

Lesson - 2

Secondary Market in India

Role of Stock Exchange -

- 1 Investor can invest in any security, and can exit in case of risk and freshly re-enter when secure.
- 2 Stock price indicate the performance and stability of the company.
- 3 Saving can be mobilized through stock exchange.
- 4 Encourages businessman & provide healthy speculation.
- 5 Opportunity to liquidate stocks immediately.
- 6 Country's economic growth is measured with trends in stock market.
- 7 Annual report and audited balance sheet shall available in public to promote transparency.
- 8 Stock exchange attracts the foreign capital.
- 9 Transactions in stock exchange made available to public to ensure fair dealing.
- 10 Stock exchange shall follow rules & regulation.

Types of Securities -

Listed securities :- Securities, which have signed the "listing agreement" with stock exchange are treated as listed securities.

Permitted securities :- Securities which are actively traded on other stx, but are not listed on an exchange, trading of such security are "Permitted securities".

* Exchange Traded Funds (ETF) (IMP)

- ETF is a security that tracks an index, commodity, bonds or basket of securities traded in stx. Indexes such as Nifty, Sensex etc.
- ETF's reflect the performance of index they track. ETF have higher liquidity and lower fees.
- ETF is traded like a common stock on stx and price of ETF is depend upon the trading in market.

* Derivatives (IMP)

- Derivatives are the financial instruments which derive their value from an underlying assets
- Underlying assets can be stocks, bonds, currency, commodity, metal and tangible assets.
- Types of derivatives - Future, Option, swaps, caps, floors, collars etc.

Derivatives includes -

- A Security derived from debt instrument, share loan, secured or unsecured.
- B Contract derive their value from underlying security.
- C Commodity derivative
- D Other instruments

* Currency derivative -

- Currency derivative are financial contract between buyer and seller involving exchange of two currencies at future date, at a pre determined rates.
- The underlying assets are currency pairs such as - USD - INR or EUR - INR.
- Currency option & future trade is done in Foreign exchange market.

Benefits -

- i offer diversification
- ii Hedging opportunities to importer & exporter
- iii Volatility in currency and provide transparency

* Commodity Derivative -

- Commodity derivatives are the financial instrument which derive their value from underlying commodity such as oil, gas, metals, minerals etc
- These market are the indicator of market sentiment.

* Future -

- A future contract means an exchange traded forward contract to buy or sell security at a predetermined quantity at predetermined price on a predetermined future date.

a) Long position: when a future contract is purchased

or the buyer agrees to ~~not~~ take delivery.

(b) Short Position - future contract is sold and the seller agrees to make delivery.

* Currency future and option contract on Exch. in IFSC -

- Trading member can contract max. 15% of total contract or 1 billion USD, whichever is higher.
- Institutional investor can hold max. 15% of total contract or 1 billion USD, whichever is higher. (Same for Eligible Foreign Investor)
- Other - Max. 6% of total contract or 100 million USD whichever is higher.

* Options -

- Option give the holder the right, but not the obligation to make or take delivery.
- Option is given to one party and other party is under obligation to make or take delivery

Call option: ^{for} Buyer ^{and} gives the right to take delivery to holder.

Price - \uparrow Yes \downarrow No.

Put option: for seller and give the right to take delivery.

Price \downarrow Yes \uparrow No.

European Option - Option can be exercised only on expiration date. Followed by Indian stock exchange.

American option - Exercised on or before the date of expiry.

* Right Entitlements -

Right issued by the company to its existing share-holders, in a ratio of their existing equity shares held on record date.

Entitlements are issued in dematerialised form

→ Options available to Eligible share holders ~

- Apply to the full extent of their rights entitlements.
- Full extent of their right entitlement and apply for additional.
- Apply for a part without renouncing.
- Apply for a part and renounce the other
- Renounce the full.

Renunciation -

On market renunciation → Renounce by trading / selling them on secondary market platform.

Off market renunciation → Renounce the transfer through depository participant. Rights can be transferred in dematerialised form only.

* Trading platform in India -

1. Main Board

- In-principal approval of draft prospectus
- Submission of Application
- IPO registration

2. SME platform

- 1 Incorporated under Companies Act 2013
- 2 Paid up capital not be more than 25 cr.
- 3 Positive Networth
- 4 Net tangible Assets of ₹ 1.5 cr.
- 5 Have combined track record of at least 3 yrs
If failed to complete its operation for 3 years, the company/LLP should funded by Bank or financial institution, Govt or SO or by group co. listed for 2 years.
- 6 Have a website
- 7 Trading in demat mode
- 8 No change in promoter in last 1 year

* 3. NSE EMERGE Platform -

- Offers emerging business a new and viable option for raising equity capital.
- It offers opportunities to investors to invest in emerging business with exciting growth plans, innovative business models & good governance.

* Regulatory Framework -

- 1 Post issue capital less than 25 cr.
- 2 Min. no. of allottees in IPO 50
- 3 Observation by Stx on DRHP
- 4 100% underwriting, 15% by merchant banker
- 5 IPO size not less than 1,00,000/-
- 6 Half yearly reporting requirement
- 7 Mandatory market making.

* Innovators Growth Platform -

- Company with intensive use of technology, I.T, intellectual property, bio-technology or nano-technology in business.

- 25% of pre-issue capital of the company shall be held for 2 years by -

- 1 QIB's
- 2 family trust with Net worth of > 500 cr.
- 3 Accredited Investors
- 4 category III of Foreign Portfolio investor
- 5 Pooled investment fund with min. assets of 150 million USD.

* Social Stock Exchange - (IMP)

- a Not for Profit organization reg. and raise fund through social stock exchange.
- b For profit social enterprise ~~not~~ identified as SSE.

Eligibility-

- 1 Shall established priority of its social intent.
- 2 Shall meet following criteria - (engaged in any 1)
 - i eradicating poverty, hunger, inequality
 - ii Promoting health care, mental healthcare
 - iii Promoting education, employment
 - iv Protecting national heritage, art & culture
 - v Slum area development, affordable housing etc.
- 3 Shall have 67% of its activity as eligible activity.
 - a) at least 67% of 3-year average revenue from eligible activity
 - b) 67% of 3 year average expenditure on eligible activity.

* Margins -

An advance payment of portion of the stock transaction.

- a. Initial margin - Minimum amount, calculated as a percentage of transaction value.
- b. Maintenance margin - Minimum amount, a percentage of market value, maintained by client with broker.
 - When the margin falls below the limit the broker starts making margin calls.
 - The broker may dispose off securities, if the margin money is not paid on time.

* Block Deal —

- A separate trading window to facilitate large trades in securities.
- 1 Morning block deal window: 8:45 am — 9:00 am
- 2 Afternoon block deal : 2:05 pm — 2:20 pm
- 3 Minimum order size shall be 10 cr.
- 4 Order between shall be 1% of the cap.
- 5 Stock exchange furnishes the detail of Block deal on the website on same day
- Bulk deal, equity shares bought or sold is more than 0.5%.
- i Reveal to the stock exchange on daily basis
- ii Notified to exchange immediately after transaction, in multiple transaction notify after one hour.

* Basis of Sensex —

- Sensex is the stock market index indicator for the BSE.
- Based on market stock index of 30 companies
- Sensex calculated by Free-float method.
- Steps of calculation —
- Market capitalization
- Free-float factor (multiple of market capitaliza^{-tion})
- Ratio & Proportion based on base index.

- * Nifty is the market indicator of NSE.
- collection of 50 stocks, referred as Nifty 50
- Calculated by Free-float market Capitalization weighted method.

(IMP) * Key risk in investing in securities market -

- 1 Market risk losses due to factors affecting the overall performance of financial market.
- 2 Unsystematic risk attached with particular co.
- 3 Inflation risk decline in purchasing power
- 4 Liquidity risk, investment can't brought or sold quickly.
- 5 Business risk affect or stop its operation due to unfavorable situations.
- 6 Volatility risk fluctuations on stock price.
- 7 Currency risk due to fluctuations in foreign exchange.
- 8 Invest through - Bank A/C
Trading A/C
Demat A/C
- 9 KYC is mandatory for opening an a/c.

* Clearing Corporation (3 marks que.)

- 1 clearing and settlement of all trade executed.
- 2 Maintain consistent settlement cycle.
- 3 Counter-party risk guarantee provider
- 4 stock exchange transfer the duties to clearing corporation with the prior approval of SEBI.
- 5 Periodical settlement of contract
- 6 Delivery and payment of security.
- 7 Other matter related to transfer.
8. clearing corporation shall make bye-laws and submit it to SEBI.

* Market Surveillance - (IMP)

- stock exchange adopt automated surveillance tool to analyze trading patterns.
- Market integrity is achieved through surveillance, inspection, investigation and enforcement of law and rules.

A Preventive Surveillance -

Market surveillance is categorised in 2 parts -

- a) Preventive surveillance (online)
 - b) Post trade surveillance (Offline)
1. checking of net worth, back ground, viability etc while boarding of trading members.
 2. Trading halt in all equity derivative market at 3 stages at 10%, 15%, 20%.

3. Order matched and trade take place within the execution range.
4. Maximum order value limit per order.
5. On logout all outstanding order are cancelled.
6. Trading member can ~~cancel~~ all outstanding orders.
7. Price band for non-derivative is 5%, 10%, 20%. For Derivative product 10%.
8. Shall clarify all the rumors.

B Post trade surveillance -

1. End day alerts generated using statistical tool.
2. Identifying unfair trade practices through pattern recognition model.
3. Transactions alert under 14 different heads.

* Risk Management in Secondary Market -

• Key risk management measures -

1. VaR based margin system
2. Intra day trading limits
3. Index based wide circuit breakers
4. Collection of margin on upfront basis
5. Automatic de-activation of trading terminal.

* FED Policy -

- Federal Reserve System is the central bank of United state.
- 5 general functions to promote effective operation
- conduct nation's monetary policy.
- Promote stability in financial system
- Promote safety ~~and~~ of individual financial ins-titution and their impact.
- Foster payment and settlement system
- Promote consumer protection and community development.

If the fed rates are hiked (increased), the value of dollar would go up, and weak the Indian rupees in comparison. It may hurt India's forex reserve and import.

* Bank Rate - (IMP)

Rate at which RBI discount bills for commercial bank, re-discount rate.

Increase in Bank rate increase the cost of borrowing by commercial banks, it result in reduction of credit volume and declines the money supply. (Inflation control)

Repo Rate → Rate at which commercial bank ~~now~~ borrow money from RBI. Reduction in repo rate helps bank to get money at low rates.

Increase in repo rates discourages banks to get money at a higher rates.

Inflation \rightarrow Increase

Deflation \rightarrow Decrease.

* Cash Reserve Ratio (CRR) — Amount the commercial banks have to maintain as a cash deposit with RBI. RBI may increase CRR if there is large money supply in economy and can decrease CRR in deflation. (4%)

* Statutory Liquidity Ratio (SLR) — Amount which commercial banks have to keep with itself. It's a powerful tool to control liquidity in economy. Increase in SLR is used as inflation control measure. (18%)

* Reverse Repo Rate (RRR) — Rate at which RBI borrows money from the commercial banks. Increase in RRR will decrease the money supply.

* Inflation Index —

2 major inflation index —

Consumer Price Index (CPI)

Wholesale Price Index (WPI)

* Wholesale Price Index (WPI)

- 1 Computed by Economic Adviser in Ministry of Commerce & Industry.
- 2 WPI is released on monthly basis earlier it was released on weekly basis.
- 3 Base year 2004-05 \Rightarrow 100
- 4 Total 676 items, computed by taking 5482 price quotations.
- 5 Divided into 3 categories
 - a) Primary articles
 - b) Fuel and power
 - c) Manufactured product.

* Consumer Price Index (CPI)

1 Released at 3 National levels -

- i CPI for Industrial workers (Urban)
- ii CPI for Agricultural Labourers (Rural)
- iii CPI Combined.

2 Base year 2012 \Rightarrow 100

3 Total 448 items in rural and 460 in urban

4 Divided in 6 main groups.

* Key difference between WPI & CPI -

1. Use of WPI to have inflationary trend in the economy. CPI is used for adjusting income and expenditure.

2. WPI based on wholesale price, CPI is based on retail price.
3. WPI collected on voluntary basis and CPI are collected by investigators.
4. CPI covers only consumer goods & services WPI covers all goods including intermediate goods.
5. WPI based on national a/c & CPI based on consumer expenditure data.