL has brought about several significant advantages and changes in the Indian financial landscape:

a) **Efficiency**: NSDL has streamlined the process of buying and selling securities by eliminating the need for physical certificates. This has made transactions quicker and more efficient.

b) **Reduced costs**: The dematerialization of securities has reduced the cost associated with printing, handling, and storing physical certificates. Investors also save on stamp duty, which is not applicable to electronic transactions.

c) **Increased transparency**: Electronic records and real-time access to demat accounts have enhanced transparency in the Indian securities market. Investors can easily track their holdings and transactions.

d) **Accessibility:** NSDL has made investing in securities more accessible to a broader range of investors. It has removed geographical barriers and made it easier for individuals across India to participate in the financial markets.

e) **Reduced risks**: The electronic format of securities and the stringent security measures implemented by NSDL have significantly reduced the risks of theft, loss, and fraud associated with physical certificates.

f) **Corporate governance**: NSDL's electronic voting platform has improved corporate governance by allowing shareholders to participate more actively in decision-making processes.

NSDL, the National Securities Depository Limited, plays a pivotal role in modernizing and revolutionizing India's financial markets. Its functions extend from facilitating the dematerialization of securities to ensuring the efficient settlement of transactions and enhancing transparency. By eliminating the need for physical certificates and providing secure electronic record-keeping, NSDL has made investing more accessible, efficient, and secure for investors across the country. As India's financial landscape continues to evolve, NSDL remains a cornerstone of the nation's financial infrastructure, shaping the way securities are bought, sold, and held in the digital age.

6.4 CDSL

Central Depository Services Limited or CDSL, is the second largest central depository of securities in India. It is founded in 1999, the headquarters of the CDSL is located in Mumbai.

It holds various securities like shares, debentures, government securities, commercial papers, bonds, mutual funds, etc. in demat account format. Under CDSL the trade activities and settlement of securities are to be processed by book entry. It focuses to provide secure and authentic depository services. CDSL enables secure transactions by playing a somewhat similar role to what banks play in handling cash and fixed deposits. Though banks help customers store their currency in electronic form the CDSL share depositories help consumers store shares in a dematerialized form.

The main Features of CDSL is to hold the securities in certificated or in un-certificated form. It helps to over-come from the problem to register the trades in the books and only transfer of securities up to 500 shares in physical form. Most of the traders have adopted the form of holding the securities in electronic format for trading.

A depository operates like a bank and only the thing that is different from the bank is that it holds money whereas, in CDSL it holds stocks, shares, bonds etc. It is an administrative body that holds the securities of the investors in an electronic format when it is asked by the investor through a registered Depository Participant (DP). The primary focus of Central Depository Service Limited is to give safe, reliable, useful and secure depository services to the investors or traders. After getting permission from the Securities and Exchange Board of India (SEBI) from February 1999, the CDSL started its working. They offer different services for holding the securities, equity, bonds, commercial papers, government, certificate of deposits etc.

6.4.1 Benefits of CSDL

a) The main benefit of Central Depository Service Limited is that all the shares are holding in the electronic format so the risk of been loss, theft or any damage to the physical share to certificates has been neglected.

b) There is no need for stamp duty for the investors when it is transferring securities in dematerialized format.

c) Through this, the companies can directly credit their investors if in case of any right issue or bonus issue of shares.

d) The investor can get real-time information about the listed company management about the holdings and can track the change in any detail related to that security or stock. Overall, CDSL plays a vital role in the Indian capital markets by providing efficient, secure, and convenient ways for investors to hold and transact in securities.

e) The Central Depository Service Limited send the investor the statement that completely contains all the holdings of that period which will be helpful to the investors to make the informed decisions for their financial strategy.

6.4.2 Functions of CDSL

a) Depository Services: CDSL provides depository services whereby investors can hold securities such as stocks, bonds, debentures, and mutual fund units in electronic form.

b) Dematerialization: One of the primary functions of CDSL is to convert physical securities (share certificates) into electronic form. This process is known as dematerialization, and it helps in eliminating the risks associated with physical certificates and facilitates faster and smoother transactions.

c) Rematerialization: CDSL also facilitates the conversion of electronic securities holdings back into physical certificates, if required. This process is known as rematerialization.

d) Transfer of Securities: CDSL enables the transfer of securities from one demat account to another electronically. This facilitates faster settlement of trades and reduces paperwork.

e) Settlement of Trades: CDSL plays a crucial role in settling trades executed on stock exchanges. It ensures the smooth transfer of securities and funds between the buyer and the seller.

f) Corporate Actions: CDSL assists in the processing of various corporate actions such as bonus issues, dividends, rights issues, and mergers for securities held in demat accounts.

g) Pledging and Hypothecation: Investors can pledge or hypothecate their securities held in demat accounts as collateral for loans or margin requirements. CDSL facilitates the pledging and release of securities.

h) **Electronic Voting**: CDSL provides electronic voting services to shareholders of companies listed on stock exchanges. Shareholders can cast their votes electronically for corporate resolutions.

i) **Issuer Services**: CDSL offers services to issuers of securities, including corporate actions, investor services, and compliance-related activities.

j) **Investor Services**: CDSL provides various services to investors, including account statements, transaction statements, alerts, and notifications related to their demat accounts.

6.5 Difference Between NSDL and CDSL

Feature	NSDL	CDSL
Meaning	National Securities Depository Limited	Central Depository Services Limited
Year of Establishment	1996	1999
Operating Market	National Stock Exchange (NSE)	Bombay Stock Exchange (BSE)
Demat Account Number Format	14-character numeric code starting with IN	16-digit numeric code
Number of Demat Accounts (as of November 2023)	Over 3.41 crore	Over 10 crore
Services Offered	Demat services, account maintenance services like updating investor details and nominee registration.	Similar to NSDL with additional facilities for pledge and hypothecation of securities.
DEMAT Account Number Format	14-character numeric code starting with IN	16-digit numeric code

6.6 Summary

Depositaries play a pivotal role in modern financial markets by facilitating the electronic holding and transfer of securities. Depositaries like NSDL and CDSL are instrumental in modernizing and enhancing the efficiency, transparency, and security of financial markets by facilitating electronic securities holding and transactions. Their services benefit investors, issuers, and market participants, contributing to the growth and stability of the overall financial ecosystem. Depositaries serve as custodians for securities in electronic form, replacing the traditional system

of physical share certificates. It convert physical securities into electronic form, known as dematerialization, making transactions more efficient and secure. They enable the transfer of securities between investors electronically, reducing paperwork and settlement time. Depositaries process corporate actions such as dividends, bonus issues, and rights offerings on behalf of investors. They provide various services to investors, including account statements, transaction statements, and electronic voting facilities. Depositaries comply with regulatory requirements set by securities market regulators, ensuring transparency and investor protection. NSDL (National Securities Depository Limited was established in 1996, NSDL was India's first electronic securities depository, promoting dematerialization and efficient securities settlement. CDSL (Central Depository Services Limited) was founded in 1999, CDSL is another major depository in India, enhancing market infrastructure and investor services. Depositaries streamline securities transactions, reducing processing time and costs associated with physical certificates.Electronic holding and transfer of securities mitigate risks such as loss, theft, and forgery associated with physical certificates. Depositaries contribute to the development and integration of capital markets by providing a robust infrastructure for securities trading and investment. Both NSDL and CDSL serve as custodians of securities in electronic form, eliminating the need for physical share certificates through dematerialization. This process has streamlined securities transactions, reducing settlement time and enhancing market efficiency. Their functions include dematerialization, facilitating the transfer of securities, processing corporate actions, and providing investor services such as account statements and electronic voting facilities. NSDL and CDSL play a crucial role in investor protection, ensuring the integrity and transparency of the securities market. The regulatory framework governing NSDL and CDSL is overseen by the Securities and Exchange Board of India (SEBI). SEBI sets rules and guidelines to regulate their operations, ensuring compliance with investor protection norms and market integrity standards. Both depositories are subject to periodic audits and inspections to maintain regulatory compliance. NSDL and CDSL have significantly contributed to the growth and development of the Indian capital markets. They have facilitated greater investor participation, enhanced market liquidity, and reduced transaction costs. Their electronic infrastructure has enabled faster settlement cycles and improved risk management practices. Despite their similar functions, NSDL and CDSL have unique ownership structures and operational models. NSDL has a diverse shareholder base, including financial institutions, whereas CDSL has strong ties with the Bombay Stock Exchange and leading banks. In conclusion, NSDL and CDSL have played a transformative role in modernizing India's securities market. Their electronic depository services have facilitated a seamless and efficient trading environment, benefiting investors, issuers, and market intermediaries alike. Their continued adherence to regulatory standards and technological innovation will be critical in shaping the future of India's financial landscape.

Glossary

- **a) Demat:** Investor securities like shares, debentures, etc. are converted into electronic data and stored in computers by a depository.
- **b) Depository:** Functions like a securities bank, where the dematerialized physical securities are traded and held in custody.
- **c) Depository Account:** An account which the investor opens with a DP wherein all the details of the investor's transactions are recorded in demat form.
- **d) Dematerialization (Demat):** Is a process whereby physical existence of security certificates is made extinct and converted into electronic holdings.
- **e) Rematerialization:** Converting the shares from electronic to physical or paper form.

Long Answer Type Questions

- **a)** Provide a detailed overview of NSDL (National Securities Depository Limited), including its establishment, objectives, and role in the Indian securities market.
- **b)** Explain the significance of dematerialization in the context of NSDL and CDSL, highlighting its benefits for investors, issuers, and market intermediaries.
- **c)** Discuss the services offered by NSDL and CDSL to investors, including account management, transaction statements, and electronic voting facilities, and explain how these services enhance investor experience.
- **d)** Compare and contrast the ownership structures of NSDL and CDSL, including their promoters, shareholders, and governance mechanisms.
- **e)** Evaluate the technological infrastructure and security measures implemented by NSDL and CDSL to ensure the safekeeping and transfer of securities in electronic form.
- **f)** Analyze the role of NSDL and CDSL in facilitating corporate actions such as dividends, bonus issues, and rights offerings, and explain how these processes benefit investors and companies.
- **g)** Discuss the regulatory framework governing depositaries in India, including the rules and guidelines prescribed by SEBI (Securities and Exchange Board of India) for the operations of NSDL and CDSL.
- **h)** Examine the challenges and opportunities faced by NSDL and CDSL in the evolving landscape of the Indian securities market, considering factors such as competition, technological advancements, and regulatory changes.
- **i)** Assess the market share and competitive positioning of NSDL and CDSL in the Indian depository services industry, and discuss the strategies employed by each depository to expand its market presence.

j) Explore the future prospects and growth potential of NSDL and CDSL, considering emerging trends in the securities market and the evolving needs of investors and issuers.

Short Answer Type Questions

a) What is the primary function of depositaries?

b) Define dematerialization in the context of depositaries.

c) Name two major depositaries in India.

d) What does NSDL stand for?

e) When was CDSL established?

f) What role do depositaries play in corporate actions?

g) How do depositaries contribute to market efficiency?

h) What services do depositaries provide to investors?

i) Who regulates depositaries in India?

j) What are the key benefits of using depositaries for securities holding and transfer?

Suggested Reading

a) Bhalla, V.K. "Management of Financial Services", Anmol Publications Pvt. Ltd., New Delhi.

b) Pathak, Bharati, "Indian Financial System", Pearson

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT VII	Statements: Holding statement, Transaction Statement. Dematerialization Procedure

Structure

7.0 Objective

7.1 Introduction

7.2 Concept of Dematerialization

7.3 Holding Statement

7.3.1 Key components in Holding Statement

7.3.2 How to view Holding Statement

7.3.3 Benefits of Holding Statement

7.4 Transaction Statement

7.4.1 Key components of Transaction Statement

7.4.2 Benefits of Transaction Statement

7.5 Dematerialization procedure

7.6 Summary

Glossary

Short answer type questions

Long answer type questions

Suggested Readings

7.0 Objectives

After studying this unit, student will be able to:

- Concept of Dematerialization
- Key components in Holding Statement
- Benefits of Holding Statement
- Various Constituents of Transaction Statement
- Benefits of Transaction Statement
- Dematerialization procedure
- Tax Planning

7.1 Introduction

Dematerialization, also known as dematerialization of securities, refers to the process of converting physical securities, such as stocks and bonds, into electronic or digital form. It involves eliminating the physical certificates that represent ownership of these securities and replacing them with electronic records stored in a centralized depository system. The dematerialized securities are then held in an account known as a Demat account, which is like a bank account but specifically for holding securities.

The process of dematerialization typically involves opening ademat (dematerialization) account with a depository participant, who acts as an intermediary between investors and the central depository. Investors can then deposit their physical certificates, which are verified and converted into electronic form. The depository maintains records of ownership and facilitates electronic transfers of securities.

Dematerialization has gained widespread adoption in many countries around the world, with centralized depositories and electronic trading platforms becoming the norm in modern securities markets. It has revolutionized the way securities are traded, making the process more efficient, secure, and accessible to a wider range of investors.

7.2 Concept of Dematerialization

Traditionally, when someone purchased stocks, bonds, or other financial instruments, they would receive physical certificates representing their ownership. These certificates had to be stored and safeguarded, and the transfer of ownership involved a cumbersome and time-consuming process of physically delivering the certificates.

With the advent of computer technology and the internet, the concept of dematerialization emerged. Dematerialization allows for the elimination of physical certificates and the conversion of securities into electronic or digital entries. In this digital form, the ownership and transfer of assets can be easily managed and recorded electronically.

Dematerialization offers several advantages over the traditional paper-based system. Here

are some key benefits:

a) **Elimination of Physical Certificates**: By converting securities into electronic form, the need for handling and storing physical certificates is eliminated. This reduces the risk of loss, theft, and damage associated with physical securities.

b) **Increased Efficiency**: Electronic records can be easily accessed and transferred, resulting in faster and smoother transactions. The time required for settlement of trades is significantly reduced, enabling quicker ownership transfers and liquidity.

c) **Cost Savings**: Dematerialization reduces administrative and transaction costs associated with physical securities. It eliminates expenses related to printing, stamp duty, courier services, and storage of physical certificates.

d) **Improved Security**: Digital records are more secure than physical certificates, as they are protected by encryption and other security measures. The risk of forgery and unauthorized transfers is minimized, enhancing the integrity of the securities market.

e) **Accessibility and Convenience**: Dematerialization allows investors to access their holdings electronically, providing them with real-time information and the ability to monitor their investments easily. It also enables online trading and seamless integration with other financial services.

Dematerialization has revolutionized the financial markets, making it easier for investors to participate and trade securities. It has played a crucial role in the development of online trading platforms and has made investing more accessible to a broader range of people. Dematerialization has transformed the way securities are held and traded, streamlining processes, increasing efficiency, and enhancing the security and convenience of investors.

7.3 Holding Statement

A holding statement, also known as an account statement or a securities statement, is a document that provides detailed information about the securities held in a particular investor's Demat account. It serves as a record of the investor's holdings and transactions in electronic or digital form. Investors can view their Demat holdings through online portals provided by depository participants (DPs) or through other platforms that offer Demat account services. These platforms usually display the details of the securities held, including the quantity, value, transaction history, and other relevant information.

A holding statement is a document that outlines the status of an individual's or organization's investment holdings. It typically includes details about the types of investments held, such as stocks, bonds, mutual funds, or other financial instruments. The statement provides information about the quantity or number of units held for each investment, as well as their current market value. It may also include additional

information like the cost basis (the original purchase price), any dividends or interest received, and the overall performance of the investments.

7.3.1 Key components in Holding Statement

A holding statement typically includes the following information:

a) **Investor Details**: The statement starts by displaying the investor's personal information, including their name, address, contact details, and unique identification number associated with their Demat account.

b) **Demat Account Information**: This section provides details about the investor's Demat account, such as the account number, type of account, and the depository participant with whom the account is held.

c) **Security Details**: The holding statement provides a comprehensive list of the securities held by the investor. It includes the names of the securities, their unique identification symbols (e.g., International Securities Identification Number - ISIN), the quantity held, and any additional information specific to each security, such as the face value or maturity date.

d) **Transaction History**: The statement also contains a transaction history, which records all the transactions related to the securities in the account. This includes information about purchases, sales, transfers, dividends, bonuses, and any other relevant activities. Each transaction is typically accompanied by details such as the date, quantity, price, and transaction type.

e) **Valuation and Holdings Summary**: Many holding statements provide a summary section that gives an overview of the investor's portfolio. This summary may include the total value of the holdings based on current market prices, the percentage change in the portfolio value, and any unrealized gains or losses.

f) **Dividends/Interest**: If you hold dividend-paying stocks or interest-bearing securities, the statement may include details of dividends or interest received during a specific period. This information typically includes the amount received, the date of payment, and the security from which it was received.

g) **Market Value**: The statement may display the market value of each holding, which represents the current worth of the security based on prevailing market prices. It helps you assess the total value of your holdings.

h) **Book Cost**: The book cost refers to the price at which you initially acquired the securities. The statement may include the book cost for each holding or provide an aggregate book cost for all holdings.

i) **Corporate Actions**: If there have been any corporate actions, such as stock splits, mergers, or rights issues, affecting the investor's holdings, the holding statement may provide information about these events and their impact on the securities.

j) **Other Account Information**: The statement may also include other relevant details, such as account maintenance fees, service charges, or any alerts or notifications pertaining to the account.

Holding statements are typically generated and sent to investors periodically, such as monthly or quarterly, by the depository participant or the institution managing the Demat account. They serve as important records for investors to track their investment positions, monitor transactions, and reconcile their holdings with their own records. Holding statements also play a vital role in providing transparency and accountability in the securities market.

It's important to review your statement of holding regularly to monitor the performance of your investments, verify the accuracy of the information, and identify any discrepancies or errors. If you have any questions or concerns, it's advisable to contact your financial institution or broker for clarification.

7.3.2 How to View Holding Statement

There are two ways to view your statement of Demat holdings in India:

a) **Central Depository Website**: In India, there are two major central depositories - CDSL (Central Depository Services Limited) and NSDL (National Securities Depository Limited). Your stockbroker would have registered your Demat account with one of these depositories. To download your Demat account statement, you need to identify the depository with which your broker has opened your Demat account. If your Demat account is registered with NSDL, it will have a 14-digit number. On the other hand, if it is registered with CDSL, it will have a 16-digit number. Once you have identified the depository, you can visit their respective websites and download the Demat account statement directly from there.

b) **Broker's Website**: Alternatively, you can also download your Demat account statement from your broker's website. Simply log in to your broker's website using your credentials and navigate to the dashboard or account section. From there, you should be able to access your holding statement, which will provide details about the securities held in your Demat account. If your broker is m.Stock, they offer a user-friendly interface that allows you to view your holdings with just a few clicks.

Remember, the specific steps may vary slightly depending on the depository or broker you are using. It's always a good idea to refer to the instructions provided by your depository or

broker for the most accurate and up-to-date information on accessing your Demat account statement.

7.3.3 Benefits of Holding Statement

A holding statement refers to a document that provides a summary of an investor's or account holder's holdings, typically in a specific financial institution or investment account. Holding statements are essential tools that offer several benefits to investors and individuals managing their finances:

1. **Portfolio Overview**: Holding statements provide a comprehensive view of all the financial assets held by an investor. This includes stocks, bonds, mutual funds, exchange-traded funds (ETFs), cash balances, and other securities. Having a clear overview of their portfolio allows investors to assess their asset allocation and diversification.
2. **Performance Tracking**: Holding statements often include the historical performance of individual investments within the portfolio. Investors can monitor how each asset has performed over time, helping them make informed decisions about holding or selling particular investments.
3. **Consolidation and Organization**: For investors with multiple accounts and investments across various financial institutions, holding statements bring all the information together in one document. This consolidation simplifies financial tracking and organization.
4. **Risk Assessment**: Holding statements allow investors to analyze the risk exposure of their portfolio. By understanding the risk levels of individual holdings and their collective impact, investors can adjust their investment strategy to align with their risk tolerance.
5. **Tax Planning**: Holding statements provide essential information for tax planning and reporting purposes. Investors can use the information to calculate capital gains or losses and determine their tax liability accurately.
6. **Better Decision Making**: Armed with comprehensive information about their investments, investors can make more informed and strategic decisions. They can evaluate whether their current investments align with their financial goals and make adjustments as needed.
7. **Transparency and Accountability**: Financial institutions issue holding statements to their clients regularly, providing a transparent record of the assets under their management. This helps build trust and accountability between the financial institution and its clients.
8. **Detecting Errors and Fraud**: Reviewing holding statements regularly allows investors to identify any discrepancies or unauthorized transactions promptly. Early detection of errors or fraudulent activities can help mitigate potential financial losses.

So, holding statements provide investors with valuable insights into their investment portfolios, helping them make better financial decisions, track performance, and plan for the future. They serve as vital tools for personal finance management and wealth building.

7.4 Transaction Statement

A statement of transaction, also known as a transaction statement or transaction history statement, is a document that provides a detailed record of the transactions carried out in a financial account over a specific period. It typically includes information about the various activities and events related to the account, such as deposits, withdrawals, purchases, sales, transfers, fees, and other relevant transactions. A transaction statement is a document that records the buying, selling, and other related activities within an investment account over a specific period. It provides a detailed summary of the transactions undertaken during that period. Transaction statements typically include information such as the date of the transaction, the security bought or sold, the quantity or number of units involved, the transaction price, and any associated fees or commissions.

Transaction statements are essential for tracking and reconciling account activity, managing personal finances, and ensuring the accuracy of transactions. They serve as a record of financial transactions and can be used for budgeting, tax purposes, and auditing. Transaction statements are crucial for tracking and monitoring the activity in your financial accounts, assessing your financial health, and reconciling your records with the account provider's information. Regularly reviewing transaction statements helps identify any errors, unauthorized transactions, or discrepancies, allowing you to take appropriate actions if necessary.

7.4.1 Key components of Transaction Statement

The key components typically found in a statement of transaction:

a) **Account Details**: The statement begins with essential account information, including the account holder's name, account number, and other relevant identification details. This helps to identify the specific account for which the transaction history is provided.

b) **Transaction Date and Time**: Each transaction listed in the statement is accompanied by the date and time at which it occurred. This chronological order allows the account holder to track the sequence of events and identify any patterns or trends.

c) **Transaction Description**: The statement provides a description of each transaction, explaining the nature or purpose of the transaction. This description may include details such as the source of funds for deposits, the recipient for withdrawals, the financial instruments involved in purchases or sales, and any additional information relevant to the transaction.

d) **Transaction Codes**: To streamline the presentation and categorization of transactions, transaction statements often use specific codes or abbreviations. These codes represent different types of transactions, making it easier for the account holder to identify and understand the nature of each transaction. For example, "D" may represent a deposit, "W" for a withdrawal, "B" for a purchase, "S" for a sale, and so on.

e) **Transaction Amounts**: The statement provides information about the monetary value or quantity associated with each transaction. This allows the account holder to track the flow of funds or assets in and out of the account, aiding in budgeting, expense management, and financial planning.

f)**Running Balance**: The transaction statement often includes a running balance column, which displays the account balance after each transaction. It helps the account holder monitor the account's balance and track the impact of each transaction on the overall account value. By comparing the running balance with the initial balance, account holders can verify the accuracy of the statement and reconcile their accounts.

g) **Fees and Charges**: If there are any fees, commissions, or charges associated with the account or transactions, they are typically listed separately in the transaction statement. This transparency allows the account holder to understand the costs involved in maintaining the account or executing specific transactions.

Transaction statements are typically generated on a regular basis, such as monthly, quarterly, or annually, depending on the financial institution or account type. The frequency of these statements allows account holders to review their financial activities, track their spending patterns, and identify any discrepancies or unauthorized transactions promptly.

Transaction statements serve several important purposes. They act as a record of financial transactions, providing evidence and documentation for auditing, tax purposes, or legal requirements. Account holders can use these statements to reconcile their accounts, ensuring that all transactions are accurately recorded and accounted for. They also enable individuals and businesses to monitor their financial health, track their cash flow, and assess their overall financial performance.

It's important to review your transaction statement regularly, comparing it with your own records or receipts, to identify any errors, fraudulent activities, or unauthorized transactions. If you notice any discrepancies, it is advisable to contact your financial institution or account provider immediately for resolution and investigation.

In conclusion, a transaction statement is a vital document that provides a detailed record of the transactions conducted within a financial account. By offering a comprehensive

overview of financial activities, transaction statements enable account holders to manage their finances effectively, monitor their account balances, track their spending, and maintain accurate financial records.

7.4.2 Benefits of Transaction Statement

Transaction statements offer several benefits for individuals and businesses:

a) **Financial Tracking**: Transaction statements help individuals and businesses keep track of their financial activities. They provide a detailed overview of deposits, withdrawals, purchases, and transfers, allowing users to monitor their spending, income, and overall financial health.

b) **Budgeting and Expense Management**: By analyzing transaction statements, individuals can assess their spending habits and identify areas where they may be overspending. This information can be used to create and maintain a budget, making it easier to manage expenses and save money.

c) **Detecting Errors and Fraud**: Regularly reviewing transaction statements enables users to identify any errors, discrepancies, or unauthorized transactions. Early detection of fraudulent activity can help prevent potential financial losses and protect against identity theft.

d) **Tax Reporting**: Transaction statements are valuable for tax purposes. They provide a clear record of all income and expenses, simplifying the process of preparing and filing tax returns. It can be particularly beneficial for self-employed individuals or small business owners.

e) **Financial Planning**: Transaction statements offer insights into long-term financial trends and patterns. By understanding how money is being spent and invested, individuals can make informed decisions and plan for future financial goals, such as saving for a house, retirement, or education.

f) **Record Keeping**: Transaction statements serve as an official record of financial activities, providing documentation that can be referenced for future audits, legal requirements, or financial planning purposes.

Overall, transaction statements play a crucial role in maintaining financial transparency, accountability, and organization, making them an essential tool for effective financial management.

7.5 Dematerialization Procedure

Dematerialization refers to the process of converting physical securities, such as share certificates and bonds, into electronic or dematerialized form. Dematerialization eliminates the need for physical certificates and allows the securities to be held and traded in

electronic format through a Demat account. The dematerialization procedure typically involves the following steps:

a) **Open a Demat Account**: To initiate the dematerialization process, you need to open a Demat account with a registered depository participant (DP). A DP is an intermediary that facilitates the dematerialization and holds the electronic securities on your behalf.

b) **Submit Dematerialization Request**: Once you have a Demat account, you need to submit a dematerialization request to your DP. This request form is usually provided by the DP and requires details such as the name of the security, quantity, distinctive numbers (if applicable), and any other required information.

c) **Submit Physical Certificates**: Along with the dematerialization request form, you need to submit the physical certificates of the securities you wish to dematerialize. These certificates should be submitted to your DP, who will verify the authenticity of the documents.

d) **Verification and Processing**: The DP will verify the submitted physical certificates and forward them to the respective issuer or registrar. The issuer or registrar then verifies the certificates and initiates the dematerialization process.

e) **Credit of Electronic Securities**: Once the verification is complete, the electronic equivalent of the securities is credited to your Demat account. The DP updates your Demat account with the quantity and details of the dematerialized securities.

f) **Intimation and Statement**: After the dematerialization process is completed, you will receive an intimation or confirmation from the DP regarding the successful dematerialization. The DP will also provide you with a statement of holdings, which reflects the dematerialized securities in your account.

g) **Trading and Managing Electronic Securities**: With your securities in electronic form, you can now trade, sell, or transfer them easily through your Demat account. You can monitor your holdings, view transaction history, and access various services provided by your DP.

7.6 Summary

A holding statement and a transaction statement are two types of financial documents that provide information about an individual's or an organization's investment holdings and transactions. Holding statements are useful for tracking the value and composition of investment portfolios. They help individuals and organizations monitor their investments' performance, assess asset allocation, and make informed decisions regarding buying, selling, or rebalancing investments. Transaction statements are essential for tracking investment activity and calculating gains or losses. They provide a comprehensive record of trades made, allowing individuals or organizations to reconcile their account activity

with their holdings and track the overall performance of their investment portfolio.

Both holding statements and transaction statements are crucial tools for investors to monitor their investments, evaluate performance, and maintain accurate records for tax and reporting purposes. These documents help individuals and organizations make informed decisions about their investment strategies and assess the progress towards their financial goals.

Glossary

a) **Dematerialization**: The process of converting physical securities (such as stock certificates) into electronic form. Dematerialization eliminates the need for physical certificates and facilitates electronic trading and settlement.

b) **Holding Statement**: A document issued by a financial institution or broker that provides details about the securities held by an investor. It typically includes information such as the quantity, description, and current value of the securities held in the investor's account.

c) **Market Value**: The current price at which an asset, security, or commodity can be bought or sold in the market. Market value is determined by the forces of supply and demand and may fluctuate over time.

d) **Tax Planning**: The process of arranging one's financial affairs in a way that minimizes tax liabilities. Tax planning involves taking advantage of tax deductions, credits, and other strategies to legally reduce the amount of taxes owed to the government.

e) **Financial Planning**: The process of setting financial goals, assessing current financial resources, and developing a strategy to achieve those goals. Financial planning typically involves budgeting, saving, investing, and managing risks to achieve long-term financial security.

f) **Stock Split**: A corporate action in which a company divides its existing shares into multiple shares. The total value of the shares remains the same, but the number of shares outstanding increases, resulting in a lower price per share. Stock splits are often undertaken to make shares more affordable to a broader range of investors.

g) **Transaction Codes**: Codes used to classify different types of financial transactions for record-keeping and reporting purposes. Transaction codes help financial institutions and regulatory authorities track and analyze various activities such as purchases, sales, transfers, and withdrawals within accounts. These codes provide a standardized way to categorize transactions for accounting and reporting purposes.

Long Answer Type Questions

a) Explain in detail the concept of Dematerialization.

b) Discuss in detail the components of the holding statement.

c) What is a Transaction Statement? What details are typically included in the transaction statement?

d) What are the ways to access and view a holding statement?

e) What benefits does the dematerialization of shares offer?

f) How one can convert physical certificates into electronic holdings?

g) What is the purpose or significance of a transaction statement in managing financial transactions?

h) What is the procedure for opening an account with a depository, and will the account holder be regularly notified of any movements in their electronic account?

i) What are the benefits of having holding in electronic form?

j) Explain in detail the dematerialization procedure.

Short Answer Type Questions

a) Define Dematerialization

b) What is a Holding Statement?

c) What do you mean by Book cost?

d) What is a Stock Split?

e) Define Market value.

f) Role of CDSL and NSDL

g) Who is a Depository Participant?

h) What is a Transaction Statement?

i) What are Transaction Codes?

j) How one can trade and manage electronic securities?

Suggested Readings

a) "Dematerialization: The Road Ahead" by B. V. H. Prasad (ICFAI University Press)

b) "Securities Operations: A Guide to Trade and Position Management" by Michael Simmons (Wiley)

c) "Demystifying Demat: Beyond Basics" by R. R. Gaur (Taxmann Publications)

d) "Handbook on Securities Statistics" by the International Monetary Fund (IMF) (International Monetary Fund)

e) "Dematerialization and Depository System" by Arpit Parikh (Taxmann Publications)

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT VIII DEMAT: Account Opening Procedure, Nomination Practices, Offline Demat Account and Online Demat Account

Structure

8.0 Objectives

8.1 Demat Account: Introduction

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- **8.2.1 Bank Account**
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8.3 How to open a Demat cum Trading Account?

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- **8.8.2 Offline Process of Nomination**

8.9 Summary

Glossary

Long Answer Type Questions

Short Answer Type Questions

8.0 Objectives

After studying the Unit, students will be able to understand:

- Bank Account
- Trading Account
- Demat Account
- Procedure to open a Demat cum Trading Account
- Documentation needed for creating a demat account
- Types of charges associated with opening demat account

8.1 Demat Account: Introduction

Investment has become a major activity in India, with a variety of investment options available such as bank schemes, gold, real estate, post services, mutual funds, etc. Investors form the backbone of the capital market and invest their money with different objectives such as profit, security, appreciation, income stability. In 1992, following the liberalisation of the Indian economy in 1991, SEBI was created by the Indian government as the authority over the securities markets. SEBI started implementing changes in the stock market. The dematerialization of securities was one significant change that was introduced by SEBI.

Let's understand what is demat account? It is a short form of Dematerialization account. It is a kind of electronic account used by investors to manage their securities in digital form. Dematerialization, often known as "Demat," is the process by which a Depository transforms an investor's securities, such as shares, debentures, etc., into electronic data and stores it in computers. Earlier, investors used to hold their securities in physical form. Managing the trading through physical exchange was tedious and risky also. However, with the advent of technology whole financial world has changed. So, even physical form of securities was also transformed into electronic forms which were managed by investors through demat account. A demat account becomes repository for electronic record of securities that allows investors to buy/sell/hold securities (shares, bonds, Mutual funds etc) in secure and convenient way by eliminating the need to store financial securities in traditional way.

The Depositories Act was adopted by the Indian Parliament in 1996. Dematerialization of stocks was pioneered in India by National stocks Depository Limited (NSDL), who took the lead in this endeavor. Central Depository Services (India) Limited (CDSL), which was later founded, was the second Depository to be acknowledged and granted a license by SEBI. As of January 2021, total demat accounts in India had touched 51.5 million.

According to the Depositories Act of 1996, the Depository retains the shares in its fiduciary role on behalf of the shareholder and is the registered owner of them in the company's records. Additionally, Depository Participants have been chosen by Depositories to create and manage Demat accounts for the investors. For share certificates and other securities that are maintained in electronic format, a Demat account functions somewhat similarly to a bank account. The hassles of handling and keeping paper shares and other related documents are reduced with the aid of Demat accounts. Additionally, keeping an organized record of all of one's assets in stocks, bonds, mutual funds, and ETFs is helpful.

8.2 Demat Account: Key Points

Similar to other tangible and intangible financial assets, we can also trade (buy and sell) in equity, debt, and other financial instruments. For storing/holding such financial assets we are in need of a Demat Account. It is required in combination with Trading Account and Bank Account. We cannot do trading (buying and selling securities) unless we have all these three accounts in combination. Details of these accounts are as follows:

8.2.1 Bank Account: This is a common Saving Bank account that is used for deposits and withdrawals of your savings i.e. money left after your routine and other expenses. This account is used to add money to a trading account that you might have opened with any broker (A middleman who is required to trade in the stock market as we can't trade directly).

8.2.2 Trading Account: This account is required to take positions (buy and sell positions) while initiating the trade i.e. Buy and Sell Securities. In this account, when we execute a transaction i.e. buying and selling securities, the money which we have added through our saving bank account is deducted and securities bought are added to it. If we carry forward this position for a further time period, those securities will be transferred to the Demat account.

8.2.3 Demat Account: This account is required to store the securities we have bought through a trading account and carried for the next trading session or a longer period. Any time when we take trades securities are added to and transferred from the Demat account. Basically, it works as a repository for the securities in which we are trading.

- An investor, interested in opening demat account must approach to a Depository participant (DP). DP can be a commercial bank, financial institution or registered broker. These DPs are further connected with Depositories, Two main depositories operating in India are National Security Depository Limited (NSDL) and Central Depository Services limited (CDSL)

- For the purpose of dematerialization, Investors can submit their physical certificate to their concerned DP who will credit the electronic units to the demat account of investor
- After the opening of demat account, investors can buy or sell securities through different stock exchanges. But for this purpose their trading account must be linked to demat account
- Securities bought will be credited to their demat account and securities sold will be debited in their demat account
- To open and maintain demat account, investors will have to pay account opening charges, annual maintenance charges, taxes (if applicable) etc.

8.3 How to open a Demat cum Trading Account?

Without leaving the comfort of your home, you can create a demat account. The full procedure can be finished in 10 to 15 minutes thanks to digitization. Below are the procedures to open a Demat account as depicted in figure 1:

- **Identifying Depository Participant**: Identify a reputed and registered Depository participant (DP) to open your demat account. As mentioned earlier, DPs can be commercial bank, financial institution or authorized registered brokers. If DP can offer the particular services you're searching for, take into account its reputation. Investors must also consider certain factors such as account opening charges, transaction fees, customer services etc before finalizing DP
- **Required documents**: Once an investor finalizes his decision about Dp, he should collect basic information required to open trading cum demat account. Basic required documents include: Identity proof, address proof, Passport size photograph, income proof etc. He must also provide his PAN card information.

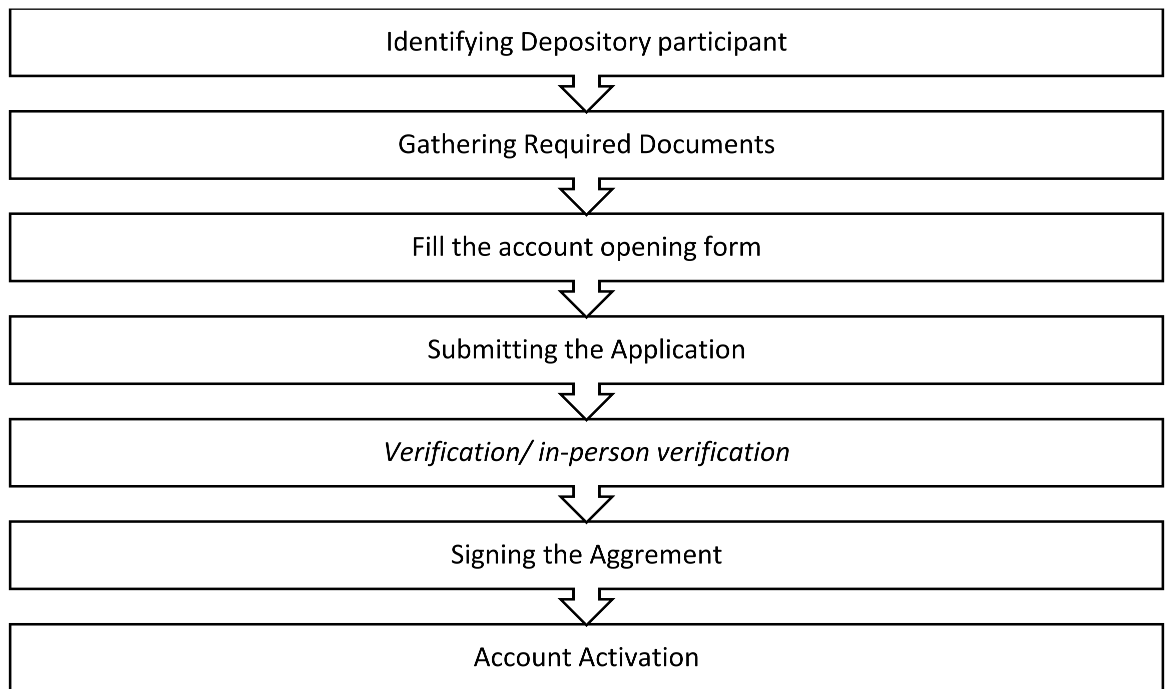

Figure 1: Steps involved to open demat account

- **Account opening**: investor will have to obtain account opening form from his DP either by personally visiting their office or downloading it from the website of DP. He must enter complete bank information, such as account number, account type, and IFSC code. Since it is used to credit amounts like interest, dividends, and other amounts payable by the issuer business whose shares you might hold in the demat account, adding a bank account is crucial. Investor must read out all the instructions carefully while filling this information
- **Submitting the Application:** When investor fills this application form completely, he has to submit it to DP along with all the supporting documents. Investor can submit it personally or sent the documents to DP through email, courier or uploading it on their software
- **Verification/ in-person verification:** After receiving the documents as submitted by investor, DP will conduct verification or in person verification (IPV).
- **Signing the Agreement:** After the verification is successfully complete, investor will be required to sign the necessary agreements. Investors must carefully read out all items of agreement before signing it.
- **Account Activation:** once the agreements are signed by investor, DP will open account on the name of investors and provide him with related credentials to access account through online mode. Investor will also get a physical welcome kit containing account details, user guide and other related information.

For the purpose of dematerialization investors have to open both trading cum Demat

account. They work differently but they are opened in combination. To open a demat cum trading account, investors have choice of selecting between two modes i.e. online and offline mode. They can open Demat Accounts with Different kinds of brokers such as Discount Broker, Banks, and Full Service Broker. But in today's era most of the investors like to open it with Discount Brokers. Let's discuss the process of opening a demat cum trading account.

8.4 Online Mode

Step 1. Download the Application (as suggested by DP) if available for the platform you have chosen otherwise visit the web page of DP

Step 2. Open the App and enter your mobile number in the space.

Step 3. Verify your number by filling in the OTP received on entered mobile number.

Step 4. Create a PIN which will be of six digits and click continue. it will accept numeric only.

Step 4 Next, Chose the email id available on your device or use any other email id to link it with the account for account updates and daily reports.

Step 5 Next, you have to complete your KYC. In this, you will fill in your details such as name, father's name, age, gender, profession, income, experience in trading, PAN and UIDAI details, etc.

Step 6. Afterward, you need to upload your signature which can be done digitally on a mobile phone treating it as a writing pad or an image of your signature might be uploaded.

Step 7. In the next step, you will have to verify your Aadhar details digitally with the help of Digi locker.

Step 8. Next, you have to upload the profile picture by taking Selfie.

Step 9. Next, you can link up your bank account with your Trading cum Demat Account through UPI or enter details manually.

Step 10. Next, you can add a nomination which will be explained later.

Step 11. The next step is to verify your application with Aadhar and Esign the application by filling in the details on NSDL Egov and providing the Aadhar OTP.

Step 12. Now, the whole process of account opening is done from your side. Wait for 2-3 days to get your user id and password after verification from the vendor.

8.5 Offline Mode

Step 1. First of All, investors are required to gather the required documents to fill out the physical form.

Step 2. In the next step, investor can approach the agent of a respective broker or we can directly visit the office of the respective broker.

Step 3. Next, he will fill the details in physical demat account opening form. The details in the form are details related with person profile, profession, experience, nomination and relates to the segments you want to trade in.

Step 4. Next, attach the respective documents such as Aadhar Card and Pan Card in duplicate with physical form. If any other document is required, it must be submitted along with the application form.

Step 5. Now, place your Signatures at required places in the physical account opening form and also self-attest the Xerox of the documents you have attached with form.

Step 6. Hand it over to the respective staff/ agent of the broker firm.

Step 7. Now, the whole process of account opening is done from your side. Wait for 2-3 days to get your user id and password after verification from the vendor.

8.6 Documentation needed for creating a demat account

There is need to submit certain documents while creating demat account. These are standard papers that SEBI has mandated, and these are:

a) PAN Card

b) Passport size photo

c) A copy of signature

d) Proof of identity – PAN card will serve as proof of identity

e) Proof of address - any of these documents can be submitted- Aadhar card, Voter ID, Passport, driving license (not more than 3 months old)

f) Bank statement

g) IT return

8.7 Types of charges associated with opening demat account

Opening or maintaining demat account require investors to pay certain fee or charges. However, these charges may vary depending upon DP selected by investors. There are various charges that stockbrokers levy for opening demat account that must be duly considered while selecting the broker and these charges are namely categorized as: Account opening fee, Annual maintenance charges (AMC), Pledging charges, unpledging charges, Dematerialization charges, Rematerialization charges, DP charges. Hence, list of some common charges levied by DP for offering demat services:

- **Account Opening Charges**: onetime fee paid by investors to open demat account. However, Some DPs offer 100% discount on these charges as promotional services
- **Annual Maintenance Charges**: This fee is normally charged on annual basis. However, some DPs may reduce it depending upon number of securities held in demat account

- **Transaction Charges**: These are the charges paid by investor every time he buys or sell securities using demat account
- **Pledge Charges**: These charges are levied if investor pledge securities as collateral for loan
- **SMS and Email Alert Charges**: very nominal charges are levied by DPs for updating the investors through SMS or Email services.

8.8 Nomination practices

In accordance with regulatory recommendations on "Nomination for Eligible Trading and Demat Accounts," it is now necessary for all owners of Trading/Demat accounts to update the nomination details by either registering the information for your nominee or choosing not to provide the nomination details. A nominee is a person who will legally inherit assets in the event of any unforeseen circumstance. Parent, mother, siblings, spouse, kids, or any other person can be nominated. It cannot be corporate entities or other non-persons. Some of the practices followed while adding nominee are:

- Only those who hold beneficiary owner accounts on their own behalf, either alone or jointly, are eligible to make the proposal. Non-persons such as societies, trusts, bodies corporate, partnership firms, kartas of Hindu Undivided Families, and those who hold power of attorney are ineligible to propose. If the account is owned jointly, the nomination form must be signed by each joint holder.
- A minor may make a nomination. The beneficial owner must then provide the name and location of the nominee designated as the Guardian of the Minor.
- A trust, society, body corporate, partnership company, karta of Hindu Undivided Family, or person who holds a power of attorney are not eligible to be nominated. Subject to the current exchange controls, an Indian who does not live in the country may occasionally be a nominee.
- Upon closing the beneficiary owner account, the nomination with regard to that account is revoked. Likewise, upon transfer of the securities, the candidature with regard to the securities stands revoked.
- Transferring securities to a nominee(s) shall constitute a legitimate discharge of the legal heir by the depository and the participant.
- Individuals who only hold beneficiary owner accounts on their own behalf jointly or jointly by the same people who made the initial candidature may cancel a nomination. Non-persons, such as an organization, trust, body corporate, partnership, karta of the Hindu Undivided Family, or a person in possession of a power of attorney, cannot.

- The candidature be withdrawn. The cancellation form must be signed by all joint holders if the beneficiary owner account is owned jointly.
- If the nomination is canceled, the submission will be rescinded, and the depository will not be required to transfer the securities to the nominee.
- A demat account allows for the nomination of a maximum of three candidates. If there are numerous nominees, the client must specify the percentage of each nominee's share, which must add up to 100%. The usual choice is to divide the claims equally among all the nominees if the beneficiary owner does not specify a percentage of allocation or share for each of the nominees.
- The earlier candidature shall stand rescinded upon the beneficial owner's request for Substitution of the existing nominees. Therefore, the information provided about the candidates in the nomination form at the time of substitution will be taken into account. Therefore, kindly include all of the candidates' full information.

Nomination is the same process, which is required in the case of Bank accounts where you have to nominate any person/persons who will receive the balance amount in case of the death of the original account holder. This person is called a nominee. The same is the case for the demat account, the only difference is the assets which is money in the case of bank accounts but are securities in the case of demat account. Now let’s talk about the Nomination Process. Section 72 of the Companies Act, 2013 asks for nomination by a holder of securities. Generally, the nomination process is completed along with trading and demat account opening. But in some cases, the nomination process does not complete with the account opening and it might be completed after a while. The nomination process might be done in two ways i.e. Online and Offline. Let’s talk about them one by one.

8.8.1 Online Process of Nomination: Nomination process is same as offered by one or more DP or specific online platform as opted by investors. However, standardized steps used in online nomination of demat account are:

- **Step 1**. Log in to online portal provided by DP using your 6-digit PIN or fingerprints if you have enabled the biometrics. This platform can be web portal or mobile application specially designed to manage demat account.
- **Step 2**. Choose “Account” at the right bottom of the app screen
- **Step 3**. Next, select “My Account” and then “Profile”.
- **Step 4**. Next, you will find “My nominee(s)”, click on it. Now a new page will appear with the heading “Nominee details”.

- **Step 5**. Next, you will have two options i.e. "Add nominee" or "Opt out". Just select "Add Nominee".
- **Step 6**. Next, fill in your nominee details and then click on "Continue".
- **Step 7**. Once you filled in the nominee details, enter their share in %. A maximum of three nominees can be added. In Case, the nominee is a minor, you are also required to fill in guardian details.
- **Step 8**. Next, click continue and it will generate the 6-digit OTP which will be sent to your registered mobile number and email.
- **Step 9**. Just fill in this OTP and click continue/submit.
- **Step 10**. Your nomination process is completed from your side, now it will take around 48 -72 hours to complete the process on the broker's end.
- **Step 11**. After 1-2 days you can check the nominee details online through the trading platform you are using.

8.8.2 Offline Process of Nomination: Usually, Investors complete the nomination while opening the account. But some complete it later. Most of them use online mode for completing the nomination process. But sometimes it might be difficult for investors due to some technical reasons, in that case they can go for offline mode also. Following is the standard procedure for offline nomination in demat accounts.

- **Step 1**. Visit the Broker's local office and ask them for the physical nomination form.
- **Step 2**. Fill in the details in the physical form and sign it where required.
- **Step 3**. If you sign the document, then there is no need for a witness, but in case of thumb impression, you will be required a witness to your identity.
- **Step 4**. Once the whole form is filled in, just submit it to the office staff of the brokers.
- **Step 5**. They will process your request as per the required time.
- **Step 6**. After 1-2 days you can check the nominee details online through the trading platform you are using.
- The standard form recommended by SEBI which is required to be filled in for Nomination purposes is on page number 6 & 7.

Opt-Out Scheme: Further, every security holder has another option i.e. opt-out which leads to not adding any nominee. In this case, the legal heir of the security holders has to prove the legality of their rights on the securities held in the Demat account. For opt-out there, we also have online and offline option which is as follow:

8.9 Summary

Demat account has made the process of holding investments (shares, bonds, government

securities, Mutual Funds etc.) quite easier. Investors need not to bother about the hassles of physical handling and maintenance of paper shares and related documents. It is digitally maintained account whereby investors can buy or sell securities. Earlier investors have to maintain the share certificates in physical form which was both cumbersome and risky. However, with advent of technology, access of demat account is available to investors even sitting at their home. Besides the shares, demat account can hold multiple assets like mutual funds, ETFs, Bonds etc. For the convenience of investors, depository participants are offering demat account opening services through both online and offline mode. Hence, depending upon the suitability of investors, they can choose any of the two modes. However, demat account opening through both offline and online modes is very simple and require same document submission.

Glossary

- **Bank Account**: A bank account is a financial account maintained by a bank or other financial institution on behalf of a customer. It allows the customer to deposit, withdraw, or transfer funds, as well as access other banking services such as loans, credit cards, and investment products.
- **Trading Account**: A trading account is an investment account used to buy and sell securities in financial markets, such as stocks, bonds, options, and mutual funds. It is typically maintained by a brokerage firm and provides the platform for executing trades and managing investment portfolios.
- **Demat Account:** A Demat account, short for "Dematerialized Account," is an electronic account used to hold and trade securities in electronic form. It eliminates the need for physical share certificates and facilitates easy and secure transactions in the stock market.
- **Dematerialization**: Dematerialization is the process of converting physical share certificates into electronic form. It involves opening a Demat account and surrendering the physical certificates to the depository participant for credit into the Demat account.
- **Investor:** An investor is an individual or entity that allocates capital with the expectation of generating a return or profit. Investors typically purchase financial assets such as stocks, bonds, real estate, or mutual funds with the aim of achieving their financial goals, such as capital appreciation, income generation, or wealth preservation.
- **NSDL**: The National Securities Depository Limited (NSDL) is one of the two central securities depositories (CSDs) in India. It facilitates the holding and trading of securities in electronic form, including equities, bonds, government securities, and mutual fund units. NSDL provides services related to Demat accounts and securities settlement.

- **CSDL**: The Central Depository Services Limited (CDSL) is the other central securities depository (CSD) in India. Like NSDL, it facilitates the holding and trading of securities in electronic form, providing services related to Demat accounts and securities settlement. CDSL competes with NSDL in offering depository services to investors and financial institutions.

Long Answer Type Questions

a) Describe the step-by-step procedure for opening a DEMAT account.

b) What documents are typically required for opening a DEMAT account?

c) Explain how individuals can choose between different types of DEMAT accounts based on their investment needs and preferences.

d) Explain the concept of nomination in DEMAT accounts and its importance.

e) Discuss the procedure for nominating individuals in a DEMAT account.

f) Differentiate between offline DEMAT accounts and online DEMAT accounts in terms of features, accessibility, and convenience.

g) Discuss the process of opening an offline DEMAT account and the associated paperwork.

h) Explain the benefits and limitations of offline DEMAT accounts, particularly in comparison to online accounts.

i) Describe the features and advantages of online DEMAT accounts, including real-time access to account information and convenience of trading.

j) Address any concerns related to security and privacy associated with online DEMAT accounts and the measures taken to mitigate them.

Short Answer Type Questions

a) What documents are required for opening a DEMAT account?

b) Explain the role of Know Your Customer (KYC) norms in the DEMAT account opening process.

c) What is the purpose of nomination in a DEMAT account?

d) How can an account holder nominate individuals in their DEMAT account?

e) Differentiate between offline and online DEMAT accounts.

f) What are some advantages of having an online DEMAT account over an offline one?

g) Types of charges associated with opening demat account

h) What is Opt-Out Scheme?

i) What is ETF?

j) What is IPV

Suggested Readings

- Clifford Gomez, “Financial markets, Institutions and Financial Services” PHI Learning

- Bhole, L.M., and Mahakud Jitendra., "Financial Institutions and Markets: Structure, Growth and Innovation" Mc Graw Hill Education
- Mishkin Frediric, Eakins Stanley, Jayakumar Tulsi and R. K. Pattnaik., "Financial Markets and Institutions" Pearson India Education
- Gupta, N.K and Monika Chopra, "Financial Markets, Institutions and Services" Ane Books, Ltd.
- MachiRaju, H.R., "Indian Financial System" Vikas Publishing house

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT IX Clearing & Settlement Procedure, Delivery Instruction Slip and Practices for Depositary Participants & Beneficial Owner

Structure:

- 9.0 Objectives
- 9.1 What is Secondary Market?
- 9.2 Transaction in secondary market & its phases
- 9.3 Participants involved in the process of Clearing and Settlement
- 9.4 Trading, clearance and settlement procedure
  - 9.4.1 Trading Procedure
  - 9.4.2 Clearing and Settlement Procedures
- 9.5 Understanding of clearing and settlement procedures at NSE
- 9.6 Considerations for investors
- 9.7 Benefits and significance of the clearing and settlement procedure
- 9.8 Delivery Instruction Slip
  - 9.8.1 Meaning and Usage of Delivery Instruction Slip (DIS)
  - 9.8.2 Cases in which DIS is beneficial
  - 9.8.3 Content of DIS
- 9.9 Example of the DIS and directions for filling the same
- 9.10 Substitution of Delivery Instruction Slip
- 9.11 Practices of Depository Participants
- 9.12 Practices of Beneficial Owners
- 9.13 Summary
  - Glossary
  - Long Answer type Questions
  - Short Answer type Questions
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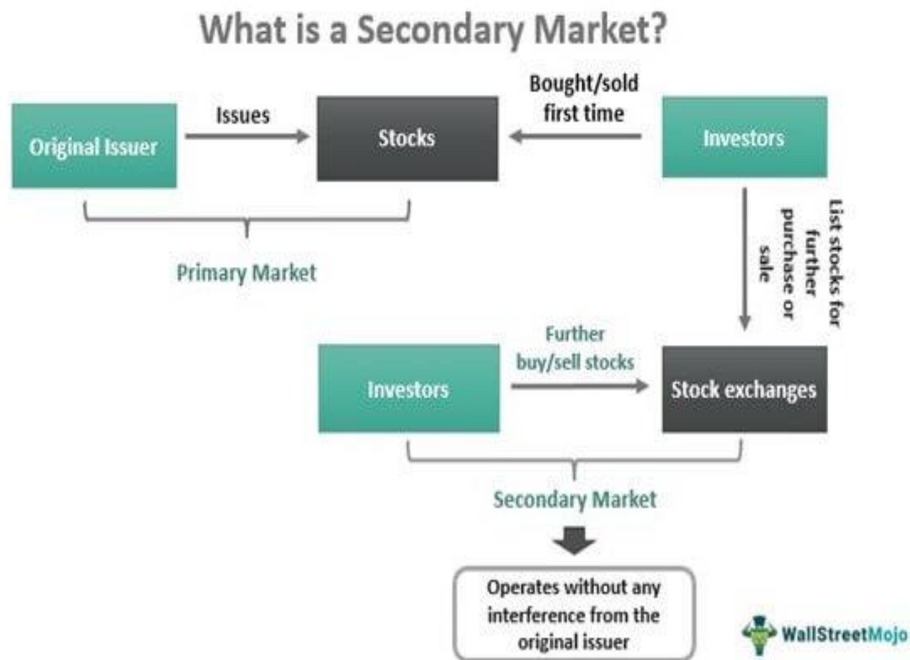
9.0 Objectives

After Studying the Unit, the students will be able to understand:

- Concept of Secondary Market
- Transaction in secondary Market & its Phases
- Trading Procedure
- Clearing and Settlement Procedures
- Significance of the clearing and settlement procedure
- Usage of Delivery Instruction Slip (DIS)
- Practices of Beneficial Owners
- Practices of Depository Participants

9.1 What is Secondary Market?

Investors and traders can trade already-issued securities on the secondary market. Secondary market transactions are not brand-new issues and have no impact on the company's capital. Securities added to the primary market can now be traded more easily.



Source: https://www.wallstreetmojo.com/secondary-market/

Any market that securities, assets, or items enter after their initial sale or acquisition is known as the secondary market. It takes place in a market known as primary market between the buyer and seller and the original issuer. These, often referred to as aftermarkets, give investors better prospects for growth, improving the economic situation of any country.

9.2 Transaction in Secondary Market & its Phases

A transaction in secondary market happens in three stages:

Trading

On the stock market, numerous trades take place at once. To match buy and sell orders from various traders, the stock exchanges employ an electronic transaction matching mechanism. Each trade is completed in this manner.

Clearing

The clearing procedure starts once a deal is conducted and two orders match. Identification of the security that belongs to the buyer and the amount that belongs to the seller is known as clearing. 'Clearing houses' oversee the entire procedure. These are separate entities.

Settlement

The following action is to satisfy the financial commitments noted in the clearance stage. This includes settling the transaction for both the sellers and buyers. So, the transaction is complete after the Seller gets money and buyer receives the security. In a rolling settlement system, the transaction is settled over the course of several days. With this type of settlement, trades are concluded after being completed in T+2 days (second working day). This period does not include bank holidays, Saturday, Sunday or any exchange holidays. A trade will therefore be completed on a Thursday if it is executed on a Tuesday. Similar to this, if you purchase shares on Friday, you need to pay the broker on that day, but the shares will be credited to your account the subsequent Tuesday. On the day your trades are settled, you are regarded as the shareholder of record.

The transaction between the seller and the buyer is completed on a "T+2 days" basis in the Indian stock market. The day the trade is put into action is known as the "T-day" or "trade day". The "T+2 days" refers to the period of time needed for the broker and stock exchanges to match the order, enable the debit of stocks and credit of money, and record these actions in the buyer's and seller's respective accounts. In the stock market, this process of balancing the books is known as clearing and settlement, and it permits the appropriate movement of money and stocks from one party to another.

In clearing, the stocks owing to the buyer is determined as well as the sum of money owed to the seller. Even though it seems straightforward, we are constrained by a instance of two individuals—a buyer and a vendor. In actuality, there are a lot of traders who execute numerous trades per session. It requires T+2 days because of this. On behalf of stock exchanges, a clearing house, which is a separate organization, oversees the entire

procedure for clearing the trades.

Following the clearance procedure is settlement. The actual exchange of assets and money between both the parties to a transaction—referred to as the "settlement"—fulfils the financial commitment. The trade is deemed "settled" when the accounts of both seller and buyer are updated with the shares and money received. In India, stock trades are often settled on a "T+2" day basis. On a "T+1" basis, treasury securities, instruments in the money market and bonds settle. Here, you will learn about the steps involved in trade settlement for both the seller and the buyer. Use this as an example. Ten shares were purchased from a corporation by a buyer for Rs 1,000 per share. A trade day, or T-day, is the day that the shares are purchased.

T Day (1ST DAY)

This is the day that the broker will credit a clearing house account with the funds deducted from the buyer's trading account or associated bank account for the purchase of the shares. The buyer's account will be charged by the broker with a transaction fee, brokerage fees, and other expenses. The broker will also credit the stocks to the account of clearing house and freeze the shares in a matched seller's DEMAT account. After banning the shares, the vendor would not be capable of selling them again.

T+1 Day (2ND DAY)

The broker makes no trades on this day. The buyer may sell the shares back if they wish to (and this will result in another clearing and settlement cycle.). Yet, the seller is unable to purchase back the same shares they sold on "T day." On T+1 day, the broker receives the shares and money from the clearing house.

T+2 Day (3RD DAY)

The last day for the transactions to be settled is "T+2". The final securities exchange and money transfer between both the seller and the buyer happen on this day. The broker deposits the seller's bank account with the funds at the closing of the day. Similar to how it would in our scenario, it would add 10 stocks to the buyer's DEMAT account. The transaction is complete once the shares and money have been credited to the buyer's and seller's respective accounts.

The clearing process involves a number of parties, including the clearing house, clearing participants, custodians, clearing banks, and depositories. The following describes each of these organizations' roles:

Clearing Corporation

The risk management, clearing, and resolution of trades made on a stock exchange are all responsibilities of the clearing corporation.

Clearing Members

Clearing Members are in charge of paying their debts as specified by the National Securities Clearing Corporation Limited (NSCCL). In order to do this, they make money or securities available in the specified accounts with clearing banks or depositories on the settlement day.

Custodians

While not trading members, custodians are clearing members. When a specific deal is allocated to them for settlement, they resolve transactions on behalf of trading participants. The custodian must state whether or not he intends to settle that trade. If he commits to closing that trade, the clearing firm transfers to him that specific obligation.

Clearing Bank

In order to settle payments, clearing banks act as a crucial link between clearing members and the clearing corporation. A separate clearing account must be opened by each clearing member at one of the specified clearing banks. The clearing member makes money accessible in the account for the pay-in and gets money in the event of a pay-out based on their responsibility as determined through clearing.

Depositories

Depository maintains securities for investors in their beneficiary accounts in Dematerialized form. The depositories require each clearing member to keep a clearing pool account open. On the day of settlement, he must have the necessary securities available in the specified account. According to the schedule for the allocation of securities, the depository uses an electronic filing system to move securities from the accounts of the cleaning staff members to those of NSCCL and vice versa.

Professional Clearing Members (PCMs)

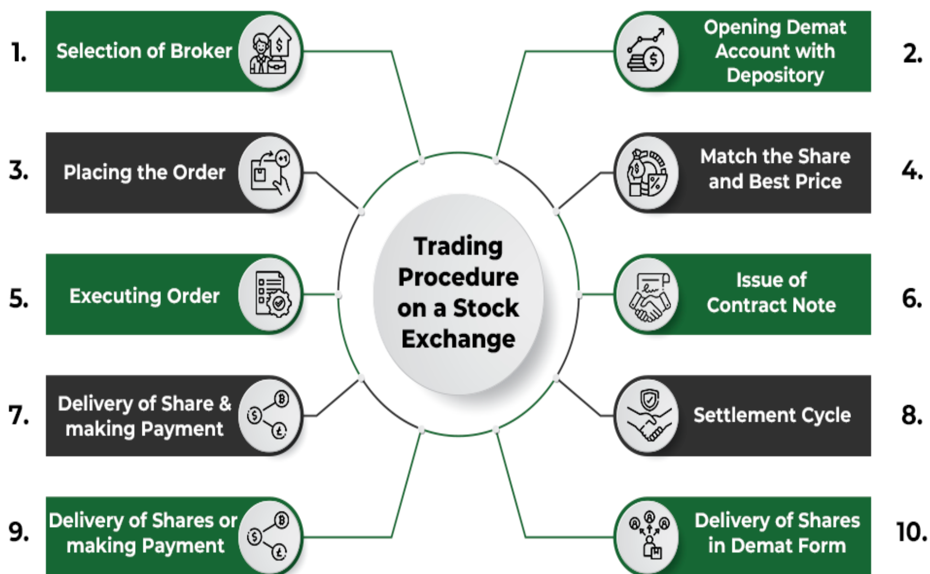
Professional clearing members are a particular group of members that NSCCL accepts (PCMs). PCMs may settle deals carried out for their customers (individuals, institutions etc.). In these circumstances, the PCM's duties and obligations are comparable to those of the custodians. PCMs also take on the trading members' clearing and settlement obligations. In this situation, the PCM does not have trading rights but does have clearing rights, meaning that he fixes the trades of his institutional clients and associate trading members.

9.4 Trading, clearance and settlement procedure

9.4.1 Trading Procedure

The corporations must first list their securities on the stock exchange before they can begin selling them through the stock exchange. Only when the regulators of the stock market are pleased with the company's financial stability and several other characteristics

is the company's domain name included among securities. Prior to now, stock exchange trading floors were where securities were bought and sold. Today, it is carried out using computers and involves the following steps:



Source: https://www.geeksforgeeks.org/trading-procedure-on-a-stock-exchange/

a) Broker Selection

Only brokers who are members of the stock exchange and are registered with SEBI may purchase and sell stocks. A broker may be an individual, a partnership business, or a corporate entity. So, choosing a broker to purchase or sell stocks on behalf of a trader or investor is the first stage in the trading process. Investors must fill out a client registration form with certain details, including their PAN number, birth date, residential address, educational background, occupation, and residency status (Indian or NRI), as well as information about their bank accounts, depository accounts, names of any other brokers they have registered with, and their client code number. The broker starts a trading account of investor after gathering information about all the things mentioned.

b) Opening of DEMAT Account

The creation of a DEMAT Account is the second step in the trading process. The securities are kept in electronic form by the Depository. An organization or entity that keeps securities, is known as a depository. National Securities Depository Ltd. (NSDL) & Central Depository Securities Ltd. (CDSL) are the only depositories operating at the moment. The only means by which the investor and the depository communicate with one another is through Depository Participants (DPs). The DP will be required to keep track of the investor's securities account balances and periodically update the investor on the status of their securities.

c) Placement of Order

The investor's placement of an order comes next after opening a DEMAT Account. The

investor can contact the broker to place an order in person, via phone, email, etc. The investor is in charge of ensuring that the order specifically states the amount or value at which the shares may be sold or purchased. For instance, Kapil can order, "Purchase 200 equity shares for maximum up to Rs. 200 per share. of XYZ Ltd."

d) Matching of shares and best price

After receiving an investor's order, the broker must go online and establish a connection with the stock exchange in order to obtain the share with the best price that is currently being offered.

e) Execution of order

When shares may be purchased or sold at the investor-specified price, the broker terminal will be notified, and the order will then be electronically completed. The broker will provide the investors with a transaction confirmation slip when the transaction has been carried out.

f) Contract Note Number Issuance

A contract note will be issued by the broker once the transaction has been completed within 24 hours. A contract note includes information about the quantity of shares purchased or sold, the date and time of the transaction, the price of the securities, and brokerage fees. A contract note is a crucial piece of legal paperwork. It aids in resolving claims of disagreement between investors and brokers. A contract note also includes a written unique order code number that the Stock Exchange assigns to every transaction.

g) Share Delivery and Payment (from Investor)

The investor then has to submit the shares they have sold or make payments for the shares they have purchased. The investor must act as soon as possible following receipt of the contract note or prior to the broker's deadline for transfer of securities to the exchange or payment. It is referred to as Pay in Day.

h) Settlement Cycle

On the day before T+2 Day, securities are delivered or paid for in cash. This is due to the T+2 day rolling settlement basis that began in April 2003. For instance, the payment must be made before Thursday, or T+2 days, if the transaction occurred on Tuesday.

i) Share Delivery and Payment (from Stock Exchange)

The Stock Exchange will then transfer the share or pay the other broker on the T+2 Day. Pay out Day is this particular day. The broker, who has already received money from the exchange, must pay the customer within 24 hours of the payout day once the shares have been delivered or payment has been made.

j) Delivery of shares in DEMAT Account

The broker will deliver securities in DEMAT form straight to the investor's DEMAT

Account as the final stage of the trading process. The investor is required to provide information about his DEMAT Account and give instructions to his DP so that the securities can be delivered straight to his beneficial owner of the account.

9.4.2 Clearing and Settlement Procedures

Online stock trading and sales have been made simple and straightforward. You get the stocks in Account known as DEMAT account when the cash has been deducted from your account. Similar to purchase transactions, sale transactions subtract shares from the Account while crediting your bank account with the selling amount. Regulators have created a Trade Cycle as well as a Settlement and Clearing Process to ensure efficient operations and low risk. It should be noted that beginning on January 27, 2023, all F&O securities and other securities in the Settlement Cycle based on T+2 system will transition to the Settlement Cycle based on T+1 cycle, a recent SEBI notification. Now, all stocks will steadily move towards settlement cycle based on T+1 Cycle.

(a) Procedure of Clearing and Settlement While Purchasing Shares

To buy or sell shares, you need a DEMAT Account, in which your shares are stored being used for buying and selling, in addition to a bank account for handling money transactions.

T-Day

The day you purchase a stock is T-Day Trade Day, also referred to as T-Day and on the same day you will obtain a contract note for the transaction. Like a stock purchase bill, the contract note looks similar. The shares have not yet been credited to your DEMAT Account, but your bank account has been debited.

T+1 Day

Day two follows the day of your purchase. T + 1 Day or Trade Day + 1 are common names for it. Your broker's commissions and the cost of the purchased shares are transferred to the securities exchange on this day. On this day, the shares are also debited from the vendor's DEMAT Account and credited to the broker's account. The broker then credits your DEMAT Account with those shares. The money that was taken out of your account to purchase the shares is credited to the seller.

Trade-related payments must be completed each day, or 24 hours, just after transaction is concluded because of the T+1 settlement cycle. For illustration, if a customer purchased stocks on Wednesday, according to T+1, they would be transferred to his DEMAT Account by Thursday.

The buyer will get the stocks in his DEMAT Account the following day if a seller sells a share utilizing the T+1 format, and the investor will receive cash within a day of the sale. The broker then credits your DEMAT Account with those shares. The money that was

taken out of your account to purchase the shares is credited to the seller.

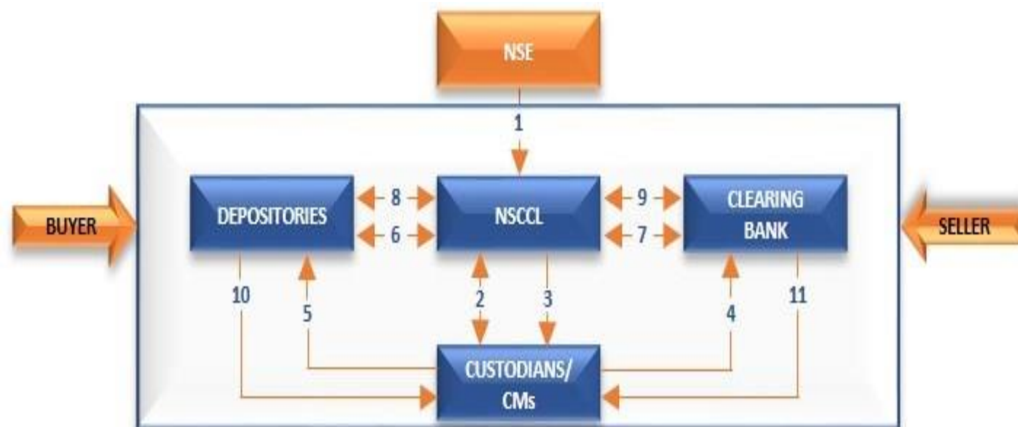
(b) Procedure of Clearing and Settlement While Selling Shares

You sell shares on day one (T-Day). The shares in your DEMAT account are immediately blocked. As a result, you cannot sell the exact same stocks on the same day. On Day 2 (T+1 Day), the broker distributes the shares, and on the same day, after all fees have been subtracted, you also take payment in your banking account.

9.5 Understanding of clearing and settlement procedures at NSE

The liabilities are then discharged by settlement after the clearing process determines what the counterparties owe and which counterparties are going to get on the settlement day. Clearance, settlement, and risk management are the three primary steps in the settlement and clearing process.

The clearing and settlement procedure for securities transactions on the NSE is outlined as below:



Source: https://www.nuvamawealth.com/investology/introduction-to-stock-markets-51c006/what-is-stock-trade-settlement-process-2a34b3

a) Trading information from NSE to NSCCL

b) The NSCCL notifies the clearing members/custodians who have returned the form of the details of the completed trade. NSCCL employs multilateral netting and establishes obligations based on the affirmation.

c) Downloading of the obligation and payment-in advice of funds/assets.

d) Directing clearing banks to release cash by the pay-in time.

e) Directing depository institutions to render securities available through pay-in-time.

f) Pay-in of securities (NSCCL instructs depository to credit its account and debit the pool account of CMs/custodians and depository follows this advice).

g) Funds are paid in (NSCCL notifies clearing banks to credit their accounts and debit the custodians'/CMs' accounts)

h) The payment of securities (the NSCCL recommends the depository to credit the pool account of the CMs/custodians and debit its account, and the depository follows this advice).

i) Funds are paid out (NSCCL instructs clearing banks to credit custodians'/CMs' accounts and debit their accounts, and clearing banks follow this advice).

j) Using DPs, the Depository notifies the Custodians/CMs.

k) Custodians/CMs are informed by clearing banks.

The following are the main procedures in clearing and settlement:

Trade Documenting:

The essential information regarding trades is documented to serve as a foundation for settlement. The exchanges' electronic trading system automatically records these specifics.

Trade Confirmation:

The terms of a trade, such as the security, amount, price, and settlement date, are agreed upon by the parties, but not the counterparty, the NSCCL. Information from direct participants is automatically generated by the computerized system.

Determination of obligations:

The next step is to determine the obligations of the parties and the amounts that the counterparties are entitled to get on the date of settlement. A member has a security-wise net obligation to receive or deliver a security and must either pay or receive funds when the NSCCL acts as a central counterparty between the counterparties to trades.

Once the members' obligations have been established through the clearing procedure, the settlement process gets going. With the aid of clearing bankers and depositories, the Clearing Corporation conducts the settlement process. An important conduit between clearing banks and depositories is the Clearing Corporation. This link guarantees the actual transfer of money and securities on the designated pay-in and pay-out days.

9.6 Considerations for Investors

You will deal with a settlement and clearing process if you are an investor trading with the stock market. As a result, you should think about the following:

DEMAT Account

You must have a DEMAT account with a licensed stockbroker before you can start trading. The majority of brokers provide an electronic DEMAT account with minimal brokerage fees.

Knowledge of Brokerage Charges

Without brokers, both sellers and buyers cannot trade on the stock market. Various brokers charge investors and traders with various brokerage fees. While registering your trading and depository account, you should examine the fees of several brokers.

Knowledge of basic trading fundamentals

Only the transaction between the buyer and seller is facilitated by the settlement process. You must understand the trading fundamentals in order to trade in the market.

9.7 Benefits and Significance of the Clearing and Settlement Procedure

Participants in the stock market are now able to purchase and sell digitally thanks to the new trading system. The following are some benefits for investors:

- It makes it possible for you to quickly and securely buy and sell stocks and shares.
- Securities are immediately transferred into accounts and become the owner's Property.
- It makes trading for market players seamless.
- Trading takes less effort and time because to digital transaction settlement.
- It does not necessitate physically going to a broker.
- The paper-based clearing and settlement processes are now digital.

9.8 DELIVERY INSTRUCTION SLIP

9.8.1 Meaning and Usage of Delivery Instruction Slip (DIS)

Investors must fill out the delivery instruction sheet in order to transfer shares offline between two DEMAT accounts. They are termed slips because investors receive a small booklet containing these blank forms when they start a trading account. The book is designed to seem like a DEMAT account cheque book and contains numerous slips. These are used to transmit securities rather than money. To carry out the transfers from the account, the slip must be completed, separated from the booklet, and given to your stock broker. As they are seeking the debit from their account, the vendor must fill out the slips. It can be utilized to transfer any kind of security, including bonds, equities, and ETFs.

9.8.2 Cases in which DIS is Beneficial

The DIS is gradually losing its significance in an investor's life since that deals and settlement are mostly conducted in digital format. Here are several situations in which these slips are still acceptable:

a) Securities traded off-market by two parties.

b) Giving securities as gift to family members.

c) In case you have numerous DEMAT accounts, and you transfer securities to yourself.

d) To take part in corporate activities of companies, such as share buybacks, etc.

e) Securities pledged to a dealer or banker for loan.

f) Securities transfer to dealer in case of incorrect settlement.

g) In case of surrender of shares as the company is delisted.

h) When a client refuses to provide a broker with power of attorney.

9.8.3 Content of DIS

The delivery slip must be managed and filled out carefully because it is crucial for offline securities transfers and sales. These slips are open to fraud and falsification, just like a check could be mishandled.

These slips come in a variety of formats and designs depending on the broker, but they all need the investor to fill out at least following data fields.

S.No.	Data Field	Description
1.	Date	To mention the date when the form was filled out.
2.	ID of DP and Client	To enter the investor's beneficial owner ID. It's the account that will be used to debit the shares.
3.	Name of the vendor	Seller's Name whose account must be debited.
4.	ISIN	All of the securities' ISINs that you want to transfer. Information can be found on the corporate website or in your account statement. If you wish to move to more than five different ISINs while using the same DIS, you must annex a second sheet or document with a comprehensive list.
5.	Name of the security	Specify the security you want to transfer by name.
6.	Quantity	The quantity of security you want to transfer.
7.	Purpose of the transfer	This must be carefully chosen because the seller will be responsible for paying stamp duty for any off-market sales of securities in which they are compensated. Some common purposes are: • Gift • Family Transfer • Self-Transfer • Sale of security etc.
8.	Details of Payment	If an investor has made a sale and received compensation, the amount of the transaction and the amount of the payment must be disclosed.
9.	Counter Party Name	Identification of the recipient of the transfer
10.	Counter DP ID	DP ID of the individual to whom you are transmitting the securities.
11.	Customer ID	This is the customer ID of the party to which the securities are being transferred.
12.	Date of execution	Date when you prefer the transfer to take place.
13.	Signature	Authorizing the transaction with your signature.

9.9 Example of the DIS and directions for filling the same

The guidelines below should be followed in order to complete a DIS:

Source: https://support.zerodha.com/category/your-zerodha-account/transfer-of-shares-and-conversion-of-shares/dis/articles/how-do-i-fill-in-a-dis-slip

a) Provide the account holder's name exactly as it appears on the demat account.

b) State the ISIN of the security being transferred in accordance with the transaction statement.

c) Name of the transferred security.

d) Mention the quantity in numbers.

e) Mention the quantity in words.

f) To remain empty (Nothing to be mentioned).

g) In the event that in case if more than five securities are being transferred, provide the count of DIS Annexures that are attached to the slip.

h) Choose the transfer explanation. If Others is chosen as the reason, be sure to indicate the specific reason from the list.

i) If the sale of the security is off-market, bank information. The section can be left empty if the securities was not sold off-market.

j) Provide the counter DP details, or the DP details of the party to whom the stocks are being transferred, when making an off-market transfer.

k) Leave this box empty if the transferred securities are not listed or traded on any exchanges.

l) After the DIS is executed, Zerodha will fill in the date.

m) The signature of the account holder must match the signature on file in the Zerodha demat account. Please include a countersignature if there are any modifications or an overwritten signature.

9.10 Substitution of Delivery Instruction Slip

Transfer via delivery instruction slips are becoming less important as SEBI pushes for digital transactions. Nowadays, many stock brokers either demand a fee or fail to provide a DIS pamphlet when a trading account is opened. In such a situation, investors must specifically request a booklet from their broker. The idea of electronic DIS (e-DIS), which allows investors to make transfer requests to their broker online, has also been introduced by some stock brokers. These online transactions are verified using OTPs that the depository sends. Also, the depositories have begun offering online services for the direct transfer of securities from the Demat account. Anything that was previously accomplished through DIS slips can now be done online.

9.11 Practices for Depositary Participants and Beneficial Owner

Depository Participants (DPs) are the intermediaries that offer depository services to investors in the Indian capital market. They act as a link between the investors and the depositories. Beneficial owners (BOs) are the ultimate owners of the securities held in electronic form with the depositories. Here are some of the practices followed by DPs and BOs:

9.11.1 Practices of Depository Participants

a) Account opening process

DPs follow a standardized account opening process. They verify the investor's identity, address proof and other KYC details before opening the account. DPs also provide necessary disclosures about the risks associated with depository services.

b) Safekeeping of securities

DPs are responsible for safekeeping the securities of the investors. They ensure that the securities are kept in a secure manner and take appropriate measures to prevent any unauthorized access.

c) Settlement of trades

DPs settle the trades on behalf of the investors. They ensure that the securities are credited or debited from the investor's account as per the trade executed. DPs also provide transaction statements and periodic statements to the investors.

d) Investor servicing

DPs offer various services to the investors such as account modification, nomination, transmission, etc. They also resolve investor grievances and provide necessary support for dematerialization and rematerialization of securities.

9.12 Practices of Beneficial Owners

a) Dematerialization of securities

BOs need to convert their physical securities into electronic form for holding them with the depositories. They need to submit necessary documents to the DPs for dematerialization.

b) Account maintenance:

BOs need to maintain their demat accounts with the DPs. They need to ensure that their account details are updated and any changes in their personal details are informed to the DPs.

c) Safekeeping of login credentials

BOs need to keep their login credentials for the demat account safe and confidential. They should not share their login details with anyone.

d) Monitoring of transactions

BOs need to monitor their demat account transactions regularly. They should verify the transaction statements provided by the DPs and report any discrepancies or unauthorized transactions immediately.

e) Nomination

BOs can nominate a person to whom the securities held in the demat account will be transferred in case of their demise. They need to submit the nomination form to the DPs.

9.13 Summary

The efficient processing of trades is made possible by clearing and settlement procedures, which are essential to the operation of stock markets. The act of clearing involves matching purchase and sell orders in order to ascertain each market participant's net position. It entails figuring out the overall quantity of securities to be transferred and the total quantity of money to be traded. Delivering securities and transferring money between buyers and sellers is known as settlement. Settlement usually takes place two business days (T+2) after the trading date. A central counterparty (CCP), which assumes the counterparty risk of each trade, serves as a middleman between buyers and sellers in some marketplaces. By guaranteeing settlement and clearing trades, the CCP lowers the risk of default. The accuracy and timeliness of clearing and settlement procedures are crucial to preserving market trust since they play a crucial part in ensuring the seamless operation of stock markets. Transferring securities from one Demat account to another requires a delivery instruction slip (DIS). For the transfer of securities to go easily and precisely, it's crucial to use a delivery instruction slip. It serves as an official approval for the transfer of securities

and creates a record of the deal. In order to prevent any delays or problems in the transfer procedure, it is crucial for account holders to make sure they complete the DIS accurately and supply accurate information. Also, it's crucial to maintain a copy of the DIS and any other paperwork pertaining to the transfer of shares for future use. Depositories are essential to the securities market's operation. They offer a platform for the electronic holding and transfer of securities. National Securities Depository Ltd (NSDL) and Central Depository Services Limited (CDSL) are India's two primary depositories. The ultimate owners of securities deposited in a depository are the beneficial owners. They are the ones who profit financially from owning the securities by receiving dividends and capital gains, for example. A Depository Participant (DP), who serves as a liaison between the beneficial owner and the depository, is how beneficial owners hold their shares.

Glossary

a) **Annual Maintenance Charges (AMC):** Fees charged by the DP for maintaining the demat account.

b) **Beneficiary Owner (BO):** The investor who holds securities in a demat account.

c) **Broker:** A financial intermediary who facilitates securities trades on behalf of clients.

d) **Central Counterparty (CCP):** An entity that interposes itself between buyers and sellers in a market, becoming the counterparty to both sides of a trade.

e) **Clearing:** The process of reconciling and confirming trades between buyers and sellers in a market.

f) **Clearing House:** An entity that acts as a central counterparty for securities transactions, ensuring that trades are settled in a timely and efficient manner.

g) **Client ID:** A unique identification number assigned to a demat account holder.

h) **Custodian:** An entity that holds securities on behalf of clients and provides related services such as trade settlement, corporate actions, and reporting.

i) **Demat Account:** An account that holds securities in electronic form.

j) **Depository:** A financial institution that holds securities in electronic form on behalf of investors.

k) **Delivery Instruction Booklet (DIB):** A booklet containing blank DIS forms used to transfer securities.

l) **Delivery Instruction Slip (DIS):** A document that authorizes the transfer of securities from one account to another.

m) **Dematerialization:** The process of converting physical securities into electronic form.

n) **Depository Participant (DP):** An entity that acts as an intermediary between the investor and the depository.

o) **ISIN:** International Securities Identification Number, a unique code assigned to each security for identification purposes.

p) **Nomination:** The process of appointing a nominee to receive the securities in the event of the BO's death.

q) **Power of Attorney (POA):** A document that authorizes another person to operate the demat account on behalf of the BO.

r) **Re-materialization:** The process of converting electronic securities into physical form.

s) **Settlement:** The process of transferring funds or securities between buyers and sellers in a market.

t) **Trade Aggregation:** The process of combining multiple trades into a single batch for processing.

u) **Trade Confirmation:** A document that confirms the details of a trade, including the parties involved, the price, and the quantity of the assets traded.

Long Answer Type Questions

a) What is the difference between a primary and secondary market? Describe the processes involved in trading and settlement in each.

b) Elaborate the process of clearing and settlement in detail.

c) Outline the various steps involved in trading.

d) What is the NSE procedure for clearing and settlement?

e) What are the various considerations which you will keep in mind as an investor? Also discuss the importance of clearing and settlement procedures for an investor.

f) What do you mean by DIS? Explain the contents of DIS in detail.

g) Explain the various instruction to fill the delivery instruction slip in detail.

h) Discuss in detail the various practices depository participants and beneficial owners.

i) What do you mean by settlement and clearing procedures? Who are the participants which involves in clearing and settlement procedures?

j) What are the key functions of a stock market?

Short Answer Type Questions

a) What do you mean by stock market?

b) Discuss the different phases of transactions in a stock market.

c) How Clearing and settlement is done?

d) What is the purpose of a trade confirmation in the settlement process?

e) Explain the importance of clearing and settlement procedures.

f) What do you mean by DIS?

g) Give example of few cases where DIS is useful?

h) What is substitution of DIS?

i) What do you mean by Depository Participants?

j) Give the meaning of beneficial owner.

Exercise

Suppose that you are an investor who has just bought 100 shares of XYZ Corp. The current market price of the stock is Rs. 50 per share, and you have purchased the shares through a brokerage firm. You have initiated the trade on Monday and the settlement date is T+2. Answer the followings:

Question 1. What is T+2 settlement?

Question 2. How much will you need to pay for your shares?

Question 3. When will the payment be due?

Question 4. How will the payment be made?

Question 5. When will you receive the shares?

Answers:

1. T+2 settlement refers to the timeline for the settlement of a stock trade. In this case, the settlement date is two business days after the trade date.
2. You will need to pay Rs. 5,000 for your 100 shares of XYZ Corp (Rs. 50 per share x 100 shares).
3. The payment will be due on the settlement date, which is two business days after the trade date.
4. The payment will be made through your brokerage firm, which will facilitate the transaction on your behalf. You may have already provided the brokerage firm with funds for the purchase, or you may need to transfer funds to your account to cover the cost of the shares.
5. You will receive the shares on the settlement date, which is two business days after the trade date. The shares will be transferred to your brokerage account, and you will be able to access them through your brokerage firm's trading platform or other account management tools.

Suggested Readings

a) "Financial Institutions, Markets, and Money" by David S. Kidwell, David W. Blackwell, David A. Whidbee, and Richard W. Sias. Publisher: John Wiley & Sons, Inc. Edition: 12th Edition.

b) "Financial Markets and Institutions" by Frederic S. Mishkin and Stanley G. Eakins. Publisher: Pearson. Edition: 9th Edition.

c) "Fundamentals of Financial Services" by N. S. Toor and Rajni Sofat. Publisher: Taxmann Publications. Edition: 7th Edition.

d) "Introduction to Financial Services" by Barbara Casu, Claudia Girardone, and Philip Molyneux. Publisher: Pearson. Edition: 2nd Edition.

e) "Settlements & Custody" by David Loader. Publisher: John Wiley & Sons. Edition: 1st Edition.

f) "Settlement Systems in Financial Markets" by Philippe Jorion. Publisher: John Wiley & Sons. Edition: 1st Edition.

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E- Financial Market and Services (BCDB33606T)

UNIT X: Trading on Stock Exchange

Chapter – 10

Structure:

10.1 Stock Market in India

10.2 Trading System

10.3 Stock Market Information System

10.4 Method of Trading on a Stock Exchange

10.5 Types of Dealings in a Stock Exchange

10.6 Some Important Terms

10.7 Factors Affecting Prices in a Stock Exchange

10.8 Exercise

OBJECTIVES

- explain the meaning and importance of stock exchange
- state the economic functions of stock exchanges
- explain the method of trading on a stock exchange

10.1 Stock Market in India

Emerging from humble and dispersed origins in the 19th Century, the stock market in India has experienced remarkable growth. By 1990, the country boasted 19 Stock Exchanges, and this number increased to 23 by 2002, as detailed in subsequent sections of this unit. Exploring the roots and evolution of the Indian stock market becomes intriguing. What roles does it play? How is it structured? What mechanisms oversee its operations? These and related inquiries will be delved into shortly.

Origin and Expansion

In the realm of economics, society, and politics, institutions and organizations are shaped by historical events and necessities. These events perpetually prompt the replacement or reformation of existing structures to ensure their relevance and functionality in contemporary circumstances. Thus, it proves beneficial to gain a concise understanding of the inception and development of the stock market in India.

The roots of India's stock exchanges can be traced back to 1800, progressing through six distinct stages. From 1800 to 1865, sporadic share offerings occurred as the East India Company and a few commercial banks engaged a small group of brokers. Notably, the period until 1865 saw the emergence of a share market frenzy fueled by the American Civil War-induced cotton famine, resulting in excessive speculation and rampant buying.

The phase from 1866 to 1900 witnessed the aftermath of the share mania, leading to the establishment of a regular securities market in Bombay. The Native Share and Stockbrokers Association was formed in 1887 to regulate brokerage business, articulate codes of conduct, and mobilize private funds for industrial growth.

The years 1901 to 1913 were marked by political developments and the Swadeshi Movement, encouraging indigenous business ventures. Calcutta became a significant center for share trading, driven by the coal boom of 1904-1908. During this time, stock exchanges were established in Calcutta and Madras.

From 1935 to 1965, India experienced the development of existing stock exchanges. Two additional exchanges were set up in Hyderabad (1943) and Delhi (1947), bringing the total to seven at the time of Independence. Between 1946 and 1990, 12 more stock exchanges were established, trading the shares of an additional 4,843 listed companies.

By 1999, there were 23 regional stock exchanges in India, with three more, namely the National Stock Exchange (NSE), the Over the Counter Exchange of India Limited (OTCEI), and Interconnected Stock Exchange of India Limited (ISE), operating on a nationwide scale. These entities adopted the Screen-Based Trading System (SBTS) to provide automated and modern trading facilities.

As of March 1999, 9,877 companies were listed on the stock exchanges, with a market capitalization of ₹5,30,772 crore. The NSE alone had a market capitalization of ₹6,36,861 crore by March 2002. Notable stock exchanges include the Bombay Stock Exchange, Ahmedabad Stock Exchange Association, Calcutta Stock Exchange Association, and the National Stock Exchange of India, among others.

10.2 Trading System

The trading systems employed vary across different exchanges. The subsequent pages provide an overview of the trading system utilized by the National Stock Exchange (NSE). Those seeking information on the trading systems of other exchanges in India or abroad can refer to the respective websites of those stock exchanges.

The NSE functions on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated, screen-based trading system embracing the order-driven market principle. NSE deliberately chose an order-driven system over a quote-driven system. This decision has not only diminished jobbing spreads on the NSE but has also had a positive impact on other exchanges, leading to a reduction in transaction costs. Before the advent of the NSE, investors aiming to transact in a security not traded on their nearest exchange had to channel orders through a series of correspondent brokers to reach the appropriate exchange. This process resulted in considerable uncertainty and elevated transaction costs. NSE has rectified this by enabling investors to access the same market and order book, regardless of location, at the same price and cost.

Market Categories

The NEAT system incorporates four distinct market types:

Normal Market:

- In the Normal Market, all orders of the regular lot size or multiples thereof are executed. For shares traded in the compulsory dematerialized mode, where the market lot is one share, various book types categorize orders as Regular lot orders, Special Term orders, Negotiated Traded orders, and Stop Loss orders based on their attributes.

Odd Lot Market:

- The Odd Lot Market handles orders with a size less than the regular lot size. An order qualifies as an odd lot order if its size is below the regular lot size. These orders lack special term attributes. In the odd-lot market, both the price and quantity of buy and sell orders must exactly match for a trade to occur. Currently, this market facility is utilized for the Limited Physical Market in accordance with SEBI directives.

Spot Market:

- Spot orders, akin to normal market orders, differ in settlement periods compared to the normal market. These orders lack special term attributes and are presently used for the Automated Lending & Borrowing Mechanism (ALBM) session.

Auction Market:

- The Auction Market involves auctions initiated by the Exchange for settlement-related reasons. Three key participants exist in this market:
  - **Initiator:** The party initiating the auction process.
  - **Competitor:** A party entering orders on the same side as the initiator.
  - **Solicitor:** A party entering orders on the opposite side to the initiator.

Order Books

- The NSE trading system offers members considerable flexibility in the types of orders they can place. Upon receipt, orders are promptly assigned unique order numbers and time stamps before being processed for potential matches. Each order carries a distinct order number and a unique time stamp. In the absence of a match, the orders are categorized into different 'books.' The orders within these books are arranged based on price-time priority, following this sequence:
- Best Price
- Within Price, by time priority
- In terms of priority, price priority dictates that the order with the best price holds precedence if two orders are entered. Time priority, on the other hand, stipulates that if two orders have the same price, the order entered first takes precedence.
- Within the Capital Market segment, various types of books exist:
- **Regular Lot Book:**
- Contains all regular lot orders without any attached attributes such as All or None (AON), Minimum Fill (MF), or Stop Loss (SL).
- **Special Terms Book:**
- Encompasses orders with special terms like AON or MF. Notably, special term orders (AON and MF) are currently unavailable on the system in adherence to SEBI directives.
- **Negotiated Trade Book:**
- Stores negotiated order entries captured by the system before being matched against corresponding trade entries from counterparties. These entries include a counterparty code along with other order details.
- **Stop-Loss Book:**
- Holds Stop Loss orders until the trigger price specified in the order is reached or surpassed. Once the trigger price condition is met, the order is released in the Regular Lot Book.
- **Odd Lot Book:**
- Contains all odd lot orders (orders with a quantity less than the marketable lot) in the system. Presently, pursuant to a SEBI directive, the Odd Lot Market is utilized for orders with a quantity less than or equal to 500 (Qty

more than the market lot) for trading, referred to as the Limited Physical Market (LPM).

- **Spot Book:**
- Encompasses all spot orders with a different settlement period. The Spot Market book type is currently employed for conducting the Automated Lending & Borrowing Mechanism (ALBM) session.
- **Auction Book:**
- Contains orders entered for all auctions. The matching process for auction orders in this book is initiated only at the end of the solicitor period.

Order Matching Guidelines

- The NSE trading system follows specific rules for matching orders. The primary principle is that the best buy order is paired with the best sell order. Orders may partially match, resulting in multiple trades. The determination of the best buy order is based on the highest price, while the best sell order is determined by the lowest price. The system views all buy orders from the seller's perspective and vice versa. Consequently, the best buy order is the one with the highest price, and the best sell order is the one with the lowest price.
- Members can either proactively enter orders, which remain in the system until fully matched or canceled, or reactively enter orders that align with existing ones in the system. Unmatched orders are termed 'passive,' while those entering to match existing orders are termed 'active.' Orders are always matched at the passive order price to prioritize earlier orders over later ones.

Order Conditions

- Trading Members can enter various types of orders based on three broad categories: time-related conditions, price-related conditions, and quantity-related conditions.

Time Conditions:

- **DAY:** A Day order is valid for the day it is entered, automatically canceling if not matched by the end of the trading day.
- **GTC (Good Till Cancelled):** This order remains in the system until canceled by the Trading Member, potentially spanning multiple trading days.
- **GTD (Good Till Days/Date):** Allows the Trading Member to specify the days or date up to which the order remains in the system, getting flushed after this period.

Price Conditions:

- **Limit Price/Order:** Allows specifying the price when entering the order.
- **Market Price/Order:** Orders to buy or sell securities at the best available price at the time of entering the order.
- **Stop Loss (SL) Price/Order:** Activated only when the market price reaches or crosses a specified threshold, not entering the market until then.
- **Sell Order (SL):** Triggered when the last traded price in the normal market reaches or falls below the trigger price.
- **Buy Order (SL):** Triggered when the last traded price in the normal market reaches or exceeds the trigger price.

Quantity Conditions:

- **Disclosed Quantity (DQ):** Allows disclosing only a part of the order quantity to the market.
- **MF (Minimum Fill):** Specifies the minimum quantity by which an order should be filled.

- **AON (All or None):** Imposes the condition that only the full order should be matched, staying in the books until fully matched or canceled.

10.3 Stock Market Information System

Stock exchange quotes and indices, as featured in daily newspapers, serve as the primary information source for stock exchange transactions and turnover. Publications like Economic Times, Financial Express, Business Standard, Business Line, Times of India, and Hindustan Times routinely provide daily quotes and indices. Specifically, for Bombay Stock Exchange (BSE) quotations published in Economic Times, information on equity shares follows a structured order: Company's name; previous day's closing price in brackets; all daily traded prices as reported by BSE; key financial parameters like earnings per share (EPS), cash earnings per share (CPS), cash P/E (price-to-earnings ratio), return on net worth (RNW), gross profit margin (GPM), etc., on different days; P/E; and the high and low prices in the past 52 weeks.

The presentation of equity share information adheres to certain conventions. The first traded price is the day's opening price, and if only one price is recorded, it also serves as the closing price. In the case of two prices, the middle quote represents either the high or low price. For four prices, one middle quote signifies the day's high, and the other represents the low. If there are no transactions for a company's share on a given day, the previous day's closing price is indicated in brackets.

Financial metrics such as EPS and CPS are defined as the average net profit after tax and cash profit per equity share, respectively. The cash P/E ratio relates the day's closing price to the cash earnings per share, distinct from the P/E ratio, which considers the net profit per share. The RNW measures net profit as a percentage of net worth, indicating the return earned on shareholders' equity capital and reserves. GPM, the gross profit margin, is presented as a percentage of gross sales, measuring the company's profit margin available to absorb various charges.

The 52-week high and low prices are recalculated daily, adjusting for bonus and rights issues of equity shares. If the day's traded price represents a yearly high or low, the entire line, including the company name, is highlighted in bold types. Significant changes in the day's closing value compared to the previous day are highlighted in bold, with a plus or minus sign as appropriate. Share-related events such as ex-dividend, ex-bonus, or ex-rights are indicated by notations like XD, XB, or XR next to the closing price. For shares with face values other than Rs. 10, the symbol is provided along with the names.

Debenture information includes details like the nominal interest rate, company name, face value, previous day's closing price, day's opening price, yield to maturity (YTM), and annualized yield. YTM adjusts the nominal return for various factors, facilitating comparison among different debenture investment options.

Beyond individual quotations, daily newspapers also feature share price indices, with BSE's 'Sensex' and 'National' indices being prominent. NSE-50 ('Nifty') has gained popularity among institutional and retail investors. Other indices, including The Economic Times Index of Ordinary Share Price, Business Standard Index of Ordinary Shares Price, and the Reserve Bank of India's Share Price Index, are also published.

10.4 Method of Trading on a Stock Exchange

Not all securities issued by companies and other entities are allowed to be quoted on a recognized stock exchange; only listed securities are eligible for trading. Details about the listing of securities will be covered in-depth later in this unit. Trading of securities on the stock

exchange floor is exclusive to members or their authorized agents. If you wish to buy or sell securities, you must engage a stock broker who is a member of the stock exchange.

When looking to purchase shares, you need to place an order with the broker for the acquisition of those shares. Additionally, you can rely on the broker's expertise in selecting the type of securities to buy. After deciding on the securities to purchase, you must deposit the estimated cost of the securities with the broker. Typically, the broker delegates this task to an authorized clerk in the stock exchange hall, who announces the requirement by "shouting in the hall" during the designated time for dealings in that specific class of securities. The announcement includes details about the securities, the required quantity, and the offered price.

Another broker in the hall will respond to your broker's call, either accepting the offer or making a counter offer. Through this process, the bargain or deal is finalized. Each broker maintains a notebook, known as sauda bahi, where they obtain the signature of the broker from whom they purchased the securities. This signature serves as confirmation of the transaction by the other party. At the end of the day, every broker submits their record of transactions to the stock exchange to reconcile purchase transactions with sales. On the settlement day, the broker takes delivery of the securities and makes the necessary payment.

You are required to pay your broker the cost of the purchased securities along with the commission, which is a fixed percentage as per the schedule set by the stock exchange. The broker then prepares a contract note in favor of the client, forwarding it to them. The contract note details the quantity and description of the purchased securities and the inclusive price (including commission) at which they were bought.

10.5 Types of Dealings in a Stock Exchange

There are several types of transactions conducted on stock exchanges, and we will briefly discuss them now.

Spot Delivery Contracts: These contracts are settled immediately, with both delivery and payment occurring on the day of the transaction or, at the latest, by the following day. However, this practice is not very common nowadays.

Ready Delivery Contracts: In these contracts, settlement occurs within a short period, usually within twelve days, with the settlement taking place on the subsequent settlement day. No postponement is allowed in the case of ready delivery contracts.

Forward Delivery Contracts: Settlement for these contracts is also scheduled for the next settlement day, but there is an option to postpone it to the subsequent settlement day if desired. This flexibility is provided only for transactions involving securities listed in the specified list (List A). Such transactions are typically speculative, where the buyer has no intention of taking delivery and making payment. Instead, they aim to cover it through another transaction, earning or losing the price difference.

For instance, if Mr. Sanjay purchases 1,000 shares of Modi Rubber at Rs. 50 per share, anticipating a price increase, he may settle it by selling 1,000 shares when the price rises, pocketing the difference. If the price falls, he might opt to settle it by selling at a lower price and paying the difference. Alternatively, expecting a price rise, he may seek a postponement of settlement to the next settlement day by paying the necessary charges. Technically, this postponement is known as 'Carry Over' or 'Badla,' and the charges are referred to as 'badla charges' (also known as contango or backwardation, as explained later in this unit). Professional badlawalas may sometimes advance the necessary sum of money to finance the purchase of

shares by the bull speculator at a certain rate of interest, enabling them to defer the sale.

It's important to note that a forward delivery contract is distinct from future trading. Future trading involves entering into a transaction to sell or buy at a future date, and such trading is prohibited in India.

10.6 Some Important Terms

The language employed by participants on the stock exchange differs somewhat from the common business terminology. These terms have been adopted for official records and reports concerning stock exchange transactions.

Bull or Long: A person who acquires securities with the anticipation of a price increase is termed a 'Bull' or 'Long.' This individual becomes active when there is an expectation of rising security prices. The bull aims to sell these securities in the future. If their expectations prove correct, they make a profit; otherwise, they incur a loss. The term 'tejiwala' is also used for a bull. If, for example, a bull makes a deal to purchase 100 shares at Rs. 105, expecting the price to rise, and on the settlement day, the share price increases to Rs. 110, they instruct their broker to settle the deal, earning a profit of Rs. 500. In case the market goes against their expectation, leading to an unfavorable price, they can postpone the settlement by paying 'badla charges' (also called contango). The term 'bull' is used because, like a bull, they tend to raise prices artificially.

Bear: A person who engages in short selling, i.e., selling securities they do not possess at the time of selling, is referred to as a 'Bear.' Bears sell at the current high price with the expectation of buying at a lower price during delivery. If the market price falls as anticipated, they gain; otherwise, they incur a loss. In the event of a market rise, bears can defer their settlement by paying 'badla charges' (also called backwardation). The sale of securities by bears is termed 'short selling,' and they must purchase these securities from the market for delivery to the buyer.

Stag: A person is called a 'stag' if they deal with new issues of companies. Stags apply for shares based on the prospectus, selling these shares at a premium soon after receiving the allotment. Similar to a bull, stags foresee a rise in the securities' price. They often apply for a large allotment, as they only need to pay application money at the time of application. Stags may sometimes create an artificial demand for securities to boost their prices. If the response to these shares is poor and the stag is allotted all applied shares, they may have to sell these shares at a discount, resulting in a loss.

Contango: The charges paid by a bull to the broker for carrying over their transaction to the next settlement date are called 'contango.' The contango amount depends on the class of securities, their quantity, value, and prevailing interest rates at the time of the transaction. It is typically equivalent to the 'middle price' of the difference between the agreed price and the market price on the settlement day.

Backwardation: This is a type of badla charge paid to the bull by the bear seeking a postponement of the transaction to the next settlement date.

Cum-Dividend: 'Cum' means 'with' or 'including.' When shares are quoted as Cum-Dividend, the buyer has the right to receive the dividend on such shares payable after the sale date. The purchase price includes the due dividend amount, as the buyer becomes a registered shareholder entitled to receive dividends declared by the company.

Ex-Dividend: This term refers to the price of shares purchased without the right to receive the company's dividend. The dividend, in this case, is payable to the person whose name appears in the company's books, and when the buyer purchases shares after the company's books' closure, they buy the shares ex-dividend.

Cornering: Cornering occurs when an individual or a group holds almost the entire supply of a particular security. In such a situation, bears find it challenging to buy these securities for fulfilling their delivery commitments. Cornering can also refer to an outsider purchasing securities in large quantities to challenge the existing management of a company or put them in an embarrassing situation.

Margin Trading: Margin trading involves buying and selling securities by depositing with the

broker a certain percentage of the transaction's value. The deposited percentage is termed 'Margin Money' or 'Margin.' This practice aims to cover potential losses with the deposit. The broker credits the customer's Margin Account when the margin money is deposited, and it is a precondition for holding securities on behalf of the client. If the margin falls short of the client's losses on the held securities, the broker may ask for additional deposits. Failure to deposit the additional amount allows the broker to sell the securities to recover the shortfall.

Arbitrage: Arbitrage operation involves buying in a market where prices are low and selling the same securities in another market where prices are relatively higher. This practice contributes to the benefits of a continuous market, bringing divergent prices from various stock exchanges to a uniform level. Arbitrage operations also expand the scope of stock exchange operations, equalizing prices subject to the cost of communication and fund transfer from one place to another.

Rigging the Market: Rigging the market occurs when the prices of specific shares are artificially forced up in the market. This manipulation is usually a result of bullish activities, where speculative buyers increase demand, pushing up market prices. Those holding large blocks of shares often buy and sell to make the market active, gradually unloading their holdings at a profit.

Settlement Day: Each stock exchange designates a specific day for settling transactions between buyers and sellers. Settlement days may occur every

10.7 Factors Affecting Prices in a Stock Exchange

The prices of securities, especially equity shares, can undergo significant and crucial fluctuations. These price changes are primarily driven by the speculative activities of traders. However, beneath these speculative transactions, one or more additional factors contribute to the volatility in prices. Generally, fluctuations can be attributed to the following factors:

1. **Interest Rate:** Changes in the interest rates set by banks for loans and overdrafts can trigger alterations in speculative activities, leading to corresponding fluctuations in security prices. A decrease in interest rates may encourage borrowing and heightened speculative activities, resulting in an increase in security prices. Conversely, an increase in interest rates may reduce borrowing, leading to lower demand for securities and a subsequent decline in prices.
2. **Financial Institutions' Activities:** Large-scale buying of securities by financial institutions tends to drive prices up as it raises public expectations about a company's prospects and creates increased demand. Conversely, substantial selling of securities by financial institutions can lead to a decrease in prices.
3. **Company Performance:** The future profitability and dividend payments of a company often influence the rise or fall of its share prices. Investors' expectations regarding the rate of return on investment and future price increases are influenced by the company's profit-earning capacity and expected dividend rates. Positive prospects lead to increased demand and rising prices, while unsatisfactory trends in performance result in reduced demand and declining share prices.

4. **Business Cycles:** Business conditions undergo cycles of prosperity and depression. During prosperity, bull speculators actively purchase securities, causing prices to rise. However, if speculators face financial constraints and are compelled to sell, prices rapidly decline, leading to a state of market depression.
5. **Changes in Board of Directors:** Changes in the Board of Directors of specific companies can influence security prices. The death or resignation of a prominent director may create doubts or concerns about the company's future prospects, typically resulting in an adverse impact on the share prices of that company.
6. **Sympathetic Fluctuation:** Securities traded on multiple stock exchanges may experience changes due to fluctuations in another exchange. If the prices of certain securities fall in one exchange for a specific reason, it can lead to a decline in the prices of the same securities in other exchanges due to prompt communication among speculators.
7. **Political Events:** Alterations in government composition, changes in international relations, conflicts, political upheavals, and wars between nations can cause fluctuations in securities prices. Political events often impact business and industry conditions.
8. **Changes in Government Policy:** Alterations in government policies related to taxation, import-export regulations, price controls, licensing, etc., can influence security prices. For example, a government decision to exempt dividends from income tax may lead to an increase in share prices, while a decision to raise income tax rates on company profits may result in price decreases.
9. **Miscellaneous Factors:** Various factors not directly linked to stock exchanges can affect security prices due to the psychological reactions of speculators. Unexpected changes in weather conditions, inadequate or excessive rainfall impacting agricultural output, prolonged lockouts, or the illness of a prominent head of government can lead to changes in the prices of shares in specific industries like fertilizers, edible oils, cotton textiles, etc.

10.8 Exercise

Answer the following Questions:

Q1 Write a note on Stock Market
Q2 Discuss the Origin of Stock Market in India
Q3 What do you mean by NEAT
Q4 What is an Order Book
Q5 Discuss Order Matching Guidelines
Q6 State the method of trading on a Stock Exchange
Q7 Discuss various types of dealings in a Stock Exchange
Q8 Write a note on:
a) Bull
b) Bear
c) Margin Trading

Q9 State the various factors affecting prices in a Stock Exchange
Q10 Why Stock Markets are called as Information System

B. COM (Hons.)

(Accounting and Taxation)

SEMESTER - IV

E-FINANCIAL MARKET AND SERVICES

UNIT XI Composition of Sensex, Nifty and Sectoral indices

STRUCTURE

11.1 Introduction

11.2 Stock Market Index

11.3 Use of Indices

11.4 Construction Process

11.5 Method for Computation of Index

11.6 Difference between Indices

11.7 Sensex and its Composition

11.8 Nifty and its Composition

11.9 Sectoral Indices

11.10 Summary

Glossary

Long Answer Type Questions

Short Answer Type Questions

Suggested Readings

11.0 Objective

After going through this unit, you will be able to:

- Understand the concept of stock indices
- Explain the index computation methodology
- Evaluate the types of indices and the difference between these indices

11.1 Introduction

We have heard people talking about how Nifty has fallen, or how the Sensex has rallied and might have wondered what are these indices, and what is their relevance in stock trading. An index is a representative number, constructed using the value of a selected number of components which can be shares, commodities, etc., based on a base year. The movement of index represents the movement of prices of the components in the index. In this chapter we will learn the construction of indices and their uses. Of indices and their uses. Stock market indices play a crucial role in providing information about market movements, benchmarking investment performance, and guiding investment decisions. They are constructed using the prices of selected components and serve as indicators of the overall health and direction of the market. An index is a representative number that is constructed using the values of a selected number of components, which can include shares, commodities, or other assets. It serves as a barometer for the overall performance of the market or a specific segment of the market. : Indices are constructed based on the prices of the components included in them. The movement of an index reflects the movement of prices of the underlying components. The composition of indices may vary depending on the methodology used and the purpose of the index. Dow Jones Industrial Average as one of the oldest continuously quoted stock indices, which has been computed since 1896. This highlights the long history and importance of stock indices in tracking market movements. There are different types of indices, including price-weighted indices and market-capitalization-weighted indices. Price-weighted indices, such as the Dow Jones Industrial Average, are calculated based on the prices of the component stocks, while market-capitalization-weighted indices, such as the S&P 500, are calculated based on the market capitalization of the component stocks. In countries with more than one stock exchange, each exchange typically has its own index. For example, in India, the Bombay Stock Exchange (BSE) has the BSE Sensex, and the National Stock Exchange (NSE) has the S&P CNX Nifty. Stock market indices are used to provide information about the price movements of stocks and to measure the overall performance of equity markets. They serve as benchmarks for investors to evaluate the performance of their investments and make investment decisions. Indices are calculated with reference to a base period and a base index value. The base period serves as a reference point for comparison, and the base index value is set at a specific level during the base period.

11.2 Stock Market Index

In the world of finance, index refers to a subset of the stock market which facilitates in determining the overall performance of the stock market. Stock market indices play a crucial role in providing a snapshot of overall market performance, serving as benchmarks for investment analysis, and offering investment opportunities through various financial instruments. They allow investors to track market trends, assess portfolio performance, and make informed investment decisions based on the broader market sentiment. Following are the key features of stock market index

a) **Definition of Index**: An index in finance refers to a subset of the stock market that represents a basket of stocks chosen to track the overall performance of the market. It serves as an indicator or benchmark to gauge the sentiment and direction of the stock market.

b) **Composition of Indices**: Indices comprise a basket of stocks selected from various sectors of the economy, rather than being limited to specific industries. This diverse composition allows indices to provide a comprehensive view of the overall stock market performance, rather than focusing on individual sectors.

c) **Benchmarking Performance**: Indices serve as benchmarks for analyzing the performance of investment portfolios. By comparing the returns of a portfolio to the performance of an index, investors can assess how well their investments are performing relative to the broader market.

d) **Investment Options**: Investors can invest in stock market indices through various financial instruments, such as mutual fund schemes and exchange-traded funds (ETFs). These investment vehicles allow investors to gain exposure to a diversified portfolio of stocks that replicate the performance of the index.

e) **Indian Stock Exchanges**: In the Indian context, there are two main stock exchanges: The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Each exchange has its own flagship index – the Sensex for BSE and the NIFTY 50 for NSE – which are widely used as benchmarks for the Indian stock market.

Stock Exchange	Index	Number of Shares
Bombay Stock Exchange (BSE)	Sensex	30
National Stock Exchange (NSE)	NIFTY 50	50

The stock market indexes are useful for a variety of reasons, such as:

- Provides a historical comparison of returns on funds invested in the stocks as compared to other investments such as gold or debt.
- Used as a standard against which to compare the performance of an equity fund.
- Lead indicator of the performance of the overall economy or a particular sector.
- Reflect highly up to date information.

a) SENSEX

The Sensex is one of the oldest stock exchanges of India. It comprises total value of 30 stocks of companies which are listed on the BSE. Indeed, these stocks belong to the largest corporations in India and, thus, represent the Indian economy's performance at large. To simplify, if the Sensex is moving upwards, then the investors or traders in the market will prefer buying stocks and on the other hand, if the Sensex is moving downward, the investors or trader will prefer to hold back their positions. The sensex movements are tracked regularly which helps in analyzing the overall growth, industry-related development.

Below are the criteria which are used in selecting the 30 stocks of the Sensex:

- Stock must be listed on the BSE.
- Large-cap stocks with high market capitalization.
- High liquidity.
- Average daily turnover.
- Wide industry representation.

b) NIFTY 50

The NIFTY 50 is the flagship index of the National Stock Exchange and one of the most recognized stock market indexes of India. It tracks the total of 50 stocks of huge companies related to various sectors and industries. The NIFTY 50 based stocks are all large-cap oriented companies which form almost three-fourth of the total capitalization in India. NIFTY 50 helps in benchmarking fund portfolios, launching of index funds, ETFs and other structured products.

Below are the criteria which are used in selecting the 50 stocks of NIFTY 50:

- Stock must be listed on the NSE and should be included in NSE's futures and options trading list.
- Company's registered office should be in India.
- Large-cap stocks with market capitalization up to INR
- High liquidity
- High volume

Difference between Sensex and NIFTY 50

The Nifty 50 and Sensex sound a lot similar to each other and thus are often used for the same purpose. But in practicality, they are quite different from each other. Let's delve more into these two indices- **Sensex** and **NIFTY 50**, to know the differences between them.

Difference Between Sensex and NIFTY 50	
SENSEX	**NIFTY 50 NIFTY 50**
Benchmark index of the BSE	Benchmark index of the NSE
Sensex made up of ‘Sensitive and Index’	NIFTY 50 made up of ‘National and Fifty’
Incorporated in the year 1986	Incorporate in the year 1996
Oldest stock index of India	Relatively newer stock index of India
Index tracks 30 stocks	Index tracks 50 stocks
Sensex index base value is 100	NIFTY 50 index base value is 1,000.
Base year is 1997-98.	Base year is 1995.
Volume and liquidity is lower than NIFTY 50.	Volume and liquidity is relatively high.
Covers 13 sectoral indices	Covers 24 sectoral indices
Sensex Top Gainers: Sun Pharma, Mahindra & Mahindra, Tata Motors, Hindustan Unilever.	**NIFTY 50 Top Gainers**: Reliance Industries, ITC, Tata Steel, HDFC, ICICI Bank, Larsen & Toubro.

11.3 Use of Indices

Stock market indices are used for different purposes. Some of the uses of stock indices are discussed below.

a) **Barometer of Economy**: Stock market indices act as a barometer for an economy. If an index of a country continuously performs negatively, this indicates a weak economic outlook for that country. It indirectly indicates the growth of economy. In recent years, we had seen a sharp growth in the South East Asian economies’ indices, because these countries became the axle of the global economic growth. Contrary to this, we had seen a continuous decline in the major stock market indices in the Euro zone, because of the current economic crisis which started in early 2009.

b) **Indicator of Country’s Performance**: It also represents a country’s growth, weakness and strength. When the market index declines, it indicates a weak country, whereas a

rising
index is an indicator of good performance. In 2009, when the US growth declined, indices
like Dow Jones, S&P 500, etc., showed a heavy fall.

c) **Benchmark for Evaluation**: Institutional investors use the index as a benchmark to evaluate their performance against the index. Stock market indices are extensively used in security analysis, and portfolio management. Investors use them for portfolio allocation.
d) **Underlying Asset for Derivative Instruments**: Stock market indices are used as underlying assets for structuring derivative instruments, like futures and option. Nifty futures, Nifty options, etc., are examples of the uses of indices for structuring derivative products.
e) **Measure of Investor Confidence**: Rising stock market indices indicate that more investors are participating in trading, and declining indices show a loss of confidence of the investors in the market, as they are keeping away from the market. For example, if Bank Nifty declines continuously, it is an indication that investors are not buying banking shares.
f) **Indicator of Industry Performance**: Indices represent prices of shares of various companies. Hence, if the companies present a good performance, the demand for their shares goes up, and consequently the indices in which these shares are included also will go up. For example, IT companies can change the trend of Nifty or SENSEX, as they have a major weight in these indices.
g) **Creation of Index Fund:** Stock market indices are used for creating index funds. An index fund is a mutual fund, or exchange traded fund, that aims to replicate the movement of
an index in the financial market. IDBI Nifty Index Fund, Quantum Index Fund, etc., are examples of index funds. These funds are traded in the stock exchanges.
h) **Technical Analysis:** Technical analysts use the indices to predict the market using the historical value of indices. The relationship between individual stock and index predicts the movement of the individual share prices

11.4 Construction Process

A stock market index can be a price index or a wealth index. The price index can be a weighted price index or an unweighted price index. In the case of a weighted price index/wealth index, weights based on market capitalisation of the shares are assigned to the prices, whereas in the unweighted price index simple arithmetical average price of the share prices is computed with a base year. This index gives an idea about how the share prices are moving. In the case of the

wealth index, the base period values are adjusted for subsequent rights and bonus shares are issued. The wealth index indicates the real wealth created by the shareholders over a period of time. Construction of an index involves selection of scrips, assigning weights for each scrip, and computing the index value. Following are the important features for construction process

a) **Types of Indices**
   - Price Index: A stock market index can be either a price index or a wealth index. Price indices focus on the movement of share prices over time.
   - Wealth Index: Wealth indices, on the other hand, consider not only the share prices but also the wealth created by shareholders over time, including factors such as rights issues and bonus shares.

b) **Construction of Price Index**
   - Weighted Price Index: In weighted price indices, weights based on market capitalization are assigned to the prices of shares. This means that larger companies with higher market capitalizations have a greater impact on the index.
   - Unweighted Price Index: Unweighted price indices compute a simple arithmetic average of share prices, without assigning any weights. This provides a basic idea of how share prices are moving in the market.

c) **Construction of Wealth Index**
   - Adjustments for Rights and Bonus Shares: Wealth indices adjust the base period values for subsequent rights and bonus shares issued to shareholders. This reflects the real wealth created by shareholders over time.

d) **Methods for Computing Indices**
   - Market Capitalization Method: This method is commonly used by stock exchanges in India to compute various indices. It involves selecting the scrips to be included in the index, choosing a base period, and computing the average price of each share during the base period. The base market capitalization is then calculated by multiplying the average price by the number of outstanding shares. Current market capitalization is similarly computed using the current price of the scrip and the current outstanding shares.

e) **Other Methods**
   - Price Weighted Method: This method calculates the index by simply summing up the prices of all the stocks in the index and dividing by the number of stocks.
   - Equal Weight Index Method: This method assigns equal weights to all the stocks in the index, regardless of their market capitalization.
   - Free Float Method: This method considers only the shares available for trading in the market, excluding shares held by promoters or other entities.

11.5 Method for Computation of Index

Four methods are commonly used for the computation of index. These methods are the

a) **Market Capitalization Method:** Market Capitalization Method Stock exchanges in India are using this method to compute various indices. Under this method, the scrips are selected for inclusion in the index, and a base period is also selected. For example, the base period can be 1990 or 2000. It can also be 1989–90 or 1999–2000. The average price of each share for the base period is computed. The number of shares outstanding is multiplied by the average price of shares to get the base market capitalization. Similarly, current market capitalization is computed by multiplying the current price of the scrip by the current outstanding shares.

An example of computing the index value under this method is given as follows:

Company	Current Period					Base Period				
	Average Price		No. of Shares Outstanding		Market Capita-lisation (Lakh)	Average Price		No of Shares Outstanding		Market Capita-lisation (Lakh)
ABC	100	×	10000	=	1000000	90	×	10000	=	900000
ACD	88	×	10000	=	880000	94	×	10000	=	940000
XYZ	12	×	100000	=	1200000	11	×	100000	=	1100000
GTA	11	×	100000	=	1100000	8.80	×	100000	=	880000
TOTAL					4180000					3820000

Current Market Capitalisation = 4180000
(Market Capitalisation = Number of shares outstanding * Price of the security)
Base Market Capitalisation = 3820000
Base Value = 100
So the index value works out to be = (4180000/3820000) × 10 = 109.42

b) **Price Weighted Method**

Under this method, we do not consider market capitalization. Instead, we take only the base price and the current market price. The index is constructed using these prices as the weights.

An example of computation of the price weighted method is shown below

Company Price	Current Price	Base Price
ABC	1001	901
ACD	886	947
XYZ	1202	1101

GTA	1108	889
Total	4197	3838

Market price weighted index = Current Price / Base Price * 100

= 4197/3838*100

= 109.35

c) Equal Weight Method

In this case also, market capitalization is not considered. Instead, equal weights are assigned to the scrips in the index. For example, if there are four scrips, the weight for each scrip will be ¼ or 0.25. Instead, taking the absolute value of the prices, the price change between the current market price and base price is computed, which is multiplied by the assigned weights to get the weighted average value of each scrip. The sum total of these weighted averages is added to the base index value, which is normally 100.

An example of the construction of this index is given below

Company	Base Price	Current Price	Percentage Change in Share Price	Weight	Weighted Average
ABC	90	99	10 ×	1/4	2.50
ACD	94	102.27	8.80 ×	1/4	2.20
XYZ	11	12.32	12.00 ×	1/4	3.00
GTA	8.80	9.77	11.02 ×	1/4	2.75
TOTAL					**10.45**

Equal Weighted index = 100 + Weighted Average

= 100 + 10.45

= 110.45

d) Free Float method index

Calculation Under the free float method of index calculation, the shares which are available for trading are considered than the total shares which are outstanding. Most of the time, promoters who hold majority of shares, strategic investors, governments holding, etc., will not be available for trading. Under the free float method, these shares, which are not made available in the market, would not be considered for calculating market capitalisation. Exchanges usually collect quarterly statements to find out the exact number of shares available for trading in the market. The method of computation of an index, which is based on free float, is explained under the BSE Indices

11.6 Difference Between Indices

Though indices are constructed using the same methodology, often, they do not move in consonance. Many times, we have seen that when the SENSEX is moving up, Nifty may be going down. Similarly, the points of change also differ between the two indices. The main reasons for this variation are:

a) **Number of Components**: The numbers of stocks included in each index make it different from the other. The greater number of shares are included, the more the index would be representative of the sector. For example, SENSEX has 30 stocks and Nifty comprises 50 stocks. The well-known international index is constructed based on 30 stocks, whereas FTSE 100 has 100 stocks included in it. STOXX comprises 50 stocks. NSE's S&P Nifty 500 is structured, based on 500 stocks. Nifty Midcap has 200 stocks in it. BSE-100, which was formerly known as BSE National Index, has 100 stocks. Previously, out of 100 stocks 22 were quoted in BSE, and the rest were quoted in BSE and other exchanges. In 1989, this index was reconstituted with the base year as 1983–84, based on 100 stocks traded in BSE.

b) **Composition of Stock**: The exchanges change the composition of the indices by dropping or adding fresh companies. When a company is de-listed, or the trading volume comes below the eligibility criteria for that index, that scrip is dropped and a fresh scrip is added. For example, in 1996, BSE replaced 15 stocks in SENSEX. The latest change took place in December 2010. Nifty changed its composition in 1996 and 1998. NSE had changed the composition of its Nifty Junior also in 1998 October. Considering the growth of the IT industry, now IT stocks have been given a major weight in the indices. The composition, and the frequency of changing the composition, differs from index to index.

c) **Weights Assigned to Scrips**: The weights allotted to each company's scrip also influences the movement of the index. These weights may represent price or value. While the popular US stock index Dow Jones, and Asian popular index Nikkei 225 of Tokyo Stock Exchange, are weighted with the price, BSE' SENSEX, Nifty, etc., are weighted with value. The price weights are arrived at by adding together the current prices of the stocks traded in the stock exchange, and dividing them by the total number of outstanding stocks. An example of price weighting is worked out in the previous paragraphs. In this method, the index is influenced more by the stocks with higher price than the stocks with lower price. The number of stocks is periodically adjusted to cover stock splits, rights shares, and bonus shares. The market value weighted index represents the current market capitalization. The current market capitalization is computed by multiplying the current market price of each stock with the total number of outstanding shares in respect of that stock. Computation of the market capitalization weighted method is shown in a previous example. Most of the indices all over the world, and those in India, except Economic

Times' Ordinary Share Index, are weighted with value. Each scrip influences the index proportionate to the importance of that scrip in the market. Hence, price changes that take place in scrips, with high market capitalisation, often have a great impact on the index. The price changes on account of rights issue; or bonus issue of shares also create changes in the index, because these corporate actions increase the number of outstanding shares, and at the same time bring down the prices of those shares. In an unweighted index, all stocks carry equal weights. An example of computation of equal weight index is worked out in a previous paragraph. Since all the stocks carry equal weight price; or volume of the scrips do not create much impact on the index. The movement of price is computed, based on the percentage change in the average price of the stocks in the particular index. Under this method, it is assumed that the investors are deploying equal amount of money in each stock included in the index. The Value Line Index of the New York Stock Exchange does not use weights; rather a geometric mean is used instead of an arithmetic mean.

d) **Base Year:** The base year of various indices differ. If the base year is close to the current year, the prices will be more representative of the current trend. If the base period is too close, the investor will lose chances to get historical information. The base year is usually revised after passing a certain period, to make it more current.

11.7 Sensex and Composition

The base period of SENSEX is 1978–79, and the base value is 100 index points. The calculation of SENSEX involves dividing the free-float market capitalisation of 30 companies in the index by a number called the Index Divisor. The Index Divisor is the only link to the original base period value of the SENSEX. For instance, if ABC has an equity capital of 1.72 billion, with each share having a face value of `10, and its closing price in BSE on January 2011 was `175, then ABC company has a market capitalisation on that date which is 175 3 1.72/10 = `30.1 billion. One can calculate BSE 30 stocks market capital on a particular day in the same method. The selection of scrips is done by giving wide representation to the industries. BSE follows qualitative and quantitative criteria in selection of stocks for inclusion in the index

Qualitative Criteria

The qualitative criteria consist of industry representation and track record. Industry Representation: Scrips are selected from major industries in India, so as to give a true representation of each sector. This process makes the index a true representative of the economic growth in the country. The selection of scrips is done carefully so as to ensure that the selected scrip reflects the present state of the industry as well as future prospects. For example, Infosys stock is having a major weightage in SENSEX, because that share represents the whole IT

industry, as the progress of IT industry is reflected in this stock. The changes in the price of Infosys can make changes in the trend of the index. Track Record: Only shares of companies having an acceptable track record are considered for inclusion in the index. Companies included in the Z group, listed mutual funds, scrips suspended on the last day of the month prior to review date, scrips objected to by the Surveillance department of the Exchange, and those that are traded under permitted category are excluded. Listing History: The scrip should have a listing history of at least three months at BSE. However, scrips with a listing history of one month are accepted, if the average free-float market capitalisation of a newly listed company ranks in the top 10 of all companies listed at BSE. Companies listed on account of a merger/demerger/amalgamation, have been exempted from minimum listing history.

Quantitative Criteria

BSE considers quantitative criteria such as trading history, revenue. Trading History: The scrip should have been traded on each and every trading day in the last three months at BSE. Exceptions are considered in extreme reasons like scrip suspension, and so on. Higher frequency in trading increases liquidity of the scrips. Revenue: The selected companies should have reported revenue in the latest four quarters from its core activity. Market Capitalisation: Companies satisfying the eligibility criteria such as track record, listing history, trading history, reporting of revenue, etc., are shortlisted, and from this list of the top 75 companies based on free-float market capitalisation (avg. 3 months), companies are selected. Any additional companies that are in the top 75, based on full market capitalisation (avg. 3 months), are also included. Ranking of Scrips: The filtered list of constituents selected, based on market capitalisation (which can be greater than 75 companies), is then ranked on absolute turnover (avg. 3 months). In this process, the scrips that have a cumulative turnover of more than 98 per cent are excluded, so long as the remaining list has more than 30 scrips. Assigning Weights: Weights are assigned, based on free-float market capitalisation. The filtered list, as mentioned in the previous paragraph, is then sorted by free float market capitalisation and any company having a weight within this filtered constituent list of more than 0.50 per cent is excluded. All remaining companies will be sorted on sector, and sub-sorted in the descending order of rank on free-float market capitalisation.

Method of Construction of SENSEX

As discussed in the introductory part of SENSEX, globally accepted and widely used free-float method is used for construction of this index. We have explained the free-float in an earlier paragraph. Free-float can be defined as the shareholding of investors that would not come, in the normal course, into the open market for trading, as these shares are treated as ‘Controlling/ Strategic Holdings’. Specifically, the following categories of holding are generally excluded from the definition of free-float:

● Shares held by founders/directors/acquirers, which has control element.

● Shares held by persons/bodies with "Controlling Interest".

● Shares held by the government as promoter/acquirer.

● Holdings through the FDI Route.

● Strategic stakes by private corporate bodies/individuals

Equity held by associate/group companies (cross-holdings).

● Equity held by Employee Welfare Trusts.

● Locked-in shares, and shares which would not be sold in the open market in the normal course. The free-float factor for each company is determined, based on the detailed information submitted by the companies in the prescribed format on a quarterly basis. BSE has placed the format on its website. Free-float market capitalisation is computed by multiplying the total market capitalisation with the free-float factor. Once the free-float of a company is determined, it is rounded-off to the higher multiple of 5, and each company is categorised into one of the 20 bands

a) **Online Computation**: The value of SENSEX is computed online on real-time basis, and then disseminated. The changes in the prices of the constituents are collected during the trading time and incorporated into the index, thereby making the index updated, so that the index also moves along with the real time price movements.

b) **Index Closure Algorithm**: The closing SENSEX on any trading day is computed, taking the weighted average of all the trades on SENSEX constituents in the last 30 minutes of trading session. If a SENSEX constituent has not traded in the last 30 minutes, the last traded price is taken for computation of the Index closure. If a SENSEX constituent has not traded at all in a day, then its last day's closing price is taken for computation of Index closure. The use of Index Closure Algorithm prevents any intentional manipulation of the closing index value.

c) **Index Maintenance:** One of the major tasks in maintaining the index is to update the base year average. The base year average updating includes replacement of stocks, adjustments for additional capital issue, rights issue, bonus issue, dividend, etc., and similar corporate announcements. However, the adjustments for corporate actions do not per se affect the index values. The maintenance is done on a day-to-day basis. BSE Index Committee has set a broad index policy, and the Index Cell of BSE does the maintenance in tune with this policy. The Index Committee is constituted by drawing experts from the area of capital market, fund managers, market participants and members of the BSE Governing Board. Index Cell ensures that SENSEX and all the other BSE indices maintain their benchmark properties by striking a delicate balance between frequent replacements in index, and maintaining its historical continuity. The issuing of additional

shares in the form of right issue, bonus issue, stock splits, etc., increases the number of outstanding shares, and therefore periodical adjustments are necessary in the market capitalisation. Adjustment is required, also, when new shares are issued by way of conversion of debentures, mergers, spin-offs, etc., or when equity is reduced by way of buy-back of shares, corporate restructuring, and so on. BSE uses the following formula for adjustment of the additional shares issued by constituent companies. The formula for adjusting the Base Market Capitalisation is as follows:

d) **New Base Market Capitalisation** (NBMC) = OBMC * (NMC/OMC)

Where: OBMC = Old Base Market Capitalisation

NMC = New Market Capitalisation

OMC = Old Market Capitalisation.

Example: A company issues right shares, which increases the market capitalisation of the shares of that company, by say, `200 crore. The existing Base Market Capitalisation (Old Base Market Capitalisation), say, is `2000 crore, and the aggregate market capitalisation of all the shares, included in the index before the right issue is made, is, say `4500 crore. The 'New Base Market Capitalisation' will then be

e) New Base Market Capitalisation = 2000 * [(4500 + 200)/4500] = 2088.89 This figure of `2088.89 crore will be used as the Base Market Capitalisation for calculating the index number from then onwards, till the next base change becomes necessary

11.8 Nifty and Composition

In NSE, indices are owned and managed by India Index Services and Products Ltd. (IISL). It is a joint venture between NSE and CRISIL. In NSE, nine indices are maintained, computed and traded. The S&P CNX NIFTY is the headline index on the National Stock Exchange of India. Fig. 3.2 shows the movement of Nifty from 1995 to 2011. It includes 50 stocks from various sectors of the economy, and they are highly liquid in nature. S&P CNX Nifty constitutes nearly 60 per cent of the total market capitalisation of the equity market. The 50 stocks are from 22 sectors, and it offers investment managers to create an efficient portfolio. The National Stock Exchange adopted the Market Capitalisation Weighted index based on the free float method.

Index Level = Sum of (Price of stock * Number of shares)* Free float adjustment factor/index divisor. To find out the free float capitalisation of a company, calculate the market capitalisation of a company, and then multiply it by its free-float factor

11.9 Sectoral Indices

Sectorial performance information is important, which may help analysts, fund managers, and investors to identify outstanding sectors which usually gave high returns, while investing in.

BSE has 14 sectorial indices that measure the performance of different segments of the economy through movement of the stock prices of the leading companiesSectoral indices act like a spotlight focusing on a specific part of the stock market, like healthcare, technology, or finance. These indices give a quick snapshot of how well or poorly a particular industry is performing. Sectoral indices offer streamlined overviews and comparative metrics focused on particular industries or sectors. These indices allow investors to gauge the performance of individual stocks in relation to their respective sectors.

Sectoral indices are stock market indices that track the performance of specific sectors within the economy. Instead of providing a broad representation of the entire market, sectoral indices focus on a particular industry or segment, allowing investors to assess the performance of individual sectors more accurately. Following are the detailed explanation of sectoral indices

a) **Purpose**: Sectoral indices are designed to provide investors with insight into the performance of specific industries or sectors within the economy. By tracking the movements of sectoral indices, investors can analyze trends, identify opportunities, and make informed investment decisions based on the performance of specific sectors.
b) **Composition**: Sectoral indices are composed of a selection of stocks from companies operating within a particular industry or sector. For example, there may be sectoral indices for industries such as technology, healthcare, finance, energy, consumer goods, and so on. The stocks included in a sectoral index are typically chosen based on criteria such as market capitalization, liquidity, and relevance to the sector.
c) **Benchmarking**: Sectoral indices serve as benchmarks for comparing the performance of individual stocks or investment portfolios within a specific sector. Investors can use sectoral indices as a reference point to evaluate the relative strength or weakness of their investments compared to the overall performance of the sector.
d) **Risk Management**: Sectoral indices also play a role in risk management by allowing investors to diversify their portfolios across different sectors. By investing in sectoral indices representing a range of industries, investors can spread their risk and reduce exposure to any single sector-specific event or economic downturn.
e) **Market Insights**: Sectoral indices provide valuable insights into the underlying dynamics and trends within specific industries. For example, a rise in the technology sectoral index may indicate increased demand for technology products and services, while a decline in the healthcare sectoral index may signal regulatory challenges or changes in consumer behavior affecting healthcare companies.

f) **Investment Vehicles**: Investors can gain exposure to sectoral indices through various investment vehicles such as exchange-traded funds (ETFs), mutual funds, and sector-specific index funds. These investment products allow investors to invest in a diversified portfolio of stocks within a particular sector without having to buy individual stocks.

Companies in the trading environment belong to specific economic sectors, and those offering similar products or services are categorized together. This classification facilitates comprehensive evaluations of the broader economic landscape by investors.

Examples of sector indices include those for Energy, Services, Healthcare, Consumer Products, Industrial, Materials, Utilities, Technology and communications, and financial sectors. Both NSE and BSE offer their versions of sectoral indices, commonly referred to as NSE sectoral indices and BSE sectoral indices. These are your go-to indices if you're interested in investing in specific sectors.

Understanding nifty sectoral indices

Nifty sectoral indices are a part of the National Stock Exchange (NSE), one of the biggest stock exchanges in India. These indices represent various economic sectors such as automobiles, healthcare, technology, and many more.

Following the nifty sectoral indices helps you understand which sectors are currently hot and which are not. This is incredibly useful because if a specific sector is doing well, the companies in that sector are likely doing well too.

Exploring the different nifty sectoral indices

Understanding the various nifty sectoral indices is akin to exploring a buffet. Each dish (or index) offers a unique flavor, and knowing what's what can help you make a more satisfying choice for your investment appetite.

Let's delve into each one to understand what they represent and why they might be significant for you.

a) **Nifty auto** – The Nifty Auto index focuses on companies in the automobile sector. Think cars, motorcycles, trucks, and even the parts that make these vehicles. This index can have a maximum of 15 companies.

b) **Nifty bank** – In simple terms, Nifty Bank represents how well the big, liquid banks in India are doing. It might include up to 12 different banks. This index is crucial for anyone interested in the banking sector, from SBI to HDFC.

c) **Nifty consumer durables** –When we talk about Nifty Consumer Durables, we're looking at companies that produce goods like washing machines, refrigerators, and air conditioners. It's a specialized focus on how consumer electronic goods companies are doing.

d) **Nifty FMCG** – FMCG stands for Fast-Moving Consumer Goods, and the Nifty FMCG index gives you a snapshot of how companies making everyday products like toothpaste, soap, and food items are performing.

e) **Nifty IT** –In today's digital age, the IT sector is more crucial than ever. The Nifty IT index helps you keep tabs on how the IT companies are performing. Companies involved in software development, IT services, and hardware might be part of this index.

f)**Nifty media** –The Nifty Media index concentrates on companies in the media and entertainment sectors. This could include firms involved in broadcasting, publishing, and even online media.

g) **Nifty metal** –Metals and mining are fundamental to many other industries, and Nifty Metal helps you gauge how this sector is performing.

h) **Nifty oil & gas** –The Nifty Oil & Gas index provides a lens into how companies in the oil, gas, and petroleum sectors are performing. In an economy heavily dependent on these resources, this index is vital for understanding market trends related to energy.

i)**Nifty pharma** –Pharmaceuticals are critical, especially in times of health crises. The Nifty Pharma index gives you insights into how the major pharma companies are doing.

j)**Nifty PSU bank** – This index focuses on public sector banks, providing insights into how our government-run financial institutions are performing.

k) **Nifty private bank** –The Nifty Private Bank index gives you a snapshot of how private-sector banks are doing. Banks like ICICI and Axis fall under this category..

l)**Nifty realty** –The Nifty Realty index is a key indicator of how the real estate sector is performing. Keep an eye on this index if you're interested in real estate investment or even just understanding how this industry is doing.

m) **Nifty financial services** –While banking is crucial, the world of financial services is much broader. The Nifty Financial Services index looks at insurance companies, non-banking financial companies, and other firms that make the financial world tick

n) **NIFTY financial services 25/50**: This index is a variant of the Nifty Financial Services index but comes with an interesting twist. As the name suggests, the index is capped; no single stock can have a weightage of more than 25%, and all stocks with an individual weight greater than 5% cannot exceed 50% of the total index. This design ensures more balanced exposure, preventing the index from being too reliant on a few high-performing stocks.

o) **NIFTY healthcare**: The NIFTY Healthcare index is designed to capture the behavior and performance of companies in the healthcare sector. It encompasses a maximum of

20 companies and uses a base value of 1000 points, with the base date being April 1, 2005. This index covers not just pharmaceuticals but also healthcare providers, equipment manufacturers, and other sub-sectors within healthcare.

Uses of Sectoral Indices

Using sectoral indices is like reading a weather report before planning a picnic. It's all about understanding the climate of the sector you're interested in. Following are the benefits of sectoral indices

- **Keep an eye on trends:** Check whether the index is moving up or down over time. An upward trend usually indicates a healthy sector.
- **Compare and contrast:** Use the nifty sector wise indices to compare the performance of one sector with another.
- **Look for opportunities:** A declining sector might offer low-priced buying opportunities, while a growing sector may present chances for quick gains.
- **Diversify:** Don't put all your eggs in one basket. Use sectoral indices to help you spread your investments across different sectors.
- **Stay updated:** Indices are reviewed semi-annually, using data from the previous six months.

11.10 Summary

Stock Market Indices are the barometer of the stock market which mimic the stock market behavior and help to determine the upward and downwards movements in the stock market. The Stock Market Indices give a broad outline of the market movement and also represent the market. As it is not possible to track the price of each stock listed on the exchange several stock market indices like BSE-SENSEX, BS@-200, DOLLEX, NSE-50, CRISIL-500 etc. are used to estimate the trends in the stock market. SENSEX is the Index for Top 30 companies in the Bombay Stock Exchange (BSE) and NIFTY is the Index of Top 50 companies in the National Stock Exchange (NSE). A stock market Index may be a Price Index or a Wealth Index. A price index is simply the average of all share prices with a base year, while in a wealth index the prices are weighted by market capitalization and the base period values are adjusted for subsequent rights and bonus offers. While the price index reflects the general price movement of stocks in the market, the wealth index helps to estimate the real wealth created for shareholders over a period of time. Sensex is also called BSE Sensitivity Index. Base Year - 1978-79 and at that time of its inception it contained only private companies geared towards commodity production, but with time more and more private and public companies came into the market and representation was given to various industrial sectors such as services, telecom, consumer goods, FMGC, automobile etc. Only the top 30 scrips are used to compute the SENSEX. It is also known as NSE-50 Index. The base year for NIFTY Index is 1995 and the base value of index is, set at

1000. This index was built by lS (India Index Service Ltd) and CRISIL (Credit Rating information Services of India) along with strategic Alliance of SOP (Standard Poor Rating Service).

Sectoral indices play a crucial role in providing investors with insights into the performance of specific industries or sectors within the economy. By tracking sectoral indices, investors can analyze sector-specific trends, benchmark their investments, manage risk, and make informed investment decisions tailored to their investment objectives and risk tolerance. Sectoral indices are stock market indices that track the performance of specific sectors within the economy. Instead of providing a broad representation of the entire market, sectoral indices focus on a particular industry or segment, allowing investors to assess the performance of individual sectors more accurately. Sectoral indices are composed of a selection of stocks from companies operating within a particular industry or sector. For example, there may be sectoral indices for industries such as technology, healthcare, finance, energy, consumer goods, and so on. The stocks included in a sectoral index are typically chosen based on criteria such as market capitalization, liquidity, and relevance to the sector.

Glossary

a) **Index:** An index is a representative number, constructed using the value of selected number of components which can be shares, commodities, and so on.
b) **Market capitalisation**: It is the product of number of outstanding shares of the company and current share price. Free float shares: Such shares of the company which can easily come in the market for trading i.e., shares held by the investors other than directors, promoters and their relatives.
c) **BSE SENSEX**: It is flagship index of BSE comprising 30 shares listed on BSE.
d) **NIFTY**: It is flagship index of NSE comprising 50 shares listed on NSE.
e) **Sectorial indices**: Indices calculated using shares of a specific industrial sector like Auto Index, IT Index, and so on.
f) **Liquidity**: It means large orders can be executed in the share without incurring a high transaction cost or paying high price than competitive price.
g) **SCRA Act:** This act addresses the issues relating to the regulation of new issue market and secondary market.
h) **IPO Grading**: Grading of the IPO by rating agencies from the viewpoint of its sustainability and solvency.
i) **Online IPO**: SEBI has now introduced a system by which companies can issue IPOs through

Long Answer Type Questions

a) Discuss the composition criteria used for selecting stocks in the Sensex and Nifty indices.

b) Explain the process of periodic review and rebalancing of the Sensex and Nifty indices.

c) Analyze the sectoral composition of the Sensex and Nifty indices.

d) Compare and contrast the composition methodologies of the Sensex and Nifty indices.

e) Evaluate the impact of market capitalization on the composition of the Sensex and Nifty indices.

f) Discuss the role of liquidity criteria in determining the composition of the Sensex and Nifty indices.

g) Explore the significance of free float market capitalization in the calculation of sectoral indices.

h) Examine the process of sector classification and categorization used in sectoral indices.

i) Investigate the impact of sectoral weightage changes on the performance of sectoral indices.

j) Assess the role of index providers in determining the composition and methodology of sectoral indices.

Short Answer Type Questions

a) What are the key criteria used for selecting stocks in the Sensex and Nifty indices?

b) How often are the Sensex and Nifty indices reviewed and rebalanced?

c) Name two sectors with the highest weightage in the Nifty index.

d) What role does market capitalization play in determining stock weights in the Sensex and Nifty indices?

e) Explain the concept of free float market capitalization and its relevance in sectoral indices.

f) How are sectors defined and categorized in sectoral indices?

g) What is the significance of liquidity criteria in stock selection for the Sensex and Nifty indices?

h) Describe the process of periodic review and rebalancing of sectoral indices.

i) How do changes in sectoral weights impact the overall performance of sectoral indices?

j) Who determines the composition and methodology of sectoral indices?

Suggested Reading:

a) Bhalla, V.K. “Management of Financial Services”, Anmol Publications Pvt. Ltd., New Delhi.

b) Pathak, Bharati, “Indian Financial System”, Pearson