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SEMESTER - III

SBEC - CAPITAL MARKET

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SKILL BASED ELECTIVE COURSE – I (SBEC)
CAPITAL MARKET
SYLLABUS

Objectives :

- To enlighten the students the role of capital markets in India.
- To create awareness about the stock market among the students.

UNIT – I

Introduction: Indian capital market and its functions - International Market – Financial innovations in India and International Market.

UNIT – II

Inventors Protection – The role of SEBI - Investors investment attitude.

UNIT – III

Rating agencies – Indian and Global – CRISIL, ICRA, CARE, ONICRA, FITCH, and SMERA. Moody's Investors service and standard & Poor's (S & P), FITCH ratings, Egan Jones, DBRs.

UNIT – IV

Indian capital market trade practices – BSE, NSE, SENSEX, NIFTY, fundamental and technical analysis – Demat trading and role of Depositories.

UNIT – V

Stock Price movement and Indian economy system – Inflation and GDP.

BOOKS FOR REFERENCE:

1. Capital market in India – Reforms and Regulations, Deepak Rathe.
2. Capital market and securities market – Sangeeth kedia.
3. Financial market and Services – Dr. Natarajan, Margam Publications, Chennai.
4. Securities Laws and Market operations – Dr. L. Natarajan, Margam Publications, Chennai.
5. Merchant Banking and Financial services – Dr. S. Gurusamy, Vijay Nicale Imprints Pvt Ltd. Chennai.

UNIT – I

INTRODUCTION:

A financial system may be defined as a set of institutions, instruments and markets which foster savings and channels them to their efficient use. The system consists of individuals, intermediaries, markets and users of savings. In simple, Indian financial system is to supply funds from individuals, institutions, companies and lending of funds when they demand. The Indian financial is classified in to (a) Industrial finance, (b) Agricultural finance, (c) Development finance and (d) Government finance.

CHARACTERISTICS OF FINANCIAL SERVICES [OR] FEATURES OF FINANCIAL SERVICES:

The following are the features of financial services.

i. Intangibility:

The basic characteristics of financial services are that they are intangible in nature. Financial Services to be successfully created and marketed, the institutions providing them must have a good image and confidence of its clients.

ii. Inseparability:

The functions of producing and supplying financial services are inseparable in nature. Therefore this helps in the perfect understanding between the financial services, firms and clients.

iii. Perish ability:

Financial Services have been created and delivered according to the needs of the customers. So they cannot be stored.

iv. Customer Orientation:

The institutions that provide financial services should know the needs of the customers in detail. Based on the needs, he has to come out with innovative financial strategies that give due regard to costs, liquidity and maturity.

v. Dynamic:

The financial services must be dynamic. They have to be constantly redefined and refined on the basis of socio-economic changes occurring in the economy, such as disposable income, standard of living, level of education etc..

ELEMENTS OF FINANCIAL SERVICE SECTOR:

The Financial Service Sector has three major elements.

i. Instruments:

These include the public issue of shares, debentures, convertible debentures, fixed deposit certificates etc.

ii. Market Players:

It includes the banks, financial institutions, Mutual funds, stock brokers etc. This includes not only those who are directly involved in the process but various intermediaries such as advisers and consultants, underwriters, sponsors etc

iii. Regulatory bodies and Specialized Institutions:

It includes the SEBI, stock exchanges, credit rating services, DFHI, Stock Holding Corporation of India Ltd (SHCI), OTCEI of India and venture capital companies.

FUNCTIONS:

1. Provision of Liquidity

The major function of the financial system is the provision of money and monetary assets for the production of goods and services. There should not be any shortage of money for productive ventures. In financial language, the money and monetary assets are referred to as liquidity. The term liquidity refers to cash or money and other assets which can be converted into cash readily without loss. Hence, all activities in a financial system are related to liquidity - either provision of liquidity or trading in liquidity. In fact, in India the R.B.I. has been vested with the monopoly power of issuing coins and currency notes. Commercial banks can also create cash (deposit) in the form of 'credit creation' and other financial institutions also deal in monetary assets.

Over supply of money is also dangerous to the economy. In India the R.B.I. is the leader of the financial system and hence it has to control the money supply and creation of credit by banks and regulate all the financial institutions in the country in the best interest of the nation. It has to shoulder the responsibility of developing a sound financial system by strengthening the institutional structure and by promoting savings and investment in the country.

2. Mobilization of Savings

Another important activity of the financial system is to mobilize savings and channelize them into productive activities. The financial system should offer appropriate incentives to attract savings and make them available for more productive ventures. Thus, the financial system facilitates the transformation of saving into investment and consumption. The financial intermediaries have to play the dominant role in this activity.

STRUCTURE OF THE INDIAN FINANCIAL SYSTEM

The Indian Financial System has undergone a dramatic change over the last 5 decades and especially the process was commendable during the last decade. Many new investment avenues and investments were introduced in the market to suit the varied needs of the investing public. Fig, 1. 1 presents the structure of the Indian financial system. The important constituents of Indian financial system are discussed as below.

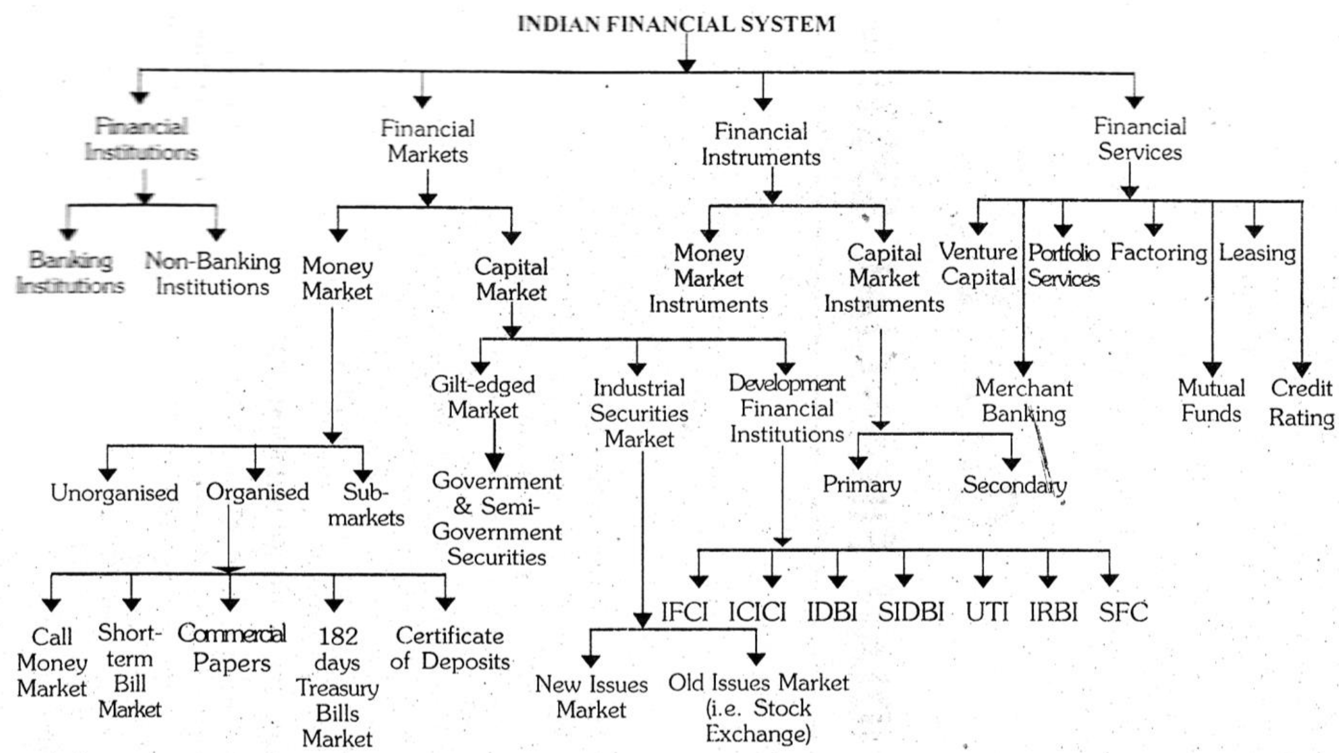


Fig. 1.1- INDIAN FINANCIAL SYSTEM

CAPITAL MARKET

INTRODUCTION:

These intermediaries mainly provide long term funds to individuals and corporate customers. They consist of term lending institutions like financial corporations and investing institutions like LIC.

MEANING:

The capital market is a market for financial assets which have a long or indefinite maturity. Generally, it deals with long term securities which have a maturity period of above one year. Capital market may be further divided into three namely:

i) Industrial securities market

ii) Government securities market and

iii) Long term loans market

IMPORTANCE OF CAPITAL MARKET

Absence of capital market acts as a deterrent factor to capital formation and economic growth. Resources would remain idle if finances are not funneled through capital market. The importance of capital market can be briefly summarized as follows:

i) The capital market serves as an important source for the productive use of the economy's savings. It mobilizes the savings of the people for further investment and thus avoids their wastage in unproductive uses.

ii) It provides incentives to saving and facilitates capital formation by offering suitable rates of interest as the price of capital.

iii) It provides an avenue for investors, particularly the household sector to invest in financial assets which are more productive than physical assets.

iv) It facilitates increase in production and productivity in the economy and thus enhances the economic welfare of the society. Thus, it facilitates "the movement of stream of command over capital to the point of highest yield" towards those who can apply them productively and profitably to enhance the national income in the aggregate.

v) The operations of different institutions in the capital market induce economic growth. They give quantitative and qualitative directions to the flow of funds and bring about rational allocation of scarce resources.

vi) A healthy capital market consisting of expert intermediaries promotes stability in values of securities representing capital funds.

vii) Moreover, it serves as an important source for technological up gradation in the industrial sector by utilizing the funds invested by the public.

Thus, a capital market serves as an important link between those who save and those who aspire to invest these savings.

FEATURES OF CAPITAL MARKET:

1. Capital market is benefited by commercial banks as they not only invest directly in various companies' shares but also undertake investments on behalf of customers.
2. Banks also promote mutual funds which in turn invest in capital market, the funds mobilized from the depositors. NRI deposits are also attracted and they also help in the promotion of activities in the capital market.
3. The new companies which are directly issuing shares to the public are helped by commercial banks either by way of underwriting or by way of issue of shares.
4. Stock invest Account: Some banks even open stock invest account which has a specific sum of amount deposited by the customers. The customer can apply to any new (company) issue of shares and he will quote the Stock Invest account in the share application form. In case of firm allotment, the company will intimate the bank and the

bank will debit the stock invest account. Thus, both primary market and secondary market are activated by commercial banks.

Capital Market consists of:

Capital market may be defined as a market for borrowing and lending long-term capital funds required by business enterprises. It refers to all the facilities and the institutional arrangements for borrowing and lending medium term and long term funds.

It consists of (1) gilt edged market; (2) Industrial securities market; (3) Development financial institutions and (4) Financial intermediaries.

1. **Gilt edged market:**

Gilt edged market is also known as government securities market, it is the market for government and semi-government securities. The return on investment is guaranteed. The value of these securities is stable in market.

2. **Industrial securities market:**

The securities which are offered to the industries are called industrial securities market. It comprises of a. primary market and b. secondary market.

a. primary market:

It is also known as new issue market where fresh shares are issued through shares and debentures. It allows for formation of capital and accelerated industrial and economic development. Through, this market fresh capital is raised.

b. secondary market:

The companies which have already issue their shares in the market; they deal their securities in secondary market. It provides a pathway for buying and selling of securities.

3. **Development financial institutions:**

The long term requirements of business concerns are provided by industrial banks and the various long term lending institutions which are created by government. The long term lending institutions are collectively referred as development banks. They are IFCI, ICICI, IDBI, SFC, SIDBI and NABARD. They provide financial assistance to both public and private sector.

4. **Financial intermediaries:**

The financial transaction which intermediate both individuals and corporate by all kinds of organization is called financial intermediaries. The financial organization (or) intermediary which is in growing stage are mutual fund, merchant banking and lease financing.

CAUSES OF FINANCIAL INNOVATION:

Financial intermediaries have to perform the task of financial innovation to meet the dynamically changing needs of economy and to help the investors cope with an increasingly volatile and uncertain market place. There is a dire necessity for the financial intermediary to go for innovation due to the following reasons.

- **Low profitability:** The profitability of the major financial intermediary, namely the bank has been very much affected in recent times. There is a decline in the profitability of traditional banking products. So, they have been compelled to seek out new products which may fetch high returns.

- **Keen Competition:** The entry of many financial intermediaries in the financial sector has led to severe competition among themselves. This keen competition has paved the way for the entry of varied nature of innovative financial products so as to meet the varied requirements of the investors.

- **Economic Liberalization:** Reform of the financial sector constitutes the most important component of India's programmes towards economic liberalization. In recent economic liberalization measures have opened the door to foreign competitors to enter into our domestic market.

- **Improved communication technology:** The communication technology has become so advanced that even the world's issuers can be linked with the investors in the global financial market without any difficulty by means of offering so many options and opportunities. Hence innovative products are brought into the domestic market in no time.

- **Customer service:** Now-a-days the customer's expectations are very great. They want newer products at lower cost or at lower credit risk to replace the existing one. To meet this increased customer sophistication, the financial intermediaries are constantly undertaking research in order to invent a new product which may suit to the requirement of the investing public. Innovation thus helps them in soliciting new business.

- **Global impact:** Many of the providers and users of capital have changed their role all over the world. Financial intermediaries have come out of their traditional approach and they are ready to assume more credit risks. As a consequence, many innovations have taken place in the global financial sector which has its own impact on the domestic sector also.

- **Investor awareness:** With the growing awareness amongst the investing public, there has been a distinct shift from investing the savings in physical assets like gold, silver, land etc. Again within the financial assets, they go from risk free bank deposits to risky investments in shares. To meet the growing awareness of the public, innovation has become the need of the hour.

FUNCTIONS OF CAPITAL MARKET:

Capital market plays an important role in mobilizing resources and diverting them in productive channels. In this way, it facilitates and promotes the process of economic growth in the country.

- ☒ Link between savers and investors: It plays an important role in mobilizing the savings and diverting them in productive investment. It transfers financial resources from surplus area to deficit and productive areas, thus increases the productivity of the country.
- ☒ Encouragement to saving:

With the development of capital market, the banking and non-banking institutions provide facilities which encourage saving. In the absence of a capital market, there are very little savings and their savings is unproductive.

- ☒ Encouragement to investment:

The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and non-bank financial institutions. Various financial assets like shares and bonds induce savers to lend to the government or invest in industry. With the development of financial institutions, capital becomes

- ☒ Promotes economic growth:

The capital market not only reflects the general condition of the economy, but also smoothens the process of economic growth. The proper allocation of resources results in the expansion of trade and industry in both public and private sectors, thus promoting balanced economic growth in the country.

- ☒ Stability in security prices:

The capital market tends to stabilize the values of stocks and securities and reduce the fluctuations in the prices to the minimum. The process of stabilization is facilitated by providing capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

- ☒ Benefits to Investors:

The credit market helps the investors i.e. those who have funds to invest in long term financial assets in many ways:

a. It brings together the buyers and sellers of securities and thus ensures the marketability of investments.

b. By advertising security prices, the stock exchange enables the investors to keep track of their investments in profitable lines.

c. it safeguards the interest of the investors by compensating them from the stock exchange compensating fund in the event of fraud and default.

TYPES OF CAPITAL MARKET:

The capital market are classified in to two viz., A. New issue market and B. Old issue market which is explained below:

A. New issue Market (or) Primary market:

Primary market deals in new financial claims or new securities. It is a market in which newly issued credit instruments are sold and purchased. Therefore, primary market is also known as ‘new issues market’. Primary market mobilizes savings and thus it supplies fresh capital to the business units. The main function of the new issues market is to make arrangements for raising new capital by corporate enterprises. These enterprises may be new or old.

B. Old issue market (or) Secondary market:

It is market where shares already existing are floating. It provides easy liquidity for shares. In secondary market shares are easily transferable. This market consists of all the recognized stock exchange in India.

METHODS OF NEW ISSUE MARKET: There are various methods of floating new issues:

1. Issue through prospectus (or) Public issue:

Issue through prospectus means the issue of a public prospectus giving details about the company, issue and the underwriters and inviting the public to subscribe to the issue.

2. Private placement (or) Offer of sale:

Private placement means placing the issue privately with a few big financiers rather than offering it to the general public. This method is faster and saves the company the cost of public placement. It first sells to issue and brokers at an agreed price and then next they will resell them at a higher price.

3. Right issue:

Right issue means issue of rights to the existing shareholders by an old corporation to subscribe to a part or the whole of the new issue in some proportion to the shares has by them.

4. Bonus issue:

Declaring bonus to the shareholders means issue of new shares to the existing shareholders in a fixed ratio to their shareholdings without charging any price for them. This method does not bring any new capital to the company.

FINANCIAL ENGINEERING:

The growing need for innovation has assumed immense importance in recent times. This process is being referred to as financial engineering. Financial engineering is the lifeblood of any financial ability. "Financial engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance".

NEW FINANCIAL PRODUCTS AND SERVICES:

Today, the importance of financial services is gaining momentum all over the world. In these days of complex finance, people expect a financial service company to play a very dynamic role not only as a provider of finance but also as a departmental store of finance. With the injection of the economic liberation policy into our economy and the opening of the economy to multinationals, the free market concept has assumed much significance.

As a result of innovations, new instruments and new products are emerging in the capital market. The capital market and the money market are getting wider and deepened. Moreover there has been a structural change in the international capital market with the emergence of new products and innovative techniques. As a result sophistication and innovations have appeared in the arena of financial intermediations. Some of them are briefly discussed.

- ☞ **Merchant Banking:** A merchant banker is a financial intermediary who helps to transfer capital from those who possess it to those who need it. Merchant banking includes a wide range of activities such as management of customer's securities, portfolio management, project counseling and appraisal, underwriting of shares and debentures, loan syndication, acting as banker for the refund orders, handling interest and dividend warrants etc.

- ☞ **Loan Syndication:** This is more or less similar to consortium financing. But this work is taken up by the merchant bankers as a lead manager. It refers to a loan arranged by a bank called lead manager for a borrower who is usually a large corporate customer or a government department. The other bank who is willing to lend can participate in the loan by contributing an amount suitable to their own lending policies. Since a single bank cannot provide such a huge sum a huge sum as loan, a number of banks join together and form a syndicate. It also enables the members of the syndicate to share the credit risk associated with a particular loan among them.
- ☞ **Leasing:** A lease is an agreement under which a company or a firm acquires a right to make use of a capital asset like machinery, on payment of a prescribed fee called rental charges. The lessee cannot acquire any ownership to the asset, but he can use it and have full control over it. He is expected to pay for all maintenance charges and repairing and operating costs. In countries like the U.S.A the U.K and Japan equipment leasing is very popular and nearly 25% of plant equipment is being financed by leasing companies. In India also, may financial companies have started equipment leasing business. Commercial banks have also been permitted to carry on this business by forming subsidiary companies.

- ☞ **Mutual Funds:** A mutual fund refers to a fund raised by a financial service company by pooling the savings of the public. It is invested in a diversified portfolio with a view to spreading and minimizing risk. The fund provides Investment Avenue for small investors who cannot participate in the equities of big companies. It ensures low risks, steady returns, high liquidity and better capital appreciation in the long run.

- ☞ **Factoring:** Factoring refers to the process of managing the sales ledger of a client by a financial service company. In other words, it is an arrangement under which a financial intermediary assumes the credit risk in the collection of book debts for its clients. The entire responsibility of collecting the book debts passes on to the factor. His services can be compared to a del-credre agent who undertakes to collect debts. But, a factor provides credit information, collets debts, monitors the sales ledger and provides finance against debts. Thus, he provides a number of services apart from financing.

- ☞ **Forfeiting:** Forfeiting is a technique by which a forfeiter (finance agency) discounts an export bill and pay ready cash to the exporter who can concentrate on the export front without bothering about collection of export bills. The forfeiter does so without any recourse to the exporter and the exporter is protected against the risk of non-payment of debts by the importers.

- ☞ **Venture capital:** A venture capital is another method of financing in the form of equity participation. A venture capitalist finances a project based on the potentialities of a new innovative project. It is in contrast to the conventional security based financing. Much thrust is given to new ideas or technological innovations. Finance is being provided not only for start-up capital but also for development capital by the financial industry.

- ☞ **Inter-Bank participation Certificates:**

The scheme of participation certificates is a scheme to even out liquidity amongst the banks and certain other financial institutions. A participation certificate is an instrument through which a banker, who has granted credit to its borrowers, can share with other institutions having surplus funds, a part or whole of the credit given by it to its borrowers. Thus the scheme facilitates inter-bank flow of funds for short periods, and reduces resource to the Reserve Bank.

Participation certifies were first introduced in 1970. the participation certificates evolved the relationship of borrower and lender between the issuing and the purchaser bank/ financial institutions. Types of participation certificates: The participation certificates are of two types viz

i. Inter-Bank Participations with Risk Sharing
ii. Inter-Bank Participations without Risk Sharing

i) Inter-Bank Participations with Risk Sharing:

The minimum period of such participations will be 91 days and the maximum period 180 days. The rate of interest will be determined by the issuing and participation banks. The issuing bank will normally repay the amount of participations together with interest to the participating bank on the date of maturity. But when the risk has materialized, the issuing bank will take necessary action in consultation with the participating bank and share the recoveries proportionally.

ii) Inter-Bank Participations without Risk Sharing:

The maximum period of such participation will be 90 days. Rate of interest thereon will be determined by the two concerned banks, but there will be a ceiling rate of 12.5%. On the date of maturity, the issuing bank will pay the amount of participations with interest to the participating banks, irrespective of the default, if any, in the advance concerned.

☞ **Global Depositary Receipts (GDRs):**

A GDR is a dollar denominated instrument traded on a stock exchange in Europe or the U.S.A. The Government of India allowed Indian companies to access international capital markets through Euro Equity Shares. The Indian companies had raised US $ 5.2 billion through launching GDR issues, and Foreign currency convertible Bonds (FCCBs). Initially, the Euro issue proceeds were to be utilized for within a period of one year from the date of issue. Since there was continued accumulation of foreign Exchange reserves with RBI and there were long gestation. Period of new investment, the Government required the issuing companies to retain the Euro issue proceeds abroad as and when expenditure for the approved end uses were incurred. The Government of India has also liberalized investment norms for NRIS so that NRIS and overseas corporate bodies can buy shares and debentures without prior permission of RBI.

Some of the innovative financial instruments introduced in recent times:

In recent times, many innovative financial instruments have come into financial market in recent times. Some of them have been briefly discussed hereunder:

☞ **Zero Interest convertible Debenture / bonds:**

These instruments carry no interest till the time of conversion. These instruments are converted into equity shares after a period of time.

☞ **Deep Discount Bonds:**

There will be no interest payments in the case of deep discount bonds. Hence, they are sold at a large discount to their nominal value.

☞ **Index-Linked Guilt Bonds:**

These are instruments having a fixed maturity. Their maturity value is linked to the index prevailing as on the date of maturity. Hence, they are inflation free instruments.

☞ **Secured premium Notes:**

These are instruments which carry no interest for three years. In other words, their interest will be paid only after 3 years and hence, companies with high capital intensive instruments can resort to this type of financing.

☞ **Variable Rate Debentures:**

Variable rate debentures are debt instruments. They carry a compound rate of interest, but this rate of interest is not a fixed one. It varies from time to time in accordance with some predetermined formula as we adopt in the case of dearness allowance calculations.

☞ **Cumulative Convertible Preference Shares:**

These instruments along with capital and accumulated dividend must be compulsorily converted into Equity shares in a period of 3 to 5 years from the date of their issue.

☞ **Convertible Bonds:**

A convertible bond is one which can be converted into equity shares at a pre-determined timing either fully or partially. There are compulsory convertible bonds which provide for conversion within 18 months of their issue.

☞ **Retirement Bond:**

This type of bond enables an investor to an assured monthly income for a fixed period after the expiry of the 'wait period' chosen by him/ no payment will be made during the 'wait period'. The longer the wait period, the higher will be the monthly income.

☞ **Regular Income bonds:**

This bond offers an attractive rate of interest payable half yearly with the facility of early redemption. The investor is assured of regular and fixed income.

☞ **Dual currency Bonds:**

Bonds that are denominated and pay interest in one currency and are redeemable in another currency come under this category. They facilitate interest rate arbitrage between two markets.

☞ **American Depository Receipt (ADR):**

American Depository Receipt (ADR) is similar to GDR, but issued in the USA. It is a security issued by a bank or a depositary issued in the USA against underlying rupee shares of a company incorporated in India.

INTERNATIONAL MARKET

International market is a competitive market. It is influenced by not only demand arid 'supply forces of goods' and services, but also various marketing environmental' factors. In 'international market consumers from different countries' buy the products they desire and marketers from different countries sell their products they produce Japan dominates in electronics and automobiles in the global market. The United States have become leader in information technology, China; Philippines and' Taiwan are potential competitors 'to textiles exporting countries: South Korean' companies have entered into Indian market and try to capture with goods market of India. South Korean companies do their business 'globally. In global shipbuilding industry, Hyundai Heavy Industries (HHI) of South Korea stands first. The HHI has secured a place in the Guinness Book of World" Records for its 'ship building activities. All countries are not Competitive in all type of products in the international market.

ADVANTAGES OF INTERNATIONAL MARKETING:

1. Reduces cost: If a company is manufacturing a good in larger quantities it automatically reduces its cost. So if companies operate in international market it gains cost competency in local and global market.

2. Can deal with seasonal fluctuations: A company manufacturing winter wears will have a market demand for a limited time if it is operating in just one market. So to deal with such kind of situations companies need to go globally to create demand for their products.

3. Increases profit: more sales equals to more profit. So it is beneficial for companies to enter international markets.

4. Earns foreign exchange: operating in other countries helps a company earn foreign exchange for the country.

5. Employment: it helps create employment home country and host country.

DISADVANTAGES OF INTERNATIONAL MARKETING:

1. Different culture: It is not necessary that the company would find same culture in both home country and host country.

2. War: if in any case a war breaks in host country then the company will be at loss.

3. Infrastructure: infrastructure in the host country may not be that developed which might create barriers for the company.

4. Government rules: rules of the government n host country might not be very supporting.

5. Marketing mix: Company might have to develop a totally different marketing mix for its product in host country than in home country which will incur cost.

WAYS TO ENTER IN INTERNATIONAL MARKET:

1. Franchising: in franchisee a company enters into an agreement with the other company to sell its good in its area and agrees to the terms and condition of the deal.
Purchasing a company: By purchasing a company in the host country a company can produce and sell goods in that country.

2. Licensing: A home country company gives the license to another company in the host country to produce and sell goods on profit sharing basis.

3. Exports: In it the company appoints some middleman in the host country and exports the goods to them and thus operates in the host country.

4. Joint venture: It is collaborating with another company in host country.

DEFINITION OF INTERNATIONAL MARKETING

- According to **Cateora** and **Graham**, "international marketing is the performance of business activities designed to plan, price, promote and direct the flow of a company's goods and services to consumers or users in more than one nation for a profit."
- According to **Terpstra** and **Sorathy**, "international marketing consists of finding and satisfying global customer needs better than the competition, both domestic and international and of coordinating marketing activities within the constraints of the global environment."

IMPORTANCE OF INTERNATIONAL MARKETING

1. Important to expand target market – Target market of a marketing organisation will be limited if it just concentrate on domestic market. When an organisation thinks globally, it looks for overseas opportunities to increase its market share and customer base.

2. Important to boost brand reputation – International marketing may give boost to a brand's reputation. Brand that sold internationally is perceived to be better than the brand that sold locally. People like to purchase products that are widely available. Hence, international marketing is important to boost brand reputation.

3. Important to connect business with the world – Expanding business into an international market gives a business an advantage to connect with new customers and new business partners. Apple - the tech giant designs its iPhone in California; outsources its manufacturing jobs to different countries like - Mongolia, China, Korea, and Taiwan; and markets them across the world. Apple have not restricted its business to a nation, rather expanded it to throughout the world. The opportunities for networking internationally are limitless. The more "places" a business is, the more connections it can make with the world.

4. Important to open door for future opportunities – International marketing can also opendoor for future business opportunities. International marketing not only increases market share and customer base, it also helps the business to connect to new vendors, a larger workforce and new technologies and ways of doing business. For example – American organisations investing in Japan have found programs like – Six Sigma and Theory Z which are helpful in shaping their business strategies.

QUESTION BANK

2 MARK QUESTIONS:

1. What is mean by capital market?
2. What is mean by primary market?
3. What is ADR?
4. What is zero interest convertible debentures?
5. What is mean by venture capital?
6. What is mean by merchant banking?
7. What is global depositary receipt?
8. What is mean by factoring?
9. What is mean by secondary market?
10. What is mean by forfeiting?

5 MARK QUESTIONS:

1. What are the characteristics of financial services?
2. Explain about the elements of financial services.
3. What are the functions of financial services?
4. What is the importance of capital market?
5. What are the features of capital market?
6. Explain about the elements of capital market.
7. Explain in detail about the types of capital market.

10 MARK QUESTIONS:

1. List out the causes for financial innovations.
2. Explain about the functions of capital market.
3. Describe about the new financial products and services.

UNIT –II

INVESTORS PROTECTION

The term ‘ investor protection ‘ refers to methods and measures adopted by a market regulator like SEBI, SEC, etc . with a view to safeguard the interest of investor. Investors, especially small investors constitute an important segment of the Indian stock market.

All the stock exchanges in India have put in place adequate measures of protection for benefits of small investors. In addition, the government regulatory authority and SEBI have initiated several steps towards strengthing the position of small investors.

LOSS OF CONFIDENCE OF SMALL INVESTORS – CAUSES

Although small investors are supposed to be protected both by the SEBI and the companies act. keeping in view the need for promoting and developing the regulation of the securities market, there has been noticed a terrible loss of confidence in them. This could be attributed to the following factors:

FAILING MUTUAL FUNDS

Many of the mutual funds in India are in doldrums. The measures of liberalization and the concerted and conscious efforts of the government and SEBI to drive the small investors towards mutual funds have meet with little success. Mutual funds have failed to come up to the expectations of the small investors , since the investors never got a consistent return on their investment . All these have resulted in the diversion of saving to other avenues such as bank deposits. A major complaints against the mutual funds is that they are not delivering the goods as advertised by them. The security and service offered by the mutual funds are far from satisfactory.

PRIVATE PLACEMENT

The private placement route chosen by the corporate sector with banks, financial institutions, and high net worth individual, has belied the hopes of innumerable small investors for an affordable capital market investment. Many corporate enterprises adopt this route because of the negligible cost involved in raising the money. To the extent the amount is raised through private placement, small investors is denied the opportunity of subscribing to the issues in the capital market.

DEMATERIALIZATION

The recent provisions of the depositories act and the regulations of the SEBI require that the securities are demated and kept with the depository. This process has contributed to enormous costs of dematerlization and safekeeping to investors. The compulsory dematerlization by the investors before selling their securities has caused considerable consternation among the small investors.

LACK OF CORPORATE INTEREST

The amount of regulations regarding listing etc clamped on the issuers by the SEBI has created hurdles in the way of entrepreneurs tapping the capital market .some of the demanding regulations include more and more disclosure requirements insisted upon by SEBI, the tightening of the clauses of the listing agreements, code of corporate governance, etc. moreover financial institutions and banks do not insist on the company t o be listed one in order to extend long term finances.

DELISTING BY MNCS

Small investors are crippled of their ability and deprived of an opportunity to make investment of funds in the highly profit making MNCS. This is because many of the foreign companies operating in india are either incorporated as wholly owned subsidiaries or indulge in buy back of the shares from the public .market. further, this has created a roadblock in the development of the capital market and works against the interest of small investors.

BOOK BULIDING

The recently introduced book building process is considered to be highly pernicious for small investors. The mechanism allows for setting the issue price at unreasonably high levels. This has greatly affected the interest of common investors. Such a price discovery practice often goes unrealistic as the market price immediately after the issue nosedives much below the issue price. Hence, the public is not enamored at all by the fanciful price fixed by this process.

TAKEOVER AND BUY-BACK

The buy back mechanism introduced by the companies Act 1999, paved way for promoters acquiring the shares easily and cheaply. This has in turn reduced the quantum of floating stock in many well – managed companies in the stock market. The capital market developments are much in tune with the interest of the promoters than in tune with protecting the investors interest.

RIGHTS OF INVESTORS

1. To receive all benefit - material information declared for the investors by the company.

2. To obtain prompt services from the company such as transfers, subdivision and consolidations of holding company.

3. To subscribe to further issue of capital by the company in the case of existing equity shareholders.

4. To pay a maximum brokerage of 2.5 percent of contract price.\

5. To receive the contract note from the broker in the specified format showing transaction price and brokerage separately.

6. To obtain delivery of shares purchased/ value of shares sold within 2 days after the payout day.

SAFEGAURD FOR INVESTORS

SELECTING THE BROKER OR SUB BROKER

Investor should deals with only SEBI registered broker sub broker after due diligence. Details of list of brokers can be procured from the members list published by the exchange and also from the website of the exchange.

FORMAL AGREEMENT

An investor is expected to enter into formal agreement with the broker before transacting business. For this purpose, he is advised scrupulously adhere to the following procedures:

a) REGISTRATION

Fill in a client registration form with broker / sub broker.

b) AGREEMENT

Enter into broker or sub broker client agreement. This agreement is compulsory for investors for registering as a client of BSE trading member. Before entering the agreement, the client is expected to carefully read and understand the terms and conditions of the agreement.

TRANSACTING BUSINESS

The following are to be borne in mind by the investors before transacting business.

a. Specifying exchange :

Specify to the broker sub broker , exchange through which your trade is to be executed and maintain separate account per exchange.

b. Contract note:

Obtain a valid contract note within 24 hrs of the execution of the trade.

The investors should ensure that the contract note contains such details as SEBI registration number of the member or sub broker. Further , such details of trade as order number, trade number, time quantity, price, brokerage, settlement number and details of other levies must also be mentioned.

BROKERAGE

As stipulated by SEBI, the maximum brokerage that can be charged is 2.5 percent of trade value. This maximum brokerage is inclusive of the brokerage charged by the sub broker(1.5 percent of trade value)

ENSURING SETTLEMENT

a. Delivery:

delivery of securities/ payment of money to the broker is to be ensured immediately upon getting the contract note for sale /purchase but in case, before the prescribed pay in day. The member should pay the money or deliver the securities to the investors within 48 hrs of the payout.

b. demat account:

Open demat account. Preferably opt for buying and selling demanded securities.

c. Depository participant:

For deliver of shares from Demat a/c, give the depository participant (DP) d details such as pool delivery out instructions to transfer the same from the beneficiary account to the pool account of broker whom shares and securities have been sold. The details such as the pool, accounts of broker to which shares are to be transferred , details of scrip, quantity etc. as per the requirement of depositories the delivery out instructions should be given atleast 48 hrs prior to the cut off time for prescribed securities pay .in.

DELIVERY

If physical delivers are received, check the deliveries received as per good/ bad delivery guidelines issued by SEBI. Bad delivery cases should be sorted out through exchange machinery immediately. All registration of shares for ownership of physical shares should be executed by a valid duly completed and stamped transfer deed.

GENERAL DO'S AND DON'T FOR INVESTOR

1. Not to deal with unregistered intermediaries which might expose to counter party risk.

2. To giver clear and unambiguous instructions to brokers / sub brokers.

3. To keep a record of all instructions issued to the broker/ sub broker.

4. To confirm with broker/ sub broker whether delivery is in physical or demat form before selling shares.

5. Not to fall prey to promises of unrealistic high returns.

6. Not to indulge in speculative trading but to go by the fundamentals only.

7. To trade within the predetermined limits.

8. To use the investors grievance redressal system of the exchanges to redress grievance, if any

9. To understand the working of the investors service call for complaints against listed companies/ brokers, and

10. To preferably trade personally through internet based trading by registering with a broker.

SOLVING INVESTORS GRIVENCES – PROCESS

BSE has established a full fledged investors services cell (ISC) to redress investors grievances. Since its establishment I 1986, the cell has played a pivotal role in enhancing and maintaing investors faith and confidence by resolving their either against listed companies or against members of the exchange. The services offered by the ISC are as under:

1. **Grievances against listed companies**

ISC forwards the complaints to the respective company and directs them to solve the matter within 15 days. Inspite of the above efforts , if the company fails to resolve the complaints and the total number of pending complaints against the company exceeds 25 and are pending more than 45 days, after issue of show cause notice for 7 days, the script of the company is suspended from trading till grievances are resolved. ISC also transfers such scripts to z category for non resolution on investors complaints.

Measures:

ISC takes many other pro active measures to resolve the investors grievances such as the following;

1. Calling the company representatives to exchange to interact with investors to resolve the complaints.

2. Calling major registrar and transfer agent to the exchange to interact and resolve the grievances of the investors and members of the exchange.

3. issuing monthly press release listing top 25 companies against whom maximum complaints are pending for resolution .the same is also released on the website of the exchange.

4. Pursuing Mumbai based companies to depute their representative to the exchange to take the pending list of complaints and resolve the same immediately.

2. **Grievances against members**

Nature of complaints:

The nature of complaints received by the exchange can be classified into the following categories:

a. Non receipt of delivery of shares / non – removal of objection/ Non receipt of sale proceed of shares / Non receipts of dividend/ Non receipt of right, bonus shares.

b. Disputes regarding rate difference.

c. Dispute relating to non settlement of accounts.

d. Miscellaneous items.

Procedures

The complaints are forwarded to the concerned members to reply/ settle the complaints within 7 days from the receipts of the letter. If no reply is received or reply received is not satifatory , the matter is placed before the IGRC (investors grievance redessal committee) headed by a retired high court judge. IGRC is constituted by the governing board to resolve complaints of non members against members through the process of reconciliation. The parties are heard and the matters is tired to be solved amicably or it is referred for arbitration under the rules, bye laws and regulation of the exchange.

SEBI (SECURITIES EXCHANGE BOARD OF INDIA)

INTRODUCTION

The Securities Exchange Board of India was set up by the government of India in april 1988. Initially it had no statutory power and its functions were: i) to collect information and advise the government on matters relating to stock and capital market, ii) to issue license to merchant banks and mutual banks, iii) to prepare legal drafts for the development role of SEBI, in 1992 it attained a legal status under SEBI Act passed by the parliament.

ORIGIN

The government of India set up the Securities Exchange Board of India (SEBI) on 12 th april 1988, but for more than three years, it had no statutory powers. During this period its functions were to:

1. Collect information and advice the government on matters relating to capital market.

2. See to the licensing and regulating of merchant banks, mutual funds;

3. Prepare the legal drafts for regulatory and developmental roles; and

4. Perform any other functions as may be entrusted to it by the government .

OBJECTIVES

The main objectives of the SEBI are as follows:

1. To protect the interest of interest of investors, ensuring a steady flow of savings into the capital market.

2. To ensure fair practices by the companies issuing securities so that they can mobilize resources at lesser cost.

3. To promote the services of brokers, merchant bankers and other intermediaries so that they become professionals.

4. To promote the development of the securities market and to regulate the same.

FUNCTIONS OF SEBI

SEBI has been entrusted with both regulatory and developmental functions . sec 11 of the SEBI Act lays down the various functions of SEBI:

Regulatory functions:

i) Regulating the business in stock exchanges and other securities market.

ii) Registering and regulating stock brokers, sub brokers, share transfer agents, bankers to the issue, trustees of trust deed, registers to the issue, underwriters, portfolio managers, investment advisers and other middlemen connected with securities market.

iii)) Registering and regulating the working of collective investment schemes including mutual funds.

iv) Prohibiting fraudulent and unfit trade practices relating to securities market.

v) Prohibiting insider trading in securities.

vi) Regulating substantial acquisition of shares and take over of companies.

DEVELOPMENTAL FUNCTIONS

i) Promoting investors education and trading of intermediaries in securities market.

ii) Conducting research and publishing information which will be useful to the participants in securities market.

iii) Promoting fair practices and code of conduct for self regulatory organisation in securities market.

POWERS OF SEBI

The SEBI Act that conferred various powers to SEBI was passed on 4th April 1992 . the following powers are vested in SEBI.

i) Power to call periodical returns from recognized stock exchange.

ii)Power to call information and explanations from recognized stock exchanges or their members.

iii) Power to conduct enquires on matters relating to stock exchanges or their members.

iv) power to approve bye laws framed by the recognized stock exchanges.

v) Power to make listing of securities compulsory for public companies.

vi) power to inspect, control and regulate stock exchanges.

vii) Power to grant registration to intermediaries working in securities market.

viii) Power to levy charges for securing the purpose of regulation.

SEBI GUIDELINES

SEBI issued separate guidelines for new issue market (primary market) stock market (secondary market), foreign institutional investors , bonus issue, right issue, debenture, underwriters, investors protection, book building, buy back of shares. These guidelines are explained below:

1. Guidelines for primary market (new issue market)

SEBI has introduced several measures to protect the interest of investors and to encourage small investors to participate in the primary market. In particular, it has tightened entry and disclosure norms to prevent exploitation of investors by unscrupulous promoters.

SEBI guidelines with regards to primary market are given below:

i) New company

a) A new company is one which has not completed 12 months commercial production and whose books have not been audited.

b) The issues of a new company should be at par. Free pricing is permitted only if the new company is promoted by the existing company with not less than 50 % of equity.

ii) Private limited companies and closely limited companies

private limited and closely held companies will be allowed to price their freely if such companies have had a track record of consistent profitability for last three years.

iii) Existing listed companies

The existing listed companies are allowed to price their public issues freely. If such free pricing is disclosed in their prospectus. Moreover, the promoters should contribute 50 % on first 100 crores of issue, 40% on next Rs 200 crores, 30 % of next Rs300 crores and Rs 15% on the balance issue amount.

iv) Composite issues

Composite issues means the right cum public issue by existing listed companies. In case of composite issue, the pricing of issue to the public may be different from that of issue of right shares to the existing shareholders. The difference in the issue price of public issue and right issue should be justified by the issuing company in its documents.

v) Lock – in – period

Lock –in – period means the minimum period of holding securities .only after the expiry of the lock in period, the securities concerned are encashable. The lock – in –period for promoters quota is 5 years and the lock-in- period for preferential allotment for associates and friends is 3 years.

vi) Public issue

With regards to public issue by the companies, SEBI has issued the following guidelines.

a) Every application for shares should be accompanied by unabridged prospectus.

b) The issue factors associated with the investment in the company should be highlighted by it in its prospectus.

c)The prospectus should specify the objectives of the issues as well as the cost of the project.

d) The prospectus should also highlight the brief history of the company and its present state of business.

e) particulars of the issuing company and other listed companies under the same management which issued capital during the last three years should be specified in the prospectus.

f) When securities are priced at premium, jurisdiction for the same should be stated.

g) Subscription list for public issue should be kept open for a minimum of three days and a maximum of 10 days.

h) The number of collection not be allowed to collect application money in cash.

i) The amount of collection centers with regards to issue should at least be 30.

j) The amount of issue should not exceed the limit as stated in the prospectus. Money received by way of over subscription cannot be retained for any reason.

k) Within 45 days from the closure of issue, a compliance report should be submitted to SEBI.

l) if minimum subscription (90% of the issue) has not been received, the entire amount should be refunded to the applicant within 120 days.

m) The capital issue should be paid fully within 120 days.

n) Underwriting is made mandatory.

o) The interval between two issues should not exceed 30 days.

p) In order to enable, the investors to determine risk, return, safety and liquidity of investment, adequate information relating to redemption, security conversion etc., should be furnished to them.

2. Secondary market

SEBI has introduced a wide range of reforms in the secondary market. These can be discussed under the heading, namely, governing body of the stock exchange. Infrastructure development of the stock exchange, settlement and clearing, Debt market segment, price stabilization, delisting, brokers, and insider trading.

i) Governing body of the stock exchange

a) The board of directors of stock exchange has to be reconstituted so as to include non members, public representatives , government representatives to the extent of 50% of total number of members.

b) Capital adequacy norms should be complied with regards to members of various exchanges on the basis of their turnover of trade.

c) Working hours of stock exchanges should be from 12 noon to 3 pm.

d) All recognized stock exchanges should report about their transactions within 24 hours.

ii) Infrastructure development of stock exchanges

Sufficient infrastructure should be available in stock exchange to facilitate trade. For ex National stock exchange (NSE) was set up with sophisticated screen based trading. SEBI will grant recognition only to those new stock exchanges which have on line screen trading facility.

iii) Settlement and clearing

SEBI has withdrawn carry forward transactions and introduced certain modified regulations. All stock exchanges should follow the practice of weekly settlement. Apart from this, SEBI has instructed all stock exchanges to set up clearing houses, clearing corporations or settlement guarantee fund for ensuring prompt settlement of the transactions. SEBI has allowed institutional investors, foregign investment, stock brokers to avail the facility of warehousing of trade.

iv) Debt market segment

NSE has a wholesale debt market segment to enable the traders to trade in debt instrument. SEBI has allowed the listing of debt instruments of those companies which have not even listed their equity shares previously. Foreign institutional investors have been permitted to invest up to 100 percent of the funds in debt instrument of Indian companies.

v) Price stabilization

SEBI keeps a constant watch over the unusual fluctuation in prices. It has instructed the stock exchanges to monitor the prices of newly listed securities. When there is an abnormal price variation in newly listed securities. SEBI would impose additional margin on purchase of such securities. SEBI has also introduced adequate measures to prevent price rigging and circular trading.

vi) Delisting

SEBI has streamlined the norms for delisting of securities from stock exchanges. In case of voluntary delisting from stock exchanges, the company would offer to buy the shares from shareholders of the region. Moreover, it also stipulates that the listing fee for three years be paid by the company concerned at the time of delisting.

vii) Brokers

SEBI has regulated the functioning of brokers through the following measures;

a) Each broker and sub broker should get their names registered with the stock exchange.

b) Capital adequacy norms have fixed for the brokers in order to ensure their professional competence, financial solvency, etc.

c) A code of conduct has been laid down for their discharge of duties, resulting in the i) execution of orders, ii) issue of contract note, iii) breach of trust, iv) being fair to client; and v) rendering investment advice.

d) Audit of the books of brokers and filing of audit report with SEBI have been made compulsory.

e) Brokers should preserve the books of accounts and other records for a minimum period of five years. SEBI has the right to inspect the books, records and documents of the brokers.

f) Brokers should disclose transaction price and brokerage separately in the contract notes issued to their clients to ensure transparency in the broker- client relationship.

g) Broker cannot underwrite more than 5% of public issue

viii) Insider trading

Insider trading means employing unfair trade methods in the stock market. It pertains to misusing one's access to price sensitive information ahead of others. To prevent insider trading, SEBI insider trading Regulation Act , 1992. The Act defines the insider and price sensitive information .

3. Foreign institutional investors

i) Foreign institutional investors are permitted to invest in securities traded in primary and secondary markets.

ii) Foreign institutional investors can invest any amount in securities. There is no restriction on the volume of investment by them.

iii) A single Foreign institutional investors can hold upto 5% equity shares capital of the company.

iv) Disinvestment can be done only through stock exchange.

v) Foreign institutional investors are liable to pay tax at 10 % on long term capital gain. They are also liable to pay tax 205 on dividend and interest.

4. Issue of bonus shares

SEBI announced the following guidelines for the issue of bonus share.

i) The article of the Association of the company should contain provision for the issue of bonus shares. In the absence of such provisions in the article, the company should pass a resolution to that effect at the general body meeting.

ii) Bonus issue is capitalization of profit. Bonus shares should be issued from free reserves created out of genuine profits or share premiums collected.

iii) Any reserve created through revaluation of fixed assets cannot be capitalized.

iv) Bonus shares cannot be issued in lieu of dividend.

v) At the time of issuing bonus shares, there should not be partly paid up shares.

vi) There should not be any default on the part of the company in payment of statutory dues to employees such as provident fund, gratuity, bonus, etc. similarly , there should not be default in payment of interest on fixed deposit or interest or principal amount thereof.

vii) There should be a gap of at least 12 months between the public or right issue of bonus shares.

viii) the proposal of bonus issue must be implemented within six months from the date of such approval by the board of directors.

ix) If the issue of bonus shares result in capital excess of subscribed and issued capital over the authorized capital, a resolution will be passed at the general body meeting for increasing the authorized.

x) no bonus issue will be made if it dilutes the rights of debenture holders whose debenture are convertible fully or partly .

5. Right issue

i) Composite issue :

The following guidelines have been issued by the SEBI in respect of rights issue

When the existing listed companies go in for public issue and right issue, it is called composite issue.

But these issue can be made at different prices whereby the company can charge lower premium on right issue than on public issue in consultation with the lead manager to the issue.

ii) Appointment of merchant broker

If the value of right issue does not exceed Rs 50 lakhs, the company(listed company) concerned need not appoint merchant broker. If the value exceed Rs 50 lakhs, the appointment of merchant broker is essential. The merchant broker so appointed will manage the issue.

iii) Minimum subscription

The Minimum subscription in respect of issue is fixed at 90% of the issue amount. If the company fails to receive Minimum subscription, the amount received should be refunded within 128 days.

iv) Preferential allotment

Preferential allotment can be made to promoters, companies, shareholders to those companies, NRIs employees and associate companies of the same group. Such Preferential allotment should be made independent of right issue.

v) Underwriting

Generally, underwriting of right issue is not mandatory. However under SEBI Rules and Regulations, 1993 a right issue can be underwritten.

vi) Right of convertible debenture holders

Right issue should not dilute the rights of fully or partly convertible debenture holders. If the conversion of convertible debenture become due within 12 months from the date of right issue, necessary reservation should be made in favour of convertible debenture holders.

vii) No retention of over subscription

A company cannot retain the amount received by way of over subscription. Further, the amount of right issue cannot exceed the limit as specified in the letter of offer.

viii) Letter of offer

After preparing the letter of offer for right issue, the lead manager should obtain SEBI clearance for the same. Then , the stock exchange should be approached for fixing the date for the right issue .the letter of offer should be prepared in compliance with the provisions of companies act. The basis for fixing the issue price should be justified in the letter of offer.

ix) Newspaper advertisement

Listed companies which make right issue should advertise so in at least two leading newspapers. The advertisement should carry details as to dispatch of letters of offer, opening date, closing date, for issue etc. the advertisement should be issued at least one week before the opening date of subscription list.

x) Submission of compliance report

The lead manger , should within 45 days from the closure of right issue submit a compliance report along with the compliance certificate issued by a qualified auditor to the SEBI.

xi) Debenture

a) The debt- equity ratio should not exceed 2:1 which means the amount of debenture can be two times the debt equity capital.

b) The rate of interest payable on debenture can be decided by the company.

c) Debenture Should be redeemed on the expiry of 7 yrs from the ate of allotment. Debenture above 7 yrs cannot normally be issued. Non convertible debenture may be redeemed at 5% premium.

d) Debenture issued to public should be secured and registered.

e) A debenture redemption fund should be created for non convertible debenture.

f) SEBI insist on prior licensing for debenture trustees. Trust deed should be ready within 6 months from the date of allotment.

Underwriters

i) Only those holding a certificate of registration issued by SEBI can act as Underwriters.

ii) The certificate of registration is valid for three years from the date of issue.

iii) The underwriting obligation accepted by the underwriters should not exceed 20 times of its net worth.

iv) In the event of inadequate subscription from the public, the company shall inform the underwriters about his liability towards subscription. Within 30 days of receipt of such intimation, the underwriter should subscribe to such securities.

v) The underwriter should , within 6 months from the end of financial year, submit the document as required by SEBI.

vi) The underwriter should preserve his books of accounts and records for a minimum period of five years.

6. Investors protection

Investors protection is a wide term which stands for various measures introduced to protect the investors from the mal practices of companies, brokers, merchant bankers, issue mangers, registrars of new issue, etc. As all investment have some inherent risks, an investor should be cautious while investing his money in securities. Apart from his personal risk , investors have to be safeguard against the malpractices of companies, brokers, etc. generally the stock exchange look into the complaints of investors when they pertain to – i) compliant against members of stock exchanges; and ii) complaints against companies listed for trading on stock trading cannot entertain the complain against sub broker, agent, merchant bankers, issue mangers, etc.

INVESTORS INVESTMENT ATTITUDE

Investment and savings attitude and behavior are influenced by the structure complexity , transparency and perceived past and future performance of different kinds of investment options, the general lack of dependent financial advice the reasons superior performance of property investment, perceptions and personal tolerance of risk : the often low level of financial literacy about product other than property ; the nature of the information people use when making financial decision ; the personal or family experience people have with investment ; a general wish to have personal control over the investment and trust in the advice of friends and family over unknown professional advisors.

Consumer decisions on savings are likely to be influenced by new or proposed changes in the investment environment the applications of lower taxes to earnings in managed funds and forthcoming regularly changes aimed at improving disclosure and prudential arrangements applying to financial product, providers and advisers are also likely to have an impact .

UNIT- III

RATING AGENCIES- INDIAN AND GLOBAL CRISIL, ICRA, CARE, ONICRA, FITCH & SMERA. MOODY'S INVESTORS SERVICE AND STANDARD & POOR'S (S&P), FITCH RATINGS, EGAN JONES, DBRS.

ORIGIN AND HISTORY OF CREDIT RATING AGENCIES:

- The origin of credit rating can be traced in the 1840's.
- The first mercantile credit agency was set up in New York by Louis Tappan in 1841.
- The agency rated the ability of merchants to pay their debts and financial obligations.
- The first rating guide was published in 1859.
- The second credit agency was set up in 1849 by John Bradstreet.
- The two credit agencies were merged and for a new agency called Dun & Bradstreet in 1993.
- Dun & Bradstreet agency acquired the Moody's Investors Service in 1962.

Moody's Investors Service:

- It is noted that Moody's Investors Service has a long history in the rating business.
- The spanning period of this agency is more than 100 years.
- In 1990, John Moody founded Moody's Investors Service.
- He published his manual called "Manual of Railroad Securities" in the year 1909.
- This agency rating various types of bonds such as utility, individual bonds and other municipality bonds.

Growth of Credit Rating Agencies- World Wide:

Year of establishment	Credit Rating Agency
1841	Mercantile Credit Agency
1900	Moody's Investors Service
1916	Poor Publishing Company
1922	Standard Statistics Company
1924	Fitch Publishing Company
1933	Dun & Bradstreet
1941	Standard & Poor

1966	McGraw Hill
1972	Canadian Bond Rating Service
1974	Thomson Bankwatch
1975	McCarthy Crisanti & Maffer
1975	Japanese Bond Rating Service
1977	Dominican Bond Rating Service
1978	IBCA
1980	Duff & Phelps Bond Rating Company
1987	CRISIL
1991	ICRA
1994	CARE
1996	Duff & Phelps Bond Rating India (P) Ltd

MEANING OF CREDIT RATING:

- Process of assigning a symbol with reference to the instrument being rated. Instrument may be bond, shares, securities etc.,
- A credit rating is an assessment of the credit worthiness of a borrower in terms of financial obligations.
- Ratings are usually expressed with alphabetical or alphanumeric symbols. They are simple and easy to understand.

DEFINITION OF CREDIT RATING:

According to the Moody's "A rating is an opinion on the future ability and legal obligation of the issuer (company) to make timely payments of principal and interest on a specific fixed income security. The rating measures the probability that the issuer will default on the security over its life"

According to standard & Poor's "Credit ratings help investors by providing an easily recognizable, simple tool that couples a possibly unknown issuer with an informative and meaningful symbol of credit quality"

MEANING OF CREDIT RATING AGENCY:

- A credit rating age is a company that assigns credit ratings, which rate a debtor's ability to pay back the debt.
- A credit rating facilitates the trading of securities on a secondary market. (Eg: ICRA, CRISIL etc.)

CREDIT RATING PROCESS / STEPS:

- Contract between Rater and Client
- Sending Expert Team to client's Place
- Data collection

- Data analysis
- Discussion
- Credit Report Preparation
- Submission to Grading Committee
- Grade communication to client

FEATURES / CHARACTERISTICS OF CREDIT RATING:

The following are the features of credit rating:

1) Rating is specific to instrument:

The rating is specific to a debt instrument. It is an analysis of the credit risk involved in the particular debt instrument.

2) Rating provides a Relative Grade:

The rating is based on the capability of the issuer debt instrument. This is done in accordance with the terms of the contract.

3) Rating Provides Guidance to Investors:

The main aim of the rating is to give guidance to investors and creditors in determining a credit risk associated with a debt instrument.

4) Rating is not a Recommendation:

The rating does not provide any sort of recommendation to buy, hold or sell an instrument. Rating does not take into consideration such as market prices, personal risk and other considerations.

5) Rating is based on Broad Parameters:

The rating process is based on certain broad parameters. It includes financial and non financial parameters. Rating is based on information supplied by the issuer and also collected from various other sources.

6) Rating does not give Guarantee for Accuracy Information:

The rating furnished by the agency does not provide any guarantee for the accuracy of the information on which the rating is based.

7) Rating provides both Qualitative and Quantitative factors:

While determining the grade, both quantitative as well as qualitative factors are employed. The decision is qualitative in nature.

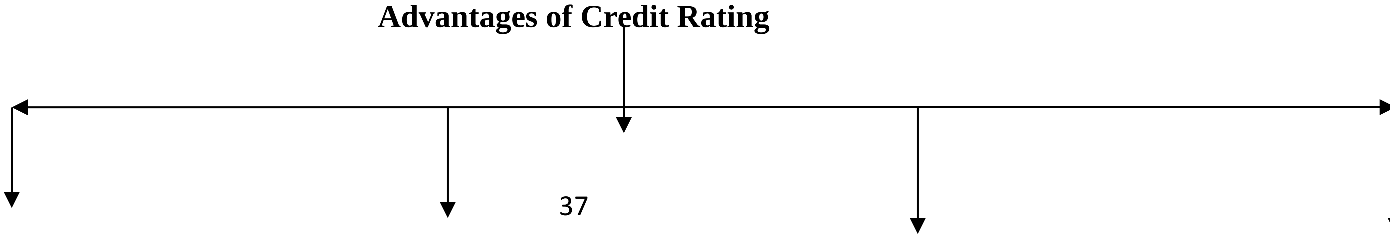
8) Estimate the Worthiness:

Rating is used to estimate the worthiness of the credit for the company. It Estimate the worthiness of the country or any individual company.

ADVANTAGES / BENEFITS OF CREDIT RATING:

The advantages of credit rating are classified into four main categories. The following are the advantages of the credit rating:

Advantages of Credit Rating



To issuer (company) | To Regulator | To Intermediaries | To investors

Advantages of credit rating to issuer:

a) Lower cost of borrowing:

A company with highly rated instrument has the opportunity to reduce the cost of borrowing from the public by quoting lesser interest. If the Fixed deposits or debentures or bonds are highly rated the investors come forward to invest in this type of safe securities.

b) Wider audience for borrowing:

A company with a highly rated instrument can approach the investors extensively for the resource mobilization using the press media. Investors in different strata of the society could be attracted by higher rated instrument as the investors understands the degree of certainty about timely payment of interest and principal on a debt instrument with better rating.

c) Rating as marketing tool:

Companies with rated instrument improve their own image and avail of the rating as a marketing tool to create better image in dealing with its customers feel confident in the utility products manufactured by the companies carrying higher rating for their credit instruments.

d) Reduction of cost in public issues:

A company with higher rated instrument is able to attract the investors and with least efforts can raise funds. Thus, the rated company can economize and minimize cost of public issues by controlling expenses on media coverage, conferences and other publicity stunts and gimmicks. Rating facilitates best pricing and timing of issues.

e) Motivation for growth:

Rating provides motivation to the company for growth as the promotors feel confident in their own efforts and are encouraged to undertake expansion of their operations or new projects. With better image created though higher credit rating the company can mobilize funds from public and financial institutions or banks from self assessment of its own status which is subject to self-discipline and self-improvement, it can perceive and avoid sickness.

f) Unknown issuer:

Credit rating provides recognition to a relatively unknown issuer while entering into the market through wider investor base who rely on rating grade rather than on 'name recognition'.

Advantages of credit rating to Intermediaries:

The following are the benefits to intermediaries:

a) Less Effort:

Highly rated instrument put the brokers to make less effort in studying the company's credit position to convince their clients to select an investment proposal.

b) Save cost:

Highly rated instrument enables brokers and other financial intermediaries to save time, energy, costs and manpower in convincing their clients about investment in any particular company.

c) Efficient practice:

Rating serves an effective tool for merchant bankers and other capital market intermediaries in the process of planning, pricing, underwriting and issues.

d) Effective monitoring:

Stock exchange intermediaries like brokers and dealers could use rating as an input for monitoring their risk exposures.

Advantages of credit rating to Regulators:

The following are the benefits of credit rating to the regulators:

a) Issue rating requirements:

Credit rating has facilitated the regulatory authorities to issue mandatory rating requirements. Eg: specific rules regarding the restriction of the entry of new issues that are rated a below a particular grade.

b) Stipulate margin:

Credit rating can stipulate different margin requirements for the mortage of rated and unrated instruments. Hence, it prohibit institutional investors from purchasing or holding instruments that are rated a below a particular level.

Advantages of credit rating to the Investors:

Credit rating offers the following advantages to the investors:

a) Information service:

Credit rating provides the information about the debt instruments to the investors. Credit rating allows recognizing the risk involved in the debt instruments. It is useful to investors to invest in risk free or less risk instruments.

b) Systematic risk evaluation:

Credit rating provides a systematic risk evaluation. Rating helps the corporate issuer of a debt instrument to offer a detailed risk evaluation. It helps the investors to arrive at a meaningful and consistent conclusion regarding quality of the instrument.

c) Professional service:

A credit rating agency provides a professional service related to different debt instruments according to their credit quality.

d) Easy to understand grade:

Credit ratings are symbolic and are therefore easy to understand. The rating establishes a link between risk and return. Investors are using the rating to assess the risk level of the instrument.

e) Low cost service:

Credit ratings are provided by a professional credit rating agency not just for the individual. Credit rating is also for organized institutional investors. So it involves low cost.

f) Efficient portfolio management:

Large investors may use the credit rating for portfolio diversification by selecting appropriate instruments from various investment options. Investors can use the information provided by rating agencies, by carefully watching ups and downs, and altering their portfolio mix.

g) Other benefits:

The investors also get benefits from other services offered by credit rating agencies, namely research in the form of industry reports, corporate reports, seminars and open access to the analysis of the agencies.

DEMERITS OF CREDIT RATING:

a) Guidance, not recommendation:

The rating process attempts to provide a mere guidance to investors/ creditors in determining the level of default risk associated with the instrument/ credit obligation. It does not attempt to provide a recommendation, nor does it take in to account such factors as market prices and personal risk reward preferences, in influencing the investment decisions.

b) Based on assumptions:

The process of rating is basically assumption based. It does not offer any performance audit to assess the performance of a firm. In fact, a rating grade is assigned solely on the basis of the information provided by the issuer.

c) Competitive ratings:

Wherever a firm be lives that it is not possible for it to obtain a favorable rating grade, it may shop around for a much favorable rating. This is quite possible especially due to competition between a relatively large numbers of players in the credit rating business.

FUNCTIONS OF CREDIT RATING:

The credit rating firms are supposed to do the following functions:

1. Superior Information:

Rating by an independent and professional firm offers a superior and more reliable source of information on credit risk for three inter related risks:

A. It Provides fair Opinion

B. Due to professional resources, a rating firm has greater ability to assess risks.

C. It has access to lot of information which may not be publicly available.

2. Low cost Information:

A rating firm which gathers, analyses, interprets and summaries complex information in a simple and readily understood format for wide public consumption represents a cost effective arrangement.

3. Basis for a proper Risk-return Trade Off:

If debt securities are rated professionally and if such ratings enjoy widespread investor acceptance and confidence, a more rational risk return trade off would be established in the capital market.

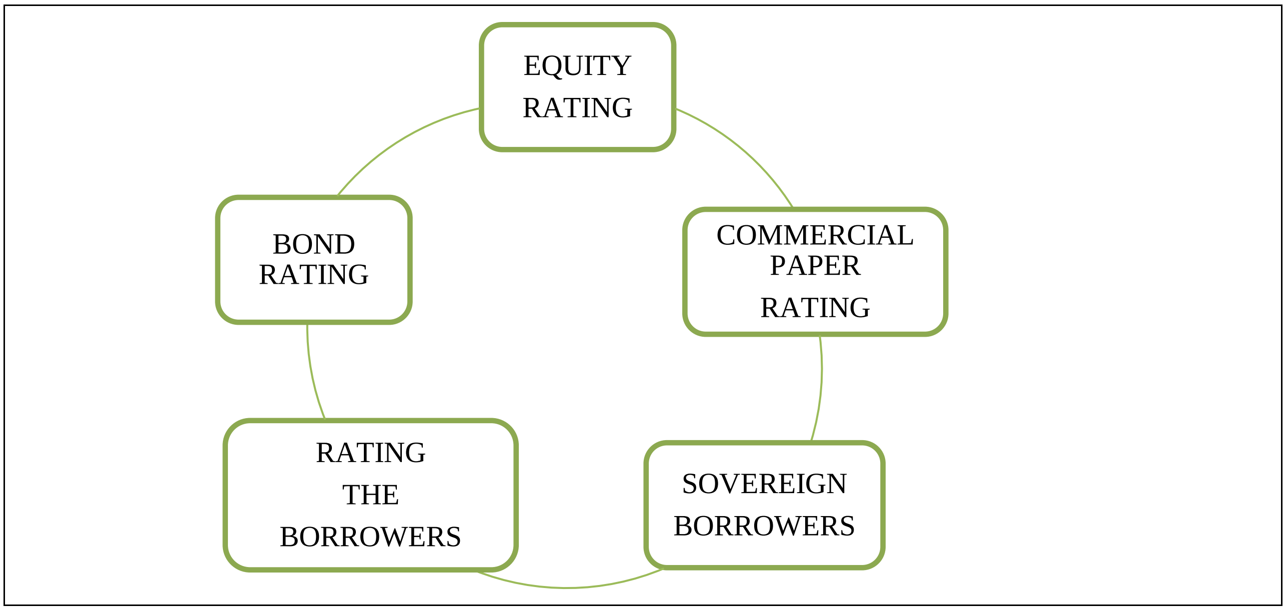
4. Healthy disciplines on corporate borrowers:

Public exposure has healthy influence over the management6 of issuer because of its desire to have a clear image.

5. Formulation of public policy guidelines on institutional investment:

The public policy on the kinds of securities that are eligible for inclusion in different kinds of institutional portfolios can be developed with great confidence if securities are rated professionally by independent agencies.

TYPES OF CREDIT RATING:



1. Equity rating:

The rating of equity shares is called equity rating.

2. Bond rating:

Rating the bonds or debts securities issued by a company, government or quasi-government body is called bond rating.

3. Commercial paper rating:

It is mandatory on the part of a corporate body to obtain the rating of approval from credit rating agency before issuing commercial papers.

4. Rating the borrowers:

This includes rating a borrower to whom a loan credit facility may be sectional.

5. Sovereign borrowers:

This includes rating a country as to its credit worthiness, probability to risk etc.

INDIAN CREDIT RATING AGENCIES:

Credit rating agencies evaluate debentures, fixed deposits and other short term credit documents of various companies after studying their financial status, industrial risks and market conditions. These companies work on the requests of the companies.

A Credit Rating Agency is a company that assigns ratings to the debtors according to their ability to pay back the debt in a timely manner. These agencies provide highly essential risk assessment reports and analytical solutions and assign a definitive credit score to both individuals as well as organizations. These reports are considered important for getting the loan.

Credit Rating Agencies in India has developed over a period of time. The most popular Credit Rating Agencies in India are CRISIL, ICRA, CARE, ONICRA, and SMERA. CRISIL is the first credit rating agency in India which started its operation in January 1988.

CREDIT RATING INFORMATION SERVICES OF INDIA LIMITED (CRISIL)

CRISIL has been promoted by the Industrial Credit and Investment Corporation of India Ltd (ICICI) and Unit Trust of India (UTI) as a Public Limited Company with its headquarters at Mumbai. The CRISIL commenced its operations from Jan 1, 1988 with a capital of Rs.4 crores in which the institutions hold shares in the proportion given below:

ICICI – 15%, UTI – 15%, ABD – 15%, LIC – 5%, GIC and its subsidiaries – 5%, SBI – 5%, HDFC – 18%, Foreign Banks – 17%.

OBJECTIVES OF CRISIL

The main objective of CRISIL has been to rate debt obligation of Indian Companies.

- ➢ Its rating provides a guide to the investors as to the risk of timely payment of interest and principal on a particular debt instrument.
- ➢ Its ratings create awareness of the concept of credit rating amongst corporations, Merchant Bankers, Brokers, regulatory authorities and helps in creating environment that facilitates the debt rating.

OPERATIONS OF CRISIL

- ➢ During 1994 – 95 CRISIL rated 379 instruments covering a debt volume of Rs.34, 544 crores the cumulative number of instruments rated by CRISIL. Since, its inception in Jan 1988, till the end of March 1995 has been 1305 and the value of instruments covered has been Rs.78, 151crores.
- ➢ The CRISIL has published CRISIL Bond Yield Tables to provide handy references to investors for determining Yield-to-maturity on a debenture, given the price of debenture, its coupon rate and its maturity period.
- ➢ During the year 1990 – 91, CRISIL started a Quarterly Publication called CRISIL RATING SCAN it includes details of rating in use, ratings reviewed during the Quarter, the instruments which have been placed under ‘rating watch’ and rating symbols with definition.
- ➢ “CRISIL CARD” services were developed by CRISIL during the year 1990 – 91. The service provides details about the company such as business it is engaged in shareholding pattern, plant location, equity share record, analyzed Profit and Loss A/c and Balance

Sheet for the last four years, accounting practices, key financial ratios, raw materials consumption etc.

- ➢ CRISIL has won international recognition and it is one of the four international companies shortlisted by ADB for being appointed as consultant.
- ➢ The CRISIL has set up an information company in collaboration with Excel Financial Limited of the UK called CRISIL Information Limited.
- ➢ The company has a paid up equity capital of Rs.50 lakhs of which EXTEL and CRISIL have contributed 26% e3ach and the balance is paid by the employees.
- ➢ CRISIL Information Ltd. Provides a wide range of information based on published data.
- ➢ CRISIL has so far rated a cumulative debt volume exceeding $30 billion covering 1500 debt instruments covering 1000 companies.

CREDIT RATING SYMBOLS BY CRISIL

Instruments which have the same rating are of similar but not identical investment quality. This is because the number of rating categories is limited and hence cannot reflect small differences in the degree of risks.

For preference shares, the letters "pf" are prefixed to the debenture rating symbols. The fixed deposit rating symbols commence with "f" and the short-term instruments use the letter "p" from the concept of 'prime'.

CRISIL assigns ratings to only rupee denominated debt instruments.

CRISIL Debenture rating symbols

High Investment Grades

AAA (Triple A)	-	Highest safety
AA (Double A)	-	High safety.

Investment Grades

A	-	Adequate safety
BBB (Triple B)	-	Moderate safety

Speculative Grades

BB (Double B)	-	Inadequate safety
B	-	High risk
C	-	Substantial risk
D	-	Default

CRISIL Fixed Deposit Rating symbols

Investment Grades

FAAA (F Triple A)	-	Highest safety
FAA (F Double A)	-	High safety
FA	-	Adequate safety

Speculative Grades

FB	-	Inadequate safety
FC	-	High Risk
FD	-	Default

Credit Rating for short term Instruments

P – 1 - Degree of safety in timely pay on the instrument is very strong

P – 2 - Strong

P – 3 - Adequate

P – 4 - Minimal

P – 5 - Expected to be in default on maturity or in default.

INVESTMENT INFORMATION AND CREDIT RATING AGENCY OF INDIA (IICRA)

IICRA has been promoted by Industrial Finance Corporation of India as its main promoter with its Head Quarters at New Delhi. It is an independent company limited by shares with an authorized share capital of Rs.10 crores against which Rs.5crores is paid-up IFCI has contributed 26% of the share capital and the balance has been contributed by UTI, LIC, GIC, PNB, Central Bank of India, Bank of Baroda, UCO Bank etc.

OBJECTIVES

i) To assist investors, both individual and institutional, in making well informed investing decisions.

ii) To assist issuers in raising funds from a wider investor base in large amounts and at a lower cost for more highly rated companies.

iii) To enable banks, investment bankers and brokers in placing debt with investors by providing them with a marketing tool.

iv) To provide regulators with a market driven system to encourage the healthy growth of the capital market in a disciplined manner without casting an additional burden n the Govt. for this purpose.

OPERATIONS

- IICRA was incorporated as a company on 16th Jan 1991 and commenced operations from 1st Sep 1991.
- During the period IICRA rated debt instruments such as non-convertible debentures, partly convertible debentures, fixed deposit programs and commercial paper programs of industrial as well as financial services companies.
- During the financial year ending March 31st, 1992, IICRA had assigned rating to 39 debt instruments.
- Out of the 39 ratings assigned 27 have been accepted and are being used by the companies.
- The performance of IICRA in its first seven (7) months of operations was impressive.
- On completion of one year's operations in Aug 1992. IICRA had rated 61 debt instruments of 55 companies.

OTHER SERVICES

IICRA has also launched two new services viz., Credit Assessment and General Assessment.

i) Credit Assessment

The assessment indicates the broad opinion of IICRA as to the relative degree of capability of the company undertaking to repay the interest and principal as per the terms of the contract.

ii) General Assessment

This service is also likely to be useful for other non-banking non-financial agencies for the purpose of merger, amalgamation, acquisition, Joint venture, collaboration and factoring of debts, etc., IICRA does not assign any specific symbols in respect of such general assessments. It provides a report on different aspects of the company's operations / managements.

IICRA Credit Rating Scale

Long term including debentures, Bonds and Preference Shares

1. Highest safety - LAAA
2. High safety - LAA
3. Adequate safety - LA
4. Moderate safety - LBBB
5. Inadequate safety - LBB
6. Risk prone - LB
7. Substantial risk - LC
8. Default, Extremely speculative - LD

Medium term including deposits fixed

1. Highest safety - MAAA
2. High safety - MAA
3. Adequate safety - MA
4. Inadequate safety - MB
5. Risk prone - MC
6. Default - MD

Short term including commercial paper

1. Highest safety - A - 1
2. High safety - A - 2
3. Adequate safety - A - 3
4. Risk prone - A - 4
6. Default - A - 5

CREDIT ANALYSIS AND RESEARCH LIMITED (CARE)

The CARE was promoted in 1993 jointly with investment companies, banks and finance companies.

OBJECTIVE / SERVICES

Services offered by CARE are

i) Credit Rating
ii) Information Service
iii) Equity Research
iv) Rating of parallel market of LPG and Kerosene.

OPERATIONS

Since, its inception till the end of March 1995, CARE has rated 249 debt instruments covering a total debt volume of Rs.9, 729 crores.

CREDIT RATING SYMBOLS BY CARE

For Long term debt instruments

1. Highest safety - CARE AAA
2. High safety - CARE AA
3. Adequate safety - CARE A
4. Inadequate safety - CARE BB
5. High risk - CARE B

For Medium Term debt instruments

1. Highest safety - CARE AAA
2. High safety - CARE AA
3. Adequate safety - CARE A
4. Inadequate safety - CARE BB
5. High risk - CARE C

For Short Term debt instruments

1. Highest safety - PR 1
2. High safety - PR 2
3. Adequate safety - PR 3
4. Inadequate safety - PR 4

ONIDA INDIVIDUAL CREDIT RATING AGENCY (ONICRA)

Credit rating agency **ONICRA** was established in 1993. It is now **ONICRA** Credit Rating Agency Of India Ltd. This is a private sector agency set up by ONIDA Finance ONICRA Credit Rating Agency is a path breaking innovative organization that analyzes data and provides rating solutions for Individuals and Small and Medium Enterprises (SMEs). This rating enables the lender or service provider to take a valued judgment on the Individual or SME based on its Financial, Background and Productivity analysis.

OPERATIONS:

- ONICRA facilitates over 200,000 transactions per day through a single window clearance on a national basis in the Telecom, Banking, Insurance, Health, Education and Automobile sectors.
- Over the years, ONICRA has developed a long list of esteemed clients. This includes some of India Inc's top 100 companies: Mahindra & Mahindra, Reliance, Volkswagen, HDFC and GENPACT. ONICRA has been acknowledged as pioneers in the field of credit rating by the Ministry of Finance in the Economic Survey (1993-1994).
- It is also recognized and empanelled by the likes of NSIC (National Small Industries Corporation) for SSI (Small Scale Industry) assessment. Rating has also been accepted by the IBA (Indian Banks Association). It delivers services from a national network of

150 operation centers. Its integrated network also comprises of 4000 FOS (Fleet on Street) personnel located at various strategic locations nationwide.

- Presence in 400 locations coupled with multilingual capabilities lends us a competitive advantage to manage complex processes in multiple geographic regions. The operations architecture allows for business and services to be conducted in the lowest turnaround time using revolutionary PRTS (Performance Rating & Tracking System) technology. Operations not only run round the clock but also meet customer needs for proximity, language and cultural compatibility without hampering productivity.

SMALL AND MEDIUM ENTERPRISES RATINGS AGENCY (SMERA)

SMERA Ratings Limited is a full service Credit Rating Agency, registered with the Securities and Exchange Board of India (SEBI), and accredited by Reserve Bank of India (RBI) as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms. SMERA is empanelled with National Small Industries Corporation (NSIC), the nodal agency of the Ministry of MSME, Government of India to provide SMERA-D&B-NSIC Micro & Small Enterprises Rating for MSEs in India. SMERA has assigned more than 48,500 ratings as on 30th November 2017.

SMERA employs over 300 professionals, a rich mix of MBAs, CAs, CFAs, FRMs, Economists, Statisticians, and Engineers. SMERA has its Registered and Head Office in Mumbai, branches at 9 cities and representatives in more than 50 clusters across India.

RATING SCALE

Rating Symbol	Definition
SMERA MSE 1	Highest credit worthiness in relation to other MSEs
SMERA MSE 2	High credit worthiness in relation to other MSEs
SMERA MSE 3	Good credit worthiness in relation to other MSEs
SMERA MSE 4	Above Average credit worthiness in relation to other MSEs
SMERA MSE 5	Average credit worthiness in relation to other MSEs
SMERA MSE 6	Below Average credit worthiness in relation to other MSEs
SMERA MSE 7	Weak credit worthiness in relation to other MSEs

SMERA MSE 8	Poor credit worthiness in relation to other MSEs

GLOBAL CREDIT RATING AGENCIES:

In developed economy, almost all the market participants are familiar with the rating process, and possess the experience to deal with new market developments. The market also helps to support the value of the rating system to the market participants with factors such as high debt volume unsupported by the government guarantee, and a liquid secondary market where the rating can be useful in purchase decisions. The credit rating system is well established in the U.S. debt markets. Euro debt markets and international bank deposit markets are fairly well accepted in countries such as UK, Canada and Australia, with a number of rating agencies in these markets. The following are the major international rating agencies:

FITCH RATINGS

Fitch ratings are an international credit rating agency based out of New York City and London. Investors use the company's ratings as a guide as to which investments will not default and subsequently yield a solid return. Fitch bases the ratings on factors, such as what kind of debt a company holds and how sensitive it is to systemic changes like interest rates. Along with Moody's and Standard & Poor's (S&P's), Fitch is one of the top three credit rating agencies in the world. The Fitch rating system is very similar to S&P's in that they both use a letter system.

The Fitch ratings system is as follows:

INVESTMENT GRADE

- AAA: companies of exceptionally high quality (established, with consistent cash flows)
- AA: still high quality; slightly more risk than AAA
- A: low default risk; slightly more vulnerable to business or economic factors
- BBB: low expectation of default; business or economic factors could adversely affect the company

NON-INVESTMENT GRADE

- BB: elevated vulnerability to default risk, more susceptible to adverse shifts in business or economic conditions; still financially flexibility
- B: degrading financial situation; highly speculative
- CCC: real possibility of default
- CC: default is a strong probabability
- C: default or default-like process has begun
- RD: issuer has defaulted on a payment
- D: defaulted

FITCH RATINGS AND SOVEREIGN NATIONS

Fitch offers sovereign credit ratings that describe each nation's ability to meet its debt obligations. Sovereign credit ratings are available to investors to help give them insight into the level of risk associated with investing in a particular country. Countries will invite Fitch and other credit rating agencies to evaluate their economic and political environments and financial situations to determine a representative rating. It's very important to obtain the best sovereign credit rating possible, particularly in the case of developing nations, as it aids in accessing funding in international bond markets. In 2018 Fitch awarded the United States with the highest AAA sovereign credit rating. On the lower end was Brazil with a BB-.

FITCH RATINGS AND INDIVIDUAL CREDIT SCORES

While Fitch, Moody's, and S&P ratings often correlate with companies, institutions, and nations many credit ratings agencies also offer individual credit scores. These play central roles in lenders' decisions to extend credit.

MOODY'S INVESTORS SERVICE,STANDARD & POOR'S (S&P),EGAN JONES and DBRS.

Discuss about the Future of Credit Rating in India

- At present, commercial paper, bonds and debentures with maturities exceeding 18months and fixed deposits of large non-banking companies registered with RBI are required to be compulsorily rated.
- There are moves to make rating compulsory for other types of borrowings such as the fixed deposit programme of manufacturing companies.
- There are number of areas where rating agencies will have to cover new ground in the coming years.
- The rating of municipal bonds, State Govt. borrowings commercial banks and public sector undertaking etc., will be covered in the near future. So, the outlook for the credit rating industry is positive.
- The Indian Credit Rating agencies have made strategic alliance with reputed international agencies.
- They adapt to a large extent, the rating methodologies adopted by their western counterparts.
- The suitability of rating methods and models formulated in well developed markets in the west is highly doubtful in Indian conditions.
- The rating agencies in India have to evolve their own methodologies with the context of Macro Economic Environment.

QUESTION BANK

2 MARKS:

1. What do you mean by credit rating?
2. Define credit rating.

3. What is low cost of borrowing?
4. How to increase the investor's population?
5. What is CRISIL?

5 MARKS:

1. What are the objectives of IICRA?
2. What are the credit rating symbols By CRISIL?
3. Explain the benefits of credit rating.
4. What are the benefits to rated companies by credit rating?
5. What are the functions of credit rating?

10 MARKS:

1. Discuss about the future of credit rating in India.
2. Explain about the functions of credit rating.
3. Explain about the objectives of CRISIL.
4. Discuss in detail about the credit rating agencies in India.

1. What do you mean by Credit Rating?

Rating is usually expressed in alphabetical or alphanumeric symbols. They are simple and easy to understand for the investors. It enables the investors to differentiate debt instrument on the basis of their underlying credit quality.

2. Define Credit Rating.

The credit rating is "A symbolic indicator of the current opinion of the relative capability of a corporate entity to service its debt obligations in a timely fashion, with specific reference to the instrument being rated".

3. What is low cost of borrowings?

A company with highly rated instruments has the opportunity to reduce the cost of borrowings by quoting lesser interest rate of fixed deposits or debentures as the investors with low risk preference would invest in safe securities though yielding low rate of return.

4. Expand CRISIL.

Credit Rating Information Service Ltd. (CRISIL)

5. Write short notes on CRISIL.

CRISIL has been promoted by the Industrial Credit and Investment Corporation of India Ltd (ICICI) and Unit Trust of India (UTI) as a Public Limited Company with its headquarters at Mumbai. The CRISIL commenced its operations from Jan 1,1988 with a capital of Rs.4 crores in which the institutions hold shares in the proportion given below:

ICICI – 15%, UTI – 15%, ABD – 15%, LIC – 5%, GIC and its subsidiaries – 5%, SBI – 5%, HDFC – 18%, Foreign Banks – 17%.

UNIT – IV

INDIAN CAPITAL MARKET TRADE PRADTICES – BSE , NSE , SENSEX , NIFTY , FUNDAMENTAL AND SENSEX ANALYSIS- DEMAT TRADING AND ROLE OF DEPOSITORIES.

Introduction

- The capital market is a vital of the financial system. Capital market provides the support of capitalism to the country.
- The wave of economic reforms initiated by the government has influenced the functioning and governance of the capital market.
- The Indian capital market is also undergoing structural transformation since liberalisation.

Meaning:

- The capital market is a place where people buy and sell securities.
- Capital market concerned with the industrial security market, government securities markets, and long term loan market.
- Capital market deals with long term loan market. It supplies long-term and medium term funds.
- It deals with shares, stocks debentures and bonds.
- Security dealt in capital markets are long-term securities.
- It provides a market mechanism for those who have saving and to those who have saving and to those who need funds for productive investments.
- The capital market aids economic growth by moiling the savings of the economic sector and directing the same towards channels of productive uses.

Definition:

According to Arun K. Datta, The capital market may be define as “ The capital market is a complex of institutions investment and practices with established links between the demand for and supply of different types of capital gains”.

Capital market India Trade Practice

A **capital market** is a financial market in which long-term debt (over a year) or equity-backed securities are bought and sold.[6] Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.

Modern capital markets are almost invariably hosted on computer-based electronic trading systems; most can be accessed only by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments.

A capital market can be either a primary market or a secondary market.

Primary Market:

In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments issue only bonds, whereas companies often issue both equity and bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf.

Secondary Market

In the secondary markets, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.

A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors).

Examples

Government on primary markets

When a government wants to raise long-term finance it will often sell bonds in the capital markets. In the 20th and early 21st centuries, many governments would use investment banks to organize the sale of their bonds. The leading bank would underwrite the bonds, and would often head up a syndicate of brokers, some of whom might be based in other investment banks. The syndicate would then sell to various investors.

Company on primary markets

When a company wants to raise money for long-term investment, one of its first decisions is whether to do so by issuing bonds or shares. If it chooses shares, it avoids increasing its debt, and in some cases the new shareholders may also provide non-monetary help, such as expertise or useful contacts. On the other hand, a new issue of shares will dilute the ownership rights of the existing shareholders, and if they gain a controlling interest, the new shareholders may even replace senior managers.

Secondary market trading

Most capital market transactions take place on the secondary market. On the primary market, each security can be sold only once, and the process to create batches of new shares or bonds is often lengthy due to regulatory requirements. On the secondary markets, there is no limit to the number of times a security can be traded, and the process is usually very quick.

There are several ways to invest in the secondary market without directly buying shares or bonds. A common method is to invest in mutual funds[g] or exchange-traded funds. It is also possible to buy and sell derivatives that are based on the secondary market; one of the most common types of these is contracts for difference – these can provide rapid profits, but can also cause buyers to lose more money than they originally invested.

Forecasting and analyses

A great deal of work goes into analysing capital markets and predicting their future movements. This includes academic study; work from within the financial industry for the purposes of making money and reducing risk; and work by governments and multilateral institutions for the purposes of regulation and understanding the impact of capital markets on the wider economy.

Capital controls

Capital controls are measures imposed by a state's government aimed at managing capital account transactions – in other words, capital market transactions where one of the counter-parties[h] involved is in a foreign country. Whereas domestic regulatory authorities try to ensure that capital market participants trade fairly with each other, and sometimes to ensure institutions like banks do not take excessive risks, capital controls aim to ensure that the macroeconomic effects of the capital markets do not have a negative impact. Countries like India employ capital controls to ensure that their citizens' money is invested at home rather than abroad.

The capital market play very important role in Indian financial system as follow:

1. To mobilize long-term savings to finance long term investments.
2. To inspirations broader ownership of productive assets.
3. To improve the efficiency of capital allocation through a competitive pricing mechanism.

4. To provide liquidity with mechanism enabling the investor to see financial assets.
5. To make lower the costs of transactions and information.
6. To make bridge between investors and companies.
7. To make quick valuation of financial instruments both equity and debt.
8. To security against market risk or price risk trough derivative trading and default risk through investment protection fund.
9. To provide operational efficiency.
10. To direct the flow of funds into efficient channels through investment, disinvestment, and reinvestment.
11. To make integration between financial sectors and non-financial sectors, Long term fund and short term fund.
12. To give opportunities to risk taker in term of equity and return taker in term of debt.

Thus, a capital market serves as an important link between those who save and those who aspire to invest their savings.

Exchanges in India

The stock exchanges are the important player of the capital market. They are the citadel of capital and fortress of finance. They are the platform of trading in securities and as such they assists and control the buying and selling of securities. Thus, stocks exchanges constitute of a market where securities issued by the central and state, governments, public bodies and joint stock companies are traded.

There are mainly four stock exchanges in India as follow:

1. Bombay Stock Exchange (BSE)
2. National Stock Exchange (NSE)
3. The Over The Counter Exchange of India (OTCEI)
4. Regional Stock Exchanges

1. Bombay Stock Exchange (BSE):

- The Bombay Stock Exchange (BSE) is an Indian stock exchange established in 1875.
- BSE is the first and largest securities market in India.
- The first in the country to be granted permanent recognition under the Securities Contract Regulation Act, 1956,
- The exchange provides an efficient and transparent market for trading in Securities.

FUNCTIONS OF BSE:

- The efficient functioning of a stock exchange creates a conducive climate for an active and growing primary market for new issues.
- An active and healthy secondary market in existing securities leads to positive environment among investors. The following are some of the important functions of a stock exchange.

- The basic function of a stock exchange is the creation of a continuous market where securities are bought and sold.
- It gives investors the chance to disinvest and reinvest. This provides both liquidity and easy marketability to already existing securities in the market.
- They allow corporations looking to expand to raise capital from investors in the primary market and facilitate trade between buyers and sellers of stock in the secondary market.
- The most important of all the functions of stock market is its FAIR PRICING function.
- The workings of the stock market enable buyers and sellers of stock, to receive the best price possible for a particular stock.
- In addition to individual stocks, the Bombay Stock Exchange also has a market in **derivatives**, which was the first to be established in India. Listed derivatives on the exchange include stock **futures and options, index futures and options**, and weekly options.

Contributes to Economic Growth:

- A stock exchange is a market in which existing securities are resold or traded. Through this process of disinvestment and reinvestment savings get channelised into their most productive investment avenues. This leads to capital formation and economic growth.
- The stock exchange can play a vital role in ensuring wider share ownership by regulating new issues, better trading practices and taking effective steps in educating the public about investments.
- The stock exchange provides sufficient scope within the provisions of law for speculative activity in a restricted and controlled manner. It is generally accepted that a certain degree of healthy speculation is necessary to ensure liquidity and price continuity in the stock market.

The powers of governing body are to:

(i) Manage and control the functioning of the stock exchanges;
(ii) Regulate trading in securities;
(iii) Fine, suspend or expel members and take such other disciplinary actions as it deems it;
(iv) Govern business conduct and relationship, settle disputes, if any, amongst members and between members and non-members;
(v) Make or amend any rules, bye laws, or regulations or suspend their operations with the approval of the government;
(vi) Interpret the rules, byelaws and regulations in its own discretion. In practice the powers of the body to manage and control are almost absolute.

BSE has taken large strides in product and service innovation for the **benefit of its members** and investors, notable ones being

- Launch of a reporting platform for corporate bonds
- Launch of the S&P BSE IPO index and S&P BSE PSU website
- Revamp of its website with wide range of new investor-friendly features
- Launch of trading in S&P BSE SENSEX futures on EUREX and leading exchanges of the BRICS nation bloc

- Launched Smart Order Routing for members and investors
- Introduced SACT (SMS alert & Complaint Tracking system)
- Launched co-location facility at BSE premises in November 2010
- Reduction in membership fees to Rs. 10 lakh for new memberships to promote financial access and inclusion
- Launch of web-based mutual fund trading platform for investors

The National Stock Exchange of India Limited

- *NSE* is the leading stock exchange of India, located in Mumbai . The NSE was established in 1992 as the first demutualized electronic exchange in the country.
- NSE was the first exchange in the country to provide a modern, fully automated screen-based electronic trading system which offered easy trading facility to the investors spread across the length and breadth of the country.
- National Stock Exchange has a total market capitalization of more than US$1.41 trillion, making it the world’s 10th-largest stock exchange as of March 2017.
- NSE's flagship index, the NIFTY 50, the 50 stock index is used extensively by investors in India and around the world as a barometer of the Indian capital markets. Nifty 50 index was launched in 1996 by the NSE.
- NSE was also instrumental in creating the National Securities Depository Limited (NSDL) which allows investors to securely hold and transfer their shares and bonds electronically. It also allows investors to hold and trade in as few as one share or bond.
- This not only made holding financial instruments convenient but more importantly, eliminated the need for paper certificates and greatly reduced the incidents of forged or fake certificates and fraudulent transactions that had plagued the Indian stock market.

The NSDL's security, combined with the transparency, lower transaction prices and efficiency that NSE offered, greatly increased the attractiveness of the Indian stock market to domestic and international investors.

Markets

NSE offers trading and investment in the following segments

Equities

- Equities
- Indices
- Mutual Funds
- Exchange Traded Funds
- Initial Public Offerings
- Security Lending and Borrowing Scheme etc.

Derivatives

- Equity Derivatives (including Global Indices like CNX 500, Dow Jones and FTSE)
- Currency Derivatives
- Interest Rate Futures

Debt

- Corporate Bonds

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.

SENSEX

- BSE SENSEX or Bombay Stock Exchange Sensitive Index is a value-weighted index composed of 30 stocks started in April, 1984. It consists of the 30 largest and most actively traded stocks, representative of various sectors, on the Bombay Stock Exchange.
- These companies account for around one-fifth of the market capitalization of the BSE.
- At irregular intervals, the Bombay Stock Exchange (BSE) authorities review and modify its composition to make sure it reflects current market conditions. The index is calculated based on a free-float capitalization method; a variation of the market cap method.
- Instead of using a company's outstanding shares it uses its float, or shares that are readily available for trading. The free-float method, therefore, does not include restricted stocks, such as those held by company insiders.

SENSEX CALCULATION:

- The base value of SENSEX has been chosen to be 100 points. This is for the purpose of ease of calculation and to logically represent the change in terms of percentage. So, next day, if the market capitalization moves up 10%, the index also moves 10% to 110.
- It is comprised of a basket of 30 stocks which represents large, liquid companies that represents overall market movement.

- The SENSEX scientifically designed based on globally accepted construction and review methodology. It is calculated using Free **Float Market Capitalization** methodology.
    - ❖ **Float Market Capitalization:**

Market capitalization of a company is determined by multiplying the prevailing price per share, with the number of shares that company has issued. For example, if a company A has issued 1 lakh shares with a market price of Rs 100 The market capitalization of this company will be 100000 shares* 100= 10,00,00,000.

Free float market capitalization is defined as that proportion of total shares issued by the company that are readily available for trading in the market.

It generally excludes promoters' holding, government holding, strategic holding and other locked-in shares that will not come to the market for trading in the normal course.

- For example, the market capitalization of each company in a Free-float index is reduced to the extent of its readily available shares in the market. Company X has 5000 shares in total, out of which 2000 shares are held by the promoters, now only 3000 shares are available for the general public. Hence 3000 shares are free floating shares.

Suppose the Index consists of only 2 stocks: Stock A and Stock B.

The company A has 1,000 shares in total, of which 200 are held by the promoters, so that only 800 shares are available for trading to the general public.
These 800 shares are the so-called 'free-floating' shares.

Similarly, company B has 2,000 shares in total, of which 1,000 are held by the promoters and the rest 1,000 are free-floating.

Now suppose the current market price of stock A is Rs 120. Thus, the 'total' market capitalisation of company A is Rs 120,000 (1,000 x 120), but its free-float market Capitalisation is Rs 96,000 (800 x 120).

Similarly, suppose the current market price of stock B is Rs 200. The total market capitalisation of company B will thus be Rs 400,000 (2,000 x 200), but its free-float market cap is only Rs 200,000 (1,000 x 200).

So as of today the market capitalisation of the index (i.e. stocks A and B) is Rs 520,000 (Rs 120,000 + Rs 400,000); while the free-float market capitalisation of the index is Rs 296,000. (Rs 96,000 + Rs 200,000).

The year 1978-79 is considered the base year of the index with a value set to 100. What this means is that suppose at that time the combined free-float market capitalisation of the stocks that comprised the index then was, say, 60,000 (remember at that time there may

have been some other stocks in the index, not A and B, but that does not matter), then we assume that an index market cap of 60,000 is equal to an
index-value of 100.

Thus the value of the index today is = 296,000 x 100/60,000 = 493.33. In a way you can say that, since 1979-80, Indian stock market has grown by 4.93 times.

NIFTY

India has two main exchange, ie. National Stock Exchange and Bombay Stock Exchange
Nifty is an index that is part of NSE and Sensex is short form of sensitivity index that forms part of BSE.

History of NIFTY 50

The NIFTY 50 is the flagship index on the National Stock Exchange of India Ltd. (NSE). The Index tracks the behaviour of a portfolio of blue chip companies, the largest and most liquid Indian securities. It includes 50 of the approximately 1600 companies listed on the NSE, captures approximately 65% of its float-adjusted market capitalization and is a true reflection of the Indian stock market.

The NIFTY 50 covers major sectors of the Indian economy and offers investment managers exposure to the Indian market in one efficient portfolio. The Index has been trading since April 1996 and is well suited for benchmarking, index funds and index-based derivatives.

The NIFTY 50 is owned and managed by India Index Services and Products Ltd. (IISL). IISL is India's first specialized company focused on an index as a core product.

Method of Computation:

NIFTY 50 is computed using free float market capitalization weighted method, wherein the level of the index reflects the total market value of all the stocks in the index relative to a particular base period. The method also takes into account constituent changes in the index and importantly corporate actions such as stock splits, rights, etc without affecting the index value.

Base Date and Value

The base period selected for NIFTY 50 index is the close of prices on November 3, 1995, which marks the completion of one year of operations of NSE's Capital Market Segment. The base value of the index has been set at 1000 and a base capital of Rs.2.06 trillion

Liquidity (Impact Cost)

For inclusion in the index, the security should have traded at an average impact cost of 0.50% or less during the last six months for 90% of the observations for a basket size of Rs. 2 Cores.

Impact cost is cost of executing a transaction in a security in proportion to the weight age of its free float market capitalisation as against the index free float market capitalisation at any point of time. This is the percentage mark- up suffered while buying / selling the desired quantity of a security compared to its ideal price (best buy + best sell) / 2

Fundamental Analysis

There are two basic types of stock analysis:

- ✓ Fundamental analysis and
- ✓ Technical analysis.

Fundamental analysis concentrates on data from sources including financial records, economic reports, company assets, and market share.

To conduct fundamental analysis on a public company or sector, investors and analysts typically analyze the metrics on a company's financial statements – balance sheet, income statement, cash flow statement, and footnotes.

These statements are released to the public in the form of a 10-Q or 10-K report through the database system, EDGAR, which is administered by the US Securities and Exchange Commission (SEC).

Also, the earnings report released by a company during its quarterly earnings press release is analyzed by investors who look to ascertain how much revenues, expenses, and profits a company made.

When running stock analysis on a company's financial statements, an analyst will usually be checking for the measure of a company's profitability, liquidity, solvency, efficiency, growth trajectory, and leverage. There are different ratios that can be used to determine how healthy a company is.

For example, the current ratio and quick ratio are used to estimate whether a company will be able to pay its short-term liabilities with its available current assets.

Technical Analysis

The second method of stock analysis is technical analysis.

Technical analysis focuses on the study of past market action to predict future price movement.

Technical analysts analyze the financial market as a whole and are primarily concerned with price and volume, as well as the demand and supply factors that move the market. Charts are a key tool for technical analysts as they show a graphical illustration of a stock's trend within a stated time period.

For example, using a chart, a technical analyst may mark certain areas as a support or resistance level. The support levels are marked by previous lows below the current trading price, and the resistance markers are placed at previous highs above the current market price of the stock. A break below the support level would indicate a bearish trend to the stock analyst, while a break above the resistance level would take on bullish outlook.

Technical stock analysis is effective only when the price trend analyzed is influenced by supply and demand forces. When outside factors are involved in a price movement, analyzing stocks using technical analysis may not be successful.

Both fundamental and technical analysis can be done independently or together. Some analysts use both methods of analyses, while others stick to one. Either way, using stock analysis to vet stocks, sectors, and the market is an important method of creating the best investment strategy for one's portfolio.

The Difference Between Fundamental and Technical Analysis

Fundamental and Technical Analysis are two completely separate analysis because the data's which we use for technical analysis is completely different from the data's which we use for fundamental analysis.

In Fundamental analysis the main data's which focused is on the financial statements of the company, but in technical analysis we use the data's of price change and deferens chart analysis to predict the future market value of the share.

Unfortunately most of investors don't use any of these analysis methods (Fundamental and Technical Analysis) to take their investment decision and most of them follow the market rumours, what other do and fall in to trap and lose their hard earned money.

Even some earned money form wild guess or following the market rumours the money which they found quickly get vanished because share market not only depend on the luck.

This is very unfortunate situation and most of the people lose their faith on share market due to lack of knowledge of fundamental analysis and Technical analysis.

Most of investors use Technical Analysis for short-term and mid-term investment strategy and for long-term investment most of the investors use fundamental analysis.

Compare with Fundamental and technical Analysis, Technical analysis is little bit risky and these analysis is not recommended for beginners.

DEMAT ACCOUNT

- Demat account is the account that should be started by an investor to buy or sell shares in the stock market.
- The investor should start the demat account with a depository participant who is recognized by SEBI.
- Now, to understand demat account, we have to understand dematerialization, depository and depository participant.

Dematerialization:

- One of the most impactful reform measures in the stock market was the introduction of dematerialization.
- Dematerialization is the practice of keeping and delivering share certificates to investors in electronic forms rather than in the physical form like a documented printed paper.

It is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited into the owner's account with his depository participant.

Who is a depository and who is depository participant?

For the introduction of dematerialization, there should be an institution or organization who should keep the share certificates in electronic forms. That institution is called depository.

A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. It also provides services related to transactions in securities. At present, there are two depositories viz. National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) are registered with SEBI.

The depositories don't directly interact with the customers who purchases and sells shares. Rather, they provide their services like keeping of share certificates in electronic forms through another set of institutions called depository participants (DP).

Depository Participant

A Depository Participant (DP) is an **agent of the depository**. It is through this agent that the depository interfaces with the investor and provides depository services. Depository participant functions are provided by diverse institutions recognised by the SEBI.

Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations /clearing houses, NBFCs and Registrar to an Issue or Share Transfer Agent complying with the requirements prescribed by SEBI can be registered as DP.

In India, a Depository Participant (DP) is described as an agent of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act

How to open Demat account in India

A Demat account is a medium which allows individuals to convert and retain physical shares in electronic format. Just like you require a bank account for savings and transactions, a demat account is required to hold securities, stocks, debentures, and investments. You may use it to buy or sell stocks. To buy shares, whether offline or online, it is mandatory to create a demat account.

Steps:

1. **Getting in touch with a registered depository:** In order to open a demat account, you'll have to first get in touch with a registered depository participant (DP). For a list of registered DPs, visit the NSDL (National Securities Depository Limited) or CDSL (Central Depository Services Limited) websites.
2. **Download the Forms.** Download or collect the account opening forms from the respective DP's office or website. Fill up the requested details in the account opening form and provide the necessary signatures. Affix photographs and submit a copy of PAN Card, proof of address, bank statement or other documents as required by the company.
3. **Wait the turn-around Time.** It usually takes about a week or two for the welcome kit to reach you depending on different company policies. A Demat account can be opened with zero balance in your account. There is no compulsion to maintain a minimum balance either.

4 **Nominate your Nominee.** It is important that you add a nominee while applying for a demat account. Check and double check the nominee details for accuracy. This will enable the nominee to receive the benefits of your securities in the event of exigencies.

After opening an account, the DP will allot you a beneficial owner identification number that will be needed for all future transactions. When you wish to sell your shares, you need to coordinate with your broker and give a 'Delivery Instruction' to your DP.Your account will then be debited with the number of shares sold by your DP. You will receive the payment from your broker.

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UNIT – V

STOCK PRICE MOVEMENTS

Stock price movements and Indian economy system – Inflation and

MEANING OF STOCK

- A stock is a general term used to describe the ownership certificates of any company. A share, on the other hand, refers to the stock certificate of a particular company. Holding a particular company's share makes you a shareholder.
- Stocks are of two types—common and preferred. The difference is while the holder of the former has voting rights that can be exercised in corporate decisions, the later doesn't. However, preferred shareholders are legally entitled to receive a certain level of dividend payments before any dividends can be issued to other shareholders.
- There is also something called **'convertible preferred stock'**. This is basically a preferred stock with an option of converting into a fixed number of common shares, usually any time after a predetermined date.

MEANING OF STOCK PRICE

- The cost of purchasing a security on an exchange. Stock prices can be affected by a number of things including volatility in the market, current economic conditions, and popularity of the company.

WHAT CAUSES STOCK PRICES TO CHANGE?

- Stock prices change every day by market forces. By this we mean that share prices change because of supply and demand. If more people want to buy a stock (demand) than sell it (supply), then the price moves up. Conversely, if more people wanted to sell a stock than buy it, there would be greater supply than demand, and the price would fall.
- Understanding supply and demand is easy. What is difficult to comprehend is what makes people like a particular stock and dislike another stock. This comes down to figuring out what news is positive for a company and what news is negative. There are many answers to this problem and just about any investor you ask has their own ideas and strategies.
- That being said, the principal theory is that the price movement of a stock indicates what investors feel a company is worth. Don't equate a company's value with the stock price. The value of a company is its market capitalization, which is the stock price multiplied by the number of shares outstanding. For example, a company that trades at $100 per share and has 1,000,000 shares outstanding has a lesser value than a company that trades at $50 but has 5,000,000 shares outstanding ($100 x 1,000,000 = $100,000,000 while $50 x 5,000,000 = $250,000,000). To further complicate things, the price of a stock doesn't only reflect a company's current value–it also reflects the growth that investors expect in the future.

THE IMPORTANT THINGS TO GRASP ABOUT THIS SUBJECT ARE THE FOLLOWING:

1. At the most fundamental level, supply and demand in the market determine stock price.
2. Price times the number of shares outstanding (market capitalization) is the value of a company. Comparing just the share price of two companies is meaningless.
3. Theoretically earnings are what affect investors' valuation of a company, but there are other indicators that investors use to predict stock price. Remember, it is investors' sentiments, attitudes, and expectations that ultimately affect stock prices.
4. There are many theories that try to explain the way stock prices move the way they do. Unfortunately, there is no one theory that can explain everything.

WYCKOFF PRICE CYCLE

According to Wyckoff, the market can be understood and anticipated through detailed analysis of supply and demand, which can be ascertained from studying price action, volume and time. As a broker, he was in a position to observe the activities of highly successful individuals and groups who dominated specific issues, and was able to decipher, through the use of what he called vertical (bar) and figure (point-and-figure) charts, the future intentions of those large interests. An idealized schematic of how he conceptualized the large interests' preparation for and execution of bull and bear markets is depicted in the figure below. The time to enter long orders is towards the end of the preparation for a price markup or bull market (accumulation of large lines of stock), while the time to initiate short positions is at the end of the preparation for price markdown.

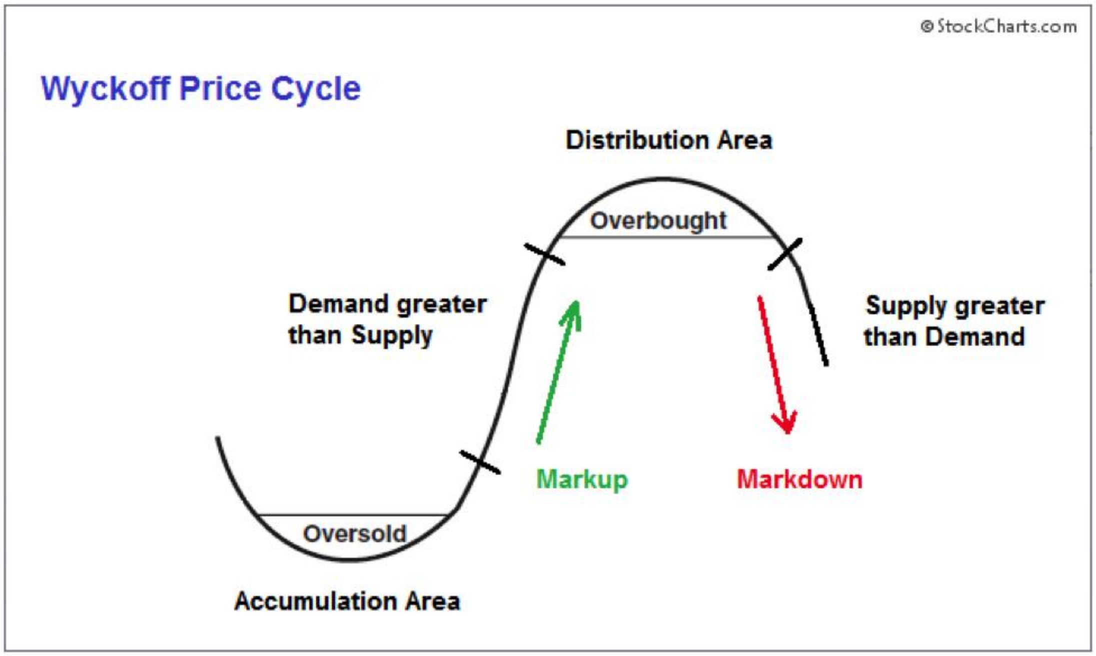

Fig: Wyckoff Price Cycle

TECHNICAL ANALYSIS

* A trend line is formed when you can draw a diagonal line between two or more price pivot points. They are commonly used to judge entry and exit investment timing when trading securities. It can also be referred to a Dutch line as it was first used in Holland.
* A trend line is a bounding line for the price movement of a security. A support trend line is formed when a securities price decreases and then rebounds at a pivot point that aligns with at least two previous support pivot points. Similarly a resistance trend line is formed when a securities price increases and then rebounds at a pivot point that aligns with at least two previous resistance pivot points.
* Trend lines can be used to identify positive and negative trending charts, whereby a positive trending chart forms an up sloping line when the support and the resistance pivots points are aligned, and a negative trending chart forms a down sloping line when the support and resistance pivot points are aligned. Trend lines are used in many ways by traders. If a stock price is moving between support and resistance trend lines, then a basic investment strategy commonly used by traders, is to buy a stock at support and sell at resistance, then short at resistance and cover the short at support.
* The logic behind this is that when the price returns to an existing principal trend line it may be an opportunity to open new positions in the direction of the trend, in the belief that the trend line will hold and the trend will continue further. A second way is that when price action breaks through the principal trend line of an existing trend, it is evidence that the trend may be going to fail, and a trader may consider trading in the opposite direction to the existing trend, or exiting positions in the direction of the trend.

ALL THE ANIMALS IN THE STOCK MARKET JUNGLE!

BULLS AND BEARS

- The bull depicts investors who are optimistic about future prospects of the stock market and believe an upward trending market is on. The polar opposite is the bear: an investor who is convinced that the market is headed for a fall.

- It is not clear how the terms originated in this context. Some believe that it was borrowed from the practice of bull-and-bear baiting.

- Others are of the opinion it is derived from the combat styles of the two animals -- a bear swipes down with its paws where a bull thrusts upwards with its horns.

- Possibly, the term bear originates from "bear skin jobbers". Bearskin traders, or jobbers as they were popularly known, often sold the bear skin before the bear was actually caught probably in the hope for a downturn in price so that they make a larger profit on the transaction.

- So bear skin jobbers sold bear skins they did not own. Later, traders who dabbled in short selling came to be called as bears.

- Short selling is a technique where traders sell shares they don't actually own. They sell a stock for a fixed price in the anticipation of the market falling and when it does, or rather if it does, they are able to pick up those securities at the lower price.

- In this process, they hope to make a profit.

- A bear and bull market later came to refer to market conditions based on the above terms.

- A bull market is when the market appears to be in a long-term climb.

- A bear market describes a market that appears to be in a long-term decline.

STAGS

- This category of market participants are not interested in a bull or bear run. They buy the shares of a company's initial public offering, or IPO, and sell them as soon as the stock is listed and trading commences.
- They do this with the hope of taking advantage of the rising stock price which enables them to make a fast profit.
- It is also known as stagging and the individual is known as a stag.

CHICKENS AND PIGS

- ✓ This refers to individuals who are fearful of the stock market and stay away. Their fear overrides their need to make profits so they stick to conservative instruments such as bonds, bank deposits or company deposits.
- ✓ Their risk tolerance in investment terms is very low.
- ✓ On the other hand, the pigs embrace risk. They are impatient, willing to take a high risk, invest based on hot tips and want to make a quick buck in a hurry.
- ✓ These are the ones who burn their fingers and lose money in the market.
- ✓ "**Bulls make money, bears make money, pigs get slaughtered**" is an old saying that cautions against excessive greed and impatience.

WOLVES

- The animal has been employed as an analogy to powerful individuals who could employ criminal or unethical means to make money. Such rapacious or ferocious individuals are behind scams that jolt the market when it comes to light.
- The most memorable example is Jordan Belfort, convicted on charges of stock fraud in his penny stock operation and stock market manipulation. His crimes and lifestyle are depicted in Martin Scorsese's 2013 film The Wolf of Wall Street.

- A wolf market is sometimes used to describe the acts of various individuals working together to manipulate the market. For instance, a group of investors may employ "wolf hunting" tactics to drive a company's stock into the ground by selling the stock short.

DEAD CAT BOUNCE

- This is stock market slang to refer to a temporary recovery. It could mean a temporary upswing of the market in the midst of a bear run or it could refer to select stocks. A dead cat bounce is a small and short-lived recovery post which the downtrend continues.

- It stems from the explanation that if you throw a dead cat against a wall at a high rate of speed, it will bounce -- but it is still dead.

OSTRICHES

- Behavioural economist George Loewenstein of Carnegie Mellon University coined the term "the ostrich effect" to describe the way investors stick their heads in the sand during bad markets hoping that their portfolio is not severely hit.

- In the investment context, "ostrich" is based on the misconception that when this large bird senses danger it buries its head in the sand.

* Similarly, investors who exhibit ostrich-like behavior ignore negative news in the hope that it will go away. After all, if you don't know for sure how your portfolio did, you can always retain the hope that it somehow fared alright.

INDIAN ECONOMY

- ❖ The seventh largest and second most populous country in the world, India has long been considered a country of unrealised potential. A new spirit of economic freedom is now stirring in the country, bringing sweeping changes in its wake. A series of ambitious economic reforms aimed at deregulating the country and stimulating foreign investment has moved India firmly into the front ranks of the rapidly growing Asia Pacific region and unleashed the latent strengths of a complex and rapidly changing nation. India's process of economic reform is firmly rooted in a political consensus that spans her diverse political parties.
- ❖ India's democracy is a known and stable factor, which has taken deep roots over nearly half a century. Importantly, India has no fundamental conflict between its political and economic systems. Its political institutions have fostered an open society with strong collective and individual rights and an environment supportive of free economic enterprise. India's time tested institutions offer foreign investors a transparent environment that guarantees the security of their long term investments. These include a free and vibrant press, a judiciary which can and does overrule the government, a sophisticated legal and accounting system and a user friendly intellectual infrastructure.
- ❖ India's dynamic and highly competitive private sector has long been the backbone of its economic activity. It accounts for over 75% of its Gross Domestic Product and offers considerable scope for joint ventures and collaborations.
- ❖ Today, India is one of the most exciting emerging markets in the world. Skilled managerial and technical manpower that match the best available in the world and a middle class whose size exceeds the population of the USA or the European Union, provide India with a distinct cutting edge in global competition.
- ❖ GDP Economic growth is measured in terms of an increase in the size of a nation’s economy. A broad measure of an economy’s output. A most widely used measure of economic output is the Gross Domestic Product.
- ❖ **Gross Domestic Product (GDP),** a calculation method in national accounting is defined as the total value of final goods and services produced within a country's borders in a year, regardless of ownership. GDP measures only final goods and services, that is those goods and services that are consumed by their final user, and not used as an input into other goods. Measuring intermediate goods and services would lead to double counting of economic activity within a country. This distinction also removes transfers between individuals and companies from GDP.

There are three approaches to calculating GDP with al rendering same results. Expenditure Approach:

Calculates the final spending on goods and services.

Product Approach: Calculates the market value of goods and service produced. Income Approach: Sums the income received by all products in the country.

Expenditure Approach to determine GDP:

GDP = private consumption + government purchases + investment + net exports Consumption is calculated by adding durable and non - durable and service expenditures. It is unaffected by the estimated value of imported goods. The investment includes investment in fixed assets and increase in inventory.

Government purchases are equal to the government expenditures less government

transfer payments. Net Exports are exports minus imports.

NOMINAL GDP AND REAL GDP Without any adjustment, the GDP calculation is distorted by inflation. This unadjusted GDP is known as the nominal GDP. In practice, GDP is adjusted by dividing the nominal GDP by a price deflator to arrive at the real GDP.

In an inflationary environment, the nominal GDP is greater than the real GDP. If the price deflator is not known, an implicit price deflator can be calculated by dividing the nominal GDP by the real GDP: Implicit Price Deflator = Nominal GDP / Real GDP The composition of this deflator is different from that of the consumer price index in that the GDP deflator includes government goods, investment goods, and exports rather than the traditional consumer-oriented basket of goods.

GDP usually is reported each quarter on a seasonally adjusted annualized basis. GDP GROWTH Countries seek to increase their GDP in order to increase their standard of living. Note that growth in GDP does not result in increased purchasing power if the growth is due to inflation or population increase.

For purchasing power, it is the real, per capita GDP that is important. While investment is an important factor in a nation's GDP growth, even more important is greater respect for laws and contracts.

GDP VERSUS GNP

- GDP measures the output of goods and services within the borders of the country. Gross National Product (GNP) measures the output of a nation's factors of production, regardless of whether the factors are located within the country's borders.

- ❖ For example, the output of workers located in another country would be included in the workers' home country GNP but not its GDP. The Gross National Product can be either larger or smaller than the country's GDP depending on the number of its citizens working outside its borders and the number of other country's citizens working within its borders.
- ❖ Real Gross Domestic Product (RGDP) and Stock Prices The measure of aggregate output in the national income accounts is Gross Domestic Product (GDP) according to Blanchard (1997). He stated that there are three ways of thinking about an economy's GDP. These are that:
- ❖ GDP is the value of the final goods and services produced in the economy during a given period
- ❖ GDP is the sum of value added in the economy during a given period ,
- ❖ GDP is the sum of incomes in the economy during a given period. Nominal GDP is simply the sum of the quantities of final goods produced times their current price. Economists use nominal for variables expressed in units of the currency of the relevant country. Nominal GDP increases over time for two reasons.
- ❖ The first is that the production of most goods increases over time.
- ❖ The second is that the price of most goods increases over time. In order to measure production and its change over time, the effect of increasing prices need to be eliminated. Hence, focus is on real GDP rather than nominal.

INFLATION

- ❖ Inflation is a situation in the economy where, there is more money chasing less of goods and services. In other words, it means there is more supply/availability of money in the economy and there are less of goods and services to buy with that increased money.
- ❖ Thus goods and services command a higher price than actual as more people are willing to pay a higher value to buy the same goods. In this inflationary situation, there is no real growth in the output of the economy per se. It's simply more money chasing few goods and services.
- ❖ For a brief moment let us suspend belief and imagine that all the money in the country is just Rs100. And all the goods produced in the country are just five apples. Naturally, each apple will fetch Rs 20. Next year, the money doubles to Rs200 but the total goods produced are again five apples. Each apple will now fetch Rs40.
- ❖ That is what inflation is all about — too much money chasing too few goods. Inflation is a hydra-headed monster, which has a desirable as well as an undesirable effect. The desirable part is that when prices are high, businessmen get more value for their goods, which entices them to produce more.
- ❖ The undesirable part is that when prices shoot up, people are forced to restrict their purchases, which can lead to recession. Rising oil prices have been one of the main

causes of inflation though that is not all. A weak monsoon till recently brought about a shortage in food items and some commodities.

- ❖ There had also been a surge in foreign exchange inflows and to keep the price of the rupee stable, the RBI has been purchasing dollars — and that means pumping in rupees into the system. To suck out the excess rupees from the system, the RBI follows a policy of sterile intervention — which translates into the RBI issuing government securities.
- ❖ There is a limit to the quantum of government securities the RBI can issue and its stock of securities at the moment is insignificant. The RBI can tighten the monetary policy by raising interest rates, however, higher interest rates will hit the balance sheet of banks that have large interest rate exposures. Moreover, the RBI is also the banker to the government by virtue of which, it tends to keep the interest rate low so that the government's interest cost remains in control.

Types of inflation: Inflation is caused by a combination of four factors. The supply of money goes up.

The supply of goods goes down

. Demand for money goes down.

Demand for goods goes up.

"Inflation can result from a decrease in aggregate supply. The two main sources of decrease in aggregate supply are an increase in wage rates

An increase in the prices of raw materials

These sources of a decrease in aggregate supply operate by increasing costs, and the resulting inflation is called cost-push inflation.

INFLATION AND ITS EFFECT ON STOCK PRICES

- ➢ Prices of stocks are determined by the net earnings of a company. It depends on how much profit, the company is likely to make in the long run. Share prices of a company usually escalate if there is speculation that the company is going to do well in the future.
- ➢ If there is a 6 downward trend speculation of a company’s future stock price movements, then its stock price will subside. Stock prices are directly proportional to the performance of a company.
- ➢ In the event of an increase in inflation, the company’s earnings will also subside and this will adversely affect the stock prices and eventually the returns from company stocks. The nominal interest rate consists of a real rate plus expected

inflation rate. The expected real rate of an economy is determined by the real factors such as productivity of capital and time preference of savers.

- It is independent of the expected inflation rate. Investigating into failure of equities to act as a hedge against inflation concluded that a major part of undervaluation of shares was due to cognitive errors on the part of the investors. They felt that in an inflationary period, the interest expense was not really an expense but rather a repayment of real principle.
- A concept they thought investors were unaware of. The stock market should perform well when there is strong economic growth and under periods of low inflation. Studies show that inflation indeed impacts the stock returns negatively. It is this statement that I aim to test if it holds.

QUESTIONS

1. What is meant by stock price?

2. What is inflation and GDP?

3. How animals are used in stock price measurement?

4. What is Wyckoff price cycle?

5. Explain technical analysis.