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Financial Market: A Study of Indian Capital Market

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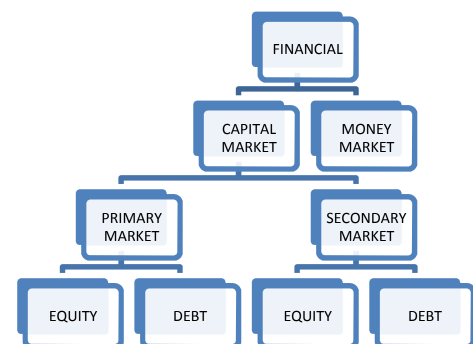
ABSTRACT

In the Globalization era, Capital market is very important sector for economy development. Capital Market is important factor of economic growth. The development of economies is intimately associated with the mobilisation and investment of financial saving. The process through which these saving are invested is capital market . Capital market can be classified as primary and secondary market. The fresh issue of securities takes place in primary market and trading among investors takes place in secondary market. Primary market is also known as new issues market. Equity investors first enter capital market though investment in primary market. In India, common investors participating in the equity primary market is massive. The number of companies offering equity through primary markets increased continuously. This Research paper described about overview of Indian capital market and trading procedure of Indian capital market through various stock exchange, and this research paper also focus on various aspects that has used in capital market.

KEYWORDS; Capital market, Investment, Financial market, Economy, Trading, Investors, Equity, Securities, Market

1. INTRODUCTION :

Capital market is a market for medium and long term funds. It includes all the organizations, institutions and instruments that provide long term and medium term funds. The common instruments used in capital market are shares, debentures, bonds, mutual funds, public deposits. It can be defined as a mechanism which channelizes saving into investment or productive use. It allocates the capital resources amongst alternative uses.



Secondary market {Stock Exchange}

The secondary market is the market for the sale and purchase of previously issued or second hand securities. In secondary market securities are not directly issued by the company to investors. The securities are sold by existing investors to other investors. Both of them can meet in secondary market and exchange securities for cash through intermediary called broker.

In secondary market companies get no additional capital as securities are bought and sold between investors only so directly there is no capital formation but secondary market indirectly contributes in

capital formation by providing liquidity to securities of the company. If there is no secondary market then investors could get back their investment only after redemption period is over or when company gets dissolved which means investments will be blocked for a long period of time but with the presence of secondary market, the investors can convert their securities into cash whenever they want and it also gives chance to investors to make profit as securities are bought and sold at market price which is generally more than the original price of the securities. This liquidity offered by secondary market encourages even those investors to invest in securities who want to invest for small period of time as there is option of selling securities at their convenience.

STOCK MARKET

A stock market or equity market is a public entity (a loose network of economic transactions, not a physical facility or discrete entity) for the trading of company stock (shares) and derivatives at an agreed price; these are securities listed on a stock exchange as well as those only traded privately.

The stocks are listed and traded on stock exchanges which are entities of a corporation or mutual organization specialized in the business of bringing buyers and sellers of the organizations to a listing of stocks and securities together. The largest stock market in the United States, by market capitalization, is the New York Stock Exchange (NYSE).

Market participants include individual retail investors, institutional investors such as mutual funds, banks, insurance companies and hedge funds, and also publicly traded corporations trading in their own shares. The purpose of a stock exchange is to facilitate the exchange of securities between buyers and sellers, thus providing a marketplace (virtual or real). The exchanges provide real-time trading information on the listed securities, facilitating price discovery.

IMPORTANCE OF STOCK MARKET

The stock market is one of the most important sources for companies to raise money. This allows businesses to be publicly traded, or raise additional financial capital for expansion by selling shares of ownership of the company in a public market. The liquidity that an exchange affords the investors gives them the ability to quickly and easily sell securities. This is an attractive feature of investing in stocks, compared to other less liquid investments.

An economy where the stock market is on the rise is considered to be an up-and-coming economy. In fact, the stock market is often considered the primary indicator of a country's economic strength and development.

Rising share prices, for instance, tend to be associated with increased business investment and vice versa. Share prices also affect the wealth of households and their consumption. Therefore, central banks tend to keep an eye on the control and behavior of the stock market and, in general, on the smooth operation of financial system functions.

Exchanges also act as the clearinghouse for each transaction, meaning that they collect and deliver the shares, and guarantee payment to the seller of a security. This eliminates the risk to an individual buyer or seller that the counterparty could default on the transaction.

The smooth functioning of all these activities facilitates economic growth in that lower costs and enterprise risks promote the production of goods and services as well as possibly employment. In this way the financial system is assumed to contribute to increased prosperity.

STOCK EXCHANGE

The Securities Contract and Regulation Act defines a stock exchange as “An organization or body of individuals,

whether incorporated or not established for the purpose of assisting, regulating and controlling of business in buying, selling and dealing in securities."

Every stock exchange has a specific location. In India there are 24 recognized stock exchanges.

Out of these stock exchanges NSEI and OTCEI are all India level stock exchanges and from business point of view Mumbai Stock Exchange is at No.1 followed by Kolkata and Delhi. The Mumbai Stock Exchange is popularly known as **Dalal Street** and Kolkata is popularly known as **Lyons Range**

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Types of operators in Stock Exchange

1. **Broker or Brokerage Firm**
   A securities firm or a registered investment advisor affiliated with a firm. Brokers are the link between investors and the stock market. When acting as a broker for the purchase or sale of listed stock, the investment advisor does not own the securities but acts as an agent for the buyer and seller and charges a commission for these services.
2. **Jobbers**
   A jobber is a member of the stock exchange. He buys and sells securities on his own behalf. He is specialized in one type of security and he makes profit by selling the securities at a higher price. In Mumbai Stock Exchange he is known as Tarawaniwala.
3. **Bulls**
   A bull is a speculator who expects rise in price. He buys securities with a view to selling them in future at a higher price and making profit out of it. In Mumbai Stock Exchange he is known as 'Tejiwala'. When prices of securities are rising as per expectations of bulls, then market is known as Bullish Market. When prices fall and bulls have to sell at a loss then it is called Bull Liquidation.
4. **Bears**
   A bear is a speculator who expects fall in the price. He sells securities which he does not possess. He is known as Mandiwala in Mumbai Stock Exchange. When prices of securities are falling as expected by bears then market is known as 'Bearish Market'. Whereas when prices rise against the expectations of bears then it is known as Bear Covering.
5. **Stag**
   A stag is also a speculator who applies for new securities in expectation that prices will rise by the time of allotment and he can sell them at premium.

2. TRADING PROCEDURE ON A STOCK EXCHANGE:

Till a few years ago trading on a stock exchange took place through a public outcry or auction system. This has been replaced by an online screen based electronic trading system as almost all exchanges have become electronic. Stock trading has, therefore, shifted from the stock market floor to the broker's office where trades are executed through a computer. Brokers are members of a stock exchange through whom trading of securities is done. Brokers may be individuals, partnership firms or corporate bodies.

They are the intermediaries between the buyers and sellers. Earlier these members owned, controlled and managed the

exchanges. The ownership and management of stock exchanges by brokers often led to a conflict of interest between the brokers and their clients. This led to 'demutualisation' of stock exchanges.

Demutualisation separates the ownership and control of stock exchanges from the trading rights of members. This reduces the conflict of interest between the exchange and the brokers and the chances of brokers using stock exchanges for personal gains.

A company's securities can be traded on a stock exchange only if they are listed or quoted on it. Companies have to fulfill a stringent set of requirements to get their securities listed on a stock exchange. This ensures that the interest of the shareholders is adequately looked after.

Transactions on a stock exchange may be carried out on either cash basis or a carryover basis. The carry over basis is also called badla and is a unique feature of Indian stock markets, particularly the BSE. A stock exchange year is divided into periods called 'accounts' which vary from a fortnight to a month. All transactions made during one account are to be settled by payment for purchases and by delivery of share certificates in the case of sales on notified days of the clearing programme of a given stock exchange.

A share certificate is proof of ownership of securities by an individual. Purchase and sale transactions in securities involved the exchange of money in return for the share certificate. This led to problems of theft, forgery, transfer delays and time involved in paperwork. To eliminate these problems an electronic book entry form of holding and transferring securities has been introduced. This is referred to as **dematerialisation of securities**.

DEMATERIALISATION ACCOUNT

In India, shares and securities are held electronically in a Dematerialized account, instead of the investor taking physical possession of certificates. A Dematerialized account is opened by the investor while registering with an investment broker (or sub-broker). The Dematerialized account number is quoted for all transactions to enable electronic settlements of trades to take place. Every shareholder will have a Dematerialized account for the purpose of transacting shares.

Access to the Dematerialized account requires an internet password and a transaction password. Transfers or purchases of securities can then be initiated. Purchases and sales of securities on the Dematerialized account are automatically made once transactions are confirmed and completed.

ADVANTAGES

A demat account also helps avoid problems typically associated with physical share certificates, for example: delivery failures caused by signature mismatch, postal delays and loss of certificate during transit. Further, it eliminates the risks associated with forgery and due to damaged stock certificates. Demat account holders also avoid stamp duty (as against 0.5 per cent payable on physical shares) and filling up of transfer deeds.

GOALS OF DEMAT SYSTEM

India adopted the Demat System for electronic storing, wherein shares and securities are represented and maintained electronically, thus eliminating the troubles associated with paper shares. After the introduction of the depository system by the Depository Act of 1996, the process for sales, purchases and transfers of shares became significantly easier and most of the risks associated with paper certificates were mitigated.

DEMAT BENEFITS

The benefits of demat are enumerated as follows:

- Easy and convenient way to hold securities
- Immediate transfer of securities
- No stamp duty on transfer of securities
- Safer than paper-shares (earlier risks associated with physical certificates such as bad delivery, fake securities, delays, thefts etc. are mostly eliminated)
- Reduced paperwork for transfer of securities
- Reduced transaction cost
- No "odd lot" problem: even one share can be sold
- Change in address recorded with a DP gets registered with all companies in which investor holds securities eliminating the need to correspond with each of them separately.
- Transmission of securities is done by DP, eliminating the need for notifying companies.
- Automatic credit into demat account for shares arising out of bonus/split, consolidation/merger, etc.
- A single demat account can hold investments in both equity and debt instruments.
- Traders can work from anywhere (e.g. even from home).

Benefit to the company

The depository system helps in reducing the cost of new issues due to lower printing and distribution costs. It increases the efficiency of the registrars and transfer agents and the secretarial department of a company. It provides better facilities for communication and timely service to shareholders and investors.

Benefit to the investor

The depository system reduces risks involved in holding physical certificates, e.g., loss, theft, mutilation, forgery, etc. It ensures transfer settlements and reduces delay in registration of shares. It ensures faster communication to investors. It helps avoid bad delivery problems due to signature differences, etc. It ensures faster payment on sale of shares. No stamp duty is paid on transfer of shares. It provides more acceptability and liquidity of securities.

Benefits to brokers

It reduces risks of delayed settlement. It ensures greater profit due to increase in volume of trading. It eliminates chances of forgery or bad delivery. It increases overall trading and profitability. It increases confidence in their investors.

DEPOSITORY PARTICIPANT

A depository (in simple terms) is an institution holding a pool of pre-verified shares held in electronic mode that offers efficient settlement of transactions. A Depository Participant (DP) is an intermediary between the investor and the depository. A DP is typically a financial organization like a bank, broker, financial institution, or custodian acting as an agent of the depository to make its services available to the investors. Each DP is assigned a unique identification number known as DP-ID. As of March 2006, there were a total of 538 DPs registered with SEBI.

DEMAT CONVERSION

Converting physical records of investments into electronic records is called "dematerialising" of securities. In order to dematerialise physical securities, investors must fill in a Demat Request Form (DRF), which is available with the DP and submit

the same along with physical certificates. Every security has an ISIN (International Securities Identification Number). A separate DRF must be filled for each ISIN.

The complete process of dematerialisation is outlined below:

- The investor surrenders the certificates for dematerialisation to the DP.

DP updates the account of the investor.

DISADVANTAGES OF DEMAT

- Trading in securities may become uncontrolled in case of dematerialized securities.
- It is incumbent upon the capital market regulator to keep a close watch on the trading in dematerialized securities and see to it that trading does not act as a detriment to investors.
- For dematerialized securities, the role of key market players such as stock-brokers needs to be supervised as they have the capability of manipulating the market.
- Multiple regulatory frameworks have to be conformed to, including the Depositories Act, Regulations and the various Bye-Laws of various depositories.
- Agreements are entered at various levels in the process of dematerialization. These may cause worries to the investor desirous of simplicity.
- There is no provision to close a demat account, which is having illiquid shares. The investor cannot close the account and he and his successors have to go on paying the charges to the participant, like annual folio charges etc.
- Most of the Indian investors are laymen and do not know the seriousness of not closing the dp account, after liquidating the holdings. Many DPs are going on charging dp charges to such dp accounts with nil holdings.
- For US persons, a demat account is subject to FBAR reporting

SECURITY RECOMMENDATIONS

A Depository Instruction (DIS) is almost like a cheque book, so it can be misused if issued blank. Hence, an investor should exercise sufficient caution while issuing a DIS slip. For example: an investor should deposit only a completely filled-in slip to the broker. Unfilled rows should be cancelled out so that they cannot be tampered with.

DERIVATIVE INSTRUMENTS

Financial innovation has brought many new financial instruments whose pay-offs or values depend on the prices of stocks. Some examples are exchange-traded funds (ETFs), stock index and stock options, equity swaps, single-stock futures, and stock index futures. These last two may be traded on futures exchanges (which are distinct from stock exchanges—their history traces back to commodities futures exchanges), or traded over-the-counter. As all of these products are only derived from stocks, they are sometimes considered to be traded in a (hypothetical) derivatives market, rather than the (hypothetical) stock market.

LEVERAGED STRATEGIES

Stock that a trader does not actually own may be traded using short selling; margin buying may be used to purchase stock with borrowed funds; or, derivatives may be used to control large blocks of stocks for a much smaller amount of money than would be required by outright purchase or sales.

Short selling

In short selling, the trader borrows stock (usually from his brokerage which holds its clients' shares or its own shares on account to lend to short sellers) then sells it on the market, betting that the price will fall. The trader eventually buys back the stock, making money if the price fell in the meantime and losing money if it rose. Exiting a short position by buying back the stock is called "covering." This strategy may also be used by unscrupulous traders in illiquid or thinly traded markets to artificially lower the price of a stock. Hence most markets either prevent short selling or place restrictions on when and how a short sale can occur. The practice of naked shorting is illegal in most (but not all) stock markets.

Margin buying

In margin buying, the trader borrows money (at interest) to buy a stock and hopes for it to rise. Most industrialized countries have regulations that require that if the borrowing is based on collateral from other stocks the trader owns outright, it can be a maximum of a certain percentage of those other stocks' value.

A margin call is made if the total value of the investor's account cannot support the loss of the trade. (Upon a decline in the value of the margined securities additional funds may be required to maintain the account's equity, and with or without notice the margined security or any others within the account may be sold by the brokerage to protect its loan position. The investor is responsible for any shortfall following such forced sales.)

INVESTMENT STRATEGIES

There are many different approaches; two basic methods are classified by either fundamental analysis or technical analysis. Fundamental analysis refers to analyzing companies by their financial statements found in SEC Filings, business trends, general economic conditions, etc. Technical analysis studies price actions in markets through the use of charts and quantitative techniques to attempt to forecast price trends regardless of the company's financial prospects.

Additionally, many choose to invest via the index method. In this method, one holds a weighted or unweighted portfolio consisting of the entire stock market or some segment of the stock market (such as the S&P 500 or Wilshire 5000). The principal aim of this strategy is to maximize diversification, minimize taxes from too frequent trading, and ride the general trend of the stock market.etoasns.

TRADING SCHEDULE

Trading on the equities segment takes place on all days of the week (except Saturdays and Sundays and holidays declared by the Exchange in advance). The market timings of the equities segment are:

- (1) Pre-open session
  - Order entry & modification Open: 09:00 hrs
  - Order entry & modification Close: 09:08 hrs*

*with random closure in last one minute. Pre-open order matching starts immediately after close of pre-open order entry.

- (2) Regular trading session
  - Normal/Retail Debt/Limited Physical Market Open: 09:15 hrs
  - Normal/Retail Debt/Limited Physical Market Close: 15:30 hrs

Block deal session is held between 09:15 hrs and 09:50 hrs.

- (3) The Closing Session is held between 15.40 hrs and 16.00 hrs.

The Exchange may however close the market on days other than the above schedule holidays or may open the market on days originally declared as holidays. The Exchange may also extend, advance or reduce trading hours when it deems fit and necessary.

Exchange Traded Funds

An (ETF) is an investment fund that is traded on a stock exchange, just like stocks. An ETF holds assets such as stocks, commodities or bonds and trades in value, around its (NAV) over the course of the trading day. Most ETFs track an index such as a stock index or a bond index. ETFs are attractive investments because of their low costs, tax efficiency and stock-like features. ETFs are the most popular type of exchange-traded products in the USA and Europe.

Exchange Traded Funds are simple and easy to understand. Most ETFs also have an intrinsically lower risk due to their diversified portfolio. This diversification coupled with low expenses allows the smallest of the investors to reap the benefits of market based returns. Retail investors can use ETF's as an easy entry vehicle into the capital markets. Equity investments are most likely to give you attractive long term growth. And, this growth is reflected in market indices.

3. TECHNOLOGY

The trading system is deployed on a highly scalable architecture where matching engines can be added based on business demand. The current deployed capacity allows the trading system to handle more than 100,000 messages per second.

The exchange has been continuously undertaking capacity enhancement measures to effectively meet the requirements of increased users and associated transaction loa

dints

ALL India level Stock Exchange

OTCEI

The OTCEI was incorporated in 1990. The trading started in this exchange n 1992. This exchange s established on the lines of NASDAQ, The OTC exchange in USA

It has been promoted by UTI, ICICI, IDBI, and IFCI. LIC, GIC, SBI capital market and bank financial services

There is no geographical location for OCTCEI. Here trading take places when buyer and seller quote prize through computer screen and purchase if prize meets their targets.

Objective of OTCEI is to address the specific needs of small business enterprises. It has been set up as a second tier exchange for smaller investors. It has nationwide reach to provide investors the convenience of electronic trading and assure liquidity of securities of small companies.

Features

1. **Compulsory market makers to provide liquidity: OTCE has introduced for the first time**

The concept of compulsory market makers, generally small companies find it difficulties to sell their securities so banks appointed by OTCEI act as compulsory market makers and buy or sell or quote for the securities of such companies and keep with them the securities of small companies for minimum period of 18 months. This provides liquidity in the market.

2. **Settlement: The payment & delivery on the OTCEI are completed within 1 week of transaction**

Advantages

1. It provides trading platform to smaller and less liquid companies which cannot be listed in regular stock exchange.
2. The cost of issuing securities in OTC is much less.
3. Small companies can easily approach public.
4. It provides transparency in dealings.
5. Dealers of OTC can deal with primary as well as secondary market.
6. Free flow of information from customers to suppliers.

4. The Securities Contracts (Regulation) Act, 1956

With a view to regulate functions of stock exchanges in country the government passed the the Securities Contracts (Regulation) Act in 1956. The act came into force in 1957.

Objectives of the Act
The main objectives of the Act are as under:

- To empower the Central government to regulate dealings and control the functioning of the stock changes in the country.
- To promote healthy and orderly development of stock exchanges in the country.
- To ensure reasonable uniformity regarding rules and bye-laws of different stock exchanges in the country.
- To prevent unhealthy speculation and other undesirable practices in the stock exchanges.
- To protect the interests of the investors.

5. Securities and Exchange Board of India {SEBI}

Securities and Exchange Board of India {SEBI} was set up in1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions. It was left as a watchdog to observe the activities but was found ineffective in regulating and controlling them. As a result in May 1992, SEBI was granted legal status. SEBI is a body corporate having a separate legal existence and perpetual succession.

Purposes and Aims of SEBI

The Securities and Exchange Board of India (SEBI) set up in 1988 was given statutory recognition in 1992 on recommendations of the Narasimham Committee. Among other things, the Board has been mandated to create an environment which would facilitate mobilization of adequate resources through the securities market and its efficient

allocation. The purposes and aims of SEBI are as follows:

- Regulating the business in stock markets and other securities markets.
- Registering and regulating the working of stock brokers and other intermediaries associated with the securities markets.
- Registering and regulating the working of collective investment schemes including mutual funds.
- Promoting and regulating the self-regulatory organizations.
- Prohibiting fraudulent and unfair trade practices relating to securities markets.
- Promoting investors' education and training of intermediaries of securities markets.
- Prohibiting insider trading in securities.
- Regulating substantial acquisition of shares and takeover of companies.
- Performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and Securities Contracts (Regulations) Act, 1956, as may be delegated to it by the Central government.

SEBI has been vested with wide-ranging powers. Firstly, to oversee constitution as well as the operations of mutual funds including presentation of accounts, following the decision to allow the entry of private sector and joint sector mutual funds. Secondly, all stock exchanges in the country have been brought under the annual inspection regime of SEBI for ensuring orderly growth of stock markets and investors' protection. Thirdly, with the repealing of the Capital Issues (Control) Act, 1947, in May 1992, SEBI has been made the regulatory authority in regard to new issues of companies. An amendment to the SEBI Act (1992) carried out March 25, 1995 has empowered SEBI to register and regulate new intermediaries in the capital market. With this empowerment, all intermediaries associated with the securities market are now regulated by SEBI. Fourthly, with effect from 1995, the SEBI has been empowered to impose penalties on different intermediaries for defaults.

The important developments can be highlighted as under: (1) the issuers complying with the eligibility criteria are allowed freedom to issue the securities at market-determined rates; (2) the secondary market has overcome the geographical barriers by moving to screen-based trading; (3) all kinds of securities — debt and equity, government and corporate—are traded on exchanges, side by side; (4) trades enjoy counter-party guarantee; (5) the trading cycle has been shortened to a day and trades are settled within 2 working days; (6) physical security certificates (and attendant risks) have almost disappeared; (7) a variety of derivatives are permitted; (8) corporate governance has improved significantly; (9) the confidence of international investors in the Indian securities market has increased considerably and now more than 500 FIIs (Foreign Institutional Investors) are registered with SEBI ; and (10) the Indian market is getting integrated with the global market, though in a limited way, through euro issues.

6 . Changes in Elements of Market Design in Indian Securities Market:

Changes In Elements of Market Design in Indian Securities Market		
Features	Prior to statutory recognition to SEBI (1992)	The present design
Regulator	No specific regulator, but Central Government oversight	A specialized regulator for securities market (SEBI) vested with powers to protect investors' interest and to develop and regulate securities market. Self Regulatory Organisations (SROs) strengthened.
Intermediaries	Some of the intermediaries (stock brokers, authorized clerks and remisiers) regulated by the SROs.	A variety of specalized intermediaries emerged. They are registered and regulated by SEBI (also by SROs)
Access to market	Granted by Central Government	Eligible issuers access the market after complying with < the issue requirements.
Pricing of securities	Determined by Central Government	Determined by market, either by the issuer through fixed price or by the investors through book building.
Access of international market	No access	Corporates allowed to issue ADRs/GDRs and raise ECBs. ADRs/GDRs have two way fungibility. FIIs allowed to trade in Indian market. MFs also allowed to invest overseas.
Corporate compliance	Very little emphasis	Emphasis on disclosures, accounting standards and corporate governance.
Mutual funds	Restricted to public sector	Open to private sector and emergence of a variety of funds and schemes.
Trading mechanism	Open outcry, Available at the trading rings of the exchanges, Opaque, Auction/negotiated deals	Screen-based trading system, orders are matched on price-time priority; transparent, trading platform accessible from all over country.
Aggregation order flow	Fragmented market through geographical distance. Order flow unobserved.	Order flow observed. The exchanges have open electronic consolidated unit order book (OECLOB).
Anonymity in trading	Absent	Complete.
Settlement system	Bilateral	Clearing House of the Exchange or the Clearing Corporation is the central counter-party.
Settlement cycle	14 day account period settlement.	Rolling settlement on T+3 basis
Counterparty risk	Present	Absent
Basis of settlement	Bilateral Netting	Mostly Electronic. Multilateral Netting.

Transfer of securities	Cumbersome. Transfer by endorsement on security and registration by issuer.	Securities are freely transferable. Transfers are recorded electronically in book entry form by depositories.
Risk management	No focus on risk management	Comprehensive risk management system encompassing capital adequacy, limits on exposure and turnover, online position monitoring, etc.
Derivatives trading	Absent	Exchange traded futures and options available on two indices and selected securities.

7. Conclusion:

The paper has presented the role of regulatory authorities for the protection of investors to encourage investors so capital formulation can be done. In this paper we have emphasized the role of SEBI as a regulatory authority. The paper has included the functions and aims of it. Securities and Exchange Board of India (SEBI) has been established with the prime mandate to protect the interest of investors in securities. It is also mandated to promote the development of, and to regulate the securities market. The main thing of this paper is that it has emphasized the steps taken by SEBI for the protection of investors. The paper has also discussed the latest changes in Indian securities market after the steps taken by the regulatory authorities. So to minimize risk of the investors and to encourage investors to increase more the regulatory authority plays an important role in Indian securities market.

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